Asia-Pacific
Economic Cooperation

2004: APEC Economic Outlook

APEC Economic Committee

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APEC Secretariat, 35 Heng Mui Keng Terrace Singapore 119616
Tel: (65) 6775 6012 Fax: (65) 6775 6013
Email: info@mail.apecsec.org.sg
Website: www.apec.org

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EXECUTIVE SUMMARY

The world economic recovery has been strengthening and broadening since 2003. Last year, the world economy grew 2.7 percent, which was much higher than the 1.3 percent and 1.8 percent in 2001 and 2002, respectively. The growth rate of the APEC economies was 3.5 percent compared to 0.7 percent and 2.4 percent in 2001 and 2002. Considering the uncertain and unfavorable situation to the economy in early 2003, especially the outbreak of severe acute respiratory syndrome (SARS) epidemic and geo-political instabilities caused by the war in Iraq, such a good economic performance of the APEC region in 2003 was surprising. Although the economic growth was initiated by the US and some Asian economies in 2002, the growth momentum has spread worldwide during 2003 and early 2004. Japan, Russia, and most ASEAN economies joined the path of high growth, all registering high GDP growth rates in 2003.

In 2003, the world economy has also enhanced the sustainability of growth. In the beginning of the upturn of this business cycle, consumption spending was first moved up by fiscal stimulating measures, particularly tax cuts in the US and the lowering of interest rates in 2002. As the economic recovery proceeded however, capital spending on fixed investments by companies has grown rapidly in most economies, which in turn accelerated the economic recovery, enhancing its sustainability. Also in this business cycle of economic recovery, the world trade grew very strongly in major economies from early 2002 to the first half of 2004, which implies a rapid proliferation of the growth momentum from the initiating economies to the rest of the world. The Russian and some Asian economies have registered very high trade growth rates, reaching double-digits in 2003.

In spite of the high economic and trade growth, the employment situation showed only very sluggish improvement in the APEC member economies as well as in the world economy. Entering the second quarter of 2004, however, the world economy seemed to be losing some of its growth momentum, and higher oil prices brought some doubts about the sustainability of global economic growth over the medium-term. In mid-2004, the world petroleum markets hinted at the possibility of a crude oil supply shortage, bringing a hike in oil prices up to around US$50 per barrel. However, inflationary pressures have recently been subsiding in most economies, and most central banks appear to adhere to accommodative policy stances with some central banks, if necessary, easing back the pace of their recent monetary tightening. Thus, the global economic outlook is generally positive. Moreover for the near future, the US and Asian economies will lead world economic growth. According to forecasts by most economic institutions, APEC economies will continue to grow actively this year and next year. They will grow about 4.5 to 5.0 percent and 3.5 to 4.0 percent in 2004 and 2005, respectively.

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FOREWORD

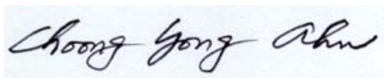
The *APEC Economic Outlook* is submitted annually at the Ministerial Meeting. The first part of the publication updates and summarizes recent developments and short-term prospects of all APEC member economies, while the second part addresses topical structural issues of particular interest at the time the report is produced.

This year's *2004 APEC Economic Outlook* is the tenth in this series. According to data on recent developments and future outlook provided by the 21 member economies, the macroeconomic development of the APEC region is delineated. Similar to other major international research institutions' analysis, we too have concluded that since 2003 major economies have been, and are still on the road to recovery. The world economy's growth this year will be the strongest since 2000. However, after 2004, the world economy is expected to experience a slight slowdown in economic growth but still maintain a GDP growth of over 4 percent. Also, reflecting the strong growth of domestic demand in major economies, world trade will grow significantly this year as well as next. However there are a number of "headwinds" that may slowdown this progress. The first is the higher oil prices caused by strong demand (mainly from the US and China), and this reflects the "terror premium" on oil prices resulting from geo-political factors in the Middle East. Another is the increasing possibility of rising interest rates initiated by the monetary authorities in the context of a cyclical peak of economic growth and soaring energy costs. In this context, the *Outlook* continues to emphasize the importance of maintaining APEC members' structural reforms to improve the efficiency of their own economic systems in order to sustain economic growth in the medium-term.

The structural chapter titled, "FTAs and RTAs in the APEC Region" analyzes a set of important elements and issues relevant for enhancing the contribution of FTAs and RTAs to help achieve the Bogor Goals. The final report gives a better collective understanding of how to strengthen the potential of FTAs and RTAs in the Asia-Pacific Region as a catalyst of regionalism and multilateralism.

The *2004 Economic Outlook* is produced through a collaborative effort of all member economies and the APEC Secretariat, with the Economic Committee (EC) Chair's Office and Chile serving as co-coordinators. The EC Chair's Office leads the first part of the *Outlook,* analyzing the economic performance and prospects of the APEC member economies, while Chile leads the structural chapter. As an integral part of the preparation of the *Outlook*, Chile hosted the 2004 international symposium, "FTAs and RTAs in the APEC Region," which was held in Santiago, Chile. It brought together views and inputs from academia, government, the business sector, and international organizations.

A very special thanks goes to Mr. Hernán Gutierrez for leading the structural chapter of the 2004 Economic Outlook, and Dr. Sangkyom Kim for leading the performance and perspective chapter. Dr. Namdoo Kim's analysis for the performance and perspective chapter is much appreciated as well. And as always, I must not forget to mention Mr. Charles Jose, the Program Director at the APEC Secretariat for his support and dedication in seeing this publication through.



Dr. Choong Yong Ahn
Chair, APEC Economic Committee
Seoul, October 2004

CHAPTER ONE:

ECONOMIC PERFORMANCE AND PROSPECTS IN THE APEC REGION

CHAPTER 1
ECONOMIC PERFORMANCE AND PROSPECTS IN THE APEC REGION

1. OVERVIEW

The world economic recovery has been strengthening and broadening since 2003. Last year, the world economy grew 2.7 percent, which was much higher than the 1.3 percent and 1.8 percent in 2001 and 2002, respectively. The growth rate of the APEC economies was 3.5 percent compared to 0.7 percent and 2.4 percent in 2001 and 2002. Considering the uncertain and unfavorable situation to the economy in early 2003, especially the outbreak of severe acute respiratory syndrome (SARS) epidemic and geo-political instabilities caused by the war in Iraq, such a good economic performance of the APEC region in 2003 was surprising. Although the economic growth was initiated by the US and some Asian economies in 2002, the growth momentum has spread worldwide during 2003 and early 2004. Japan, Russia, and most ASEAN economies joined the path of high growth, all registering high GDP growth rates in 2003.

In 2003, the world economy has also enhanced the sustainability of growth. In the beginning of the upturn of this business cycle, consumption spending was first moved up by fiscal stimulating measures, particularly tax cuts in the US and the lowering of interest rates in 2002. As the economic recovery proceeded however, capital spending on fixed investments by companies has grown rapidly in most economies, which in turn accelerated the economic recovery, enhancing its sustainability. Also in this business cycle of economic recovery, the world trade grew very strongly in major economies from early 2002 to the first half of 2004, which implies a rapid proliferation of the growth momentum from the initiating economies to the rest of the world. The Russian and some Asian economies have registered very high trade growth rates, reaching double-digits in 2003.

In spite of the high economic and trade growth, the employment situation showed only very sluggish improvement in the APEC member economies as well as in the world economy. Entering the second quarter of 2004, however, the world economy seemed to be losing some of its growth momentum, and higher oil prices brought some doubts about the sustainability of global economic growth over the medium-term. In mid-2004, the world petroleum markets hinted at the possibility of a crude oil supply shortage, bringing a hike in oil prices up to around US$50 per barrel. However, inflationary pressures have recently been subsiding in most economies, and most central banks appear to adhere to accommodative policy stances with some central banks, if necessary, easing back the pace of their recent monetary tightening. Thus, the global economic outlook is generally positive. Moreover for the near future, the US and Asian economies will lead world economic growth. According to forecasts by most economic institutions, APEC economies will continue to grow actively this year and next year. They will grow about 4.5 to 5.0 percent and 3.5 to 4.0 percent in 2004 and 2005, respectively.

2. RECENT ECONOMIC PERFORMANCE AND TRENDS

2.1 Strong Economic Growth

The economy in the Asia-Pacific region showed significant resilience in 2003. In spite of uncertainties caused by the Iraq situation, higher oil prices, and the outbreak of the SARS epidemic, real GDP of the APEC region grew 3.5 percent in 2003, much higher than the 0.7 percent and 2.4 percent in 2001 and 2002, respectively. Economic recovery has been led by the US and Asian member economies since 2002. In 2003, most APEC member economies showed higher GDP growth rates than those in 2002. The highest growth rates were registered by former-socialist economies such as China, Viet Nam and Russia. Even Japan and Papua New Guinea had positive growth rates in 2003 compared to negative rates in 2002. The exceptions to this trend of higher growth in 2003 were Korea, Singapore and Canada, which recorded lower growth rates than those of 2002.

The United States real gross domestic product (GDP) surged at an average annual rate of 5.8 percent during the second half of 2003 and grew 3.0 percent during the whole year of 2003. The US GDP grew at a 4.5 percent annualized rate in the first quarter and a 3.3 percent in the second quarter of 2004. Though growth has moderated in the second quarter of 2004, growth over the last four quarters remains among the fastest in the last twenty years. Due to the growth-enhancing policies pursued by the Administration and the Federal Reserve during the past three years, the economic expansion is strong, industrial production is rising, employment is increasing, after-tax incomes are growing, and Federal receipts are returning to normal levels. Since the Administration took office, fiscal and monetary policies have focused primarily on overcoming powerful forces that brought growth to a near standstill in the second half of 2000, pulled the economy into recession in 2001, and then impeded the recovery that began in November 2002. These forces included: the sharp fall in the stock market that began in March 2000; the decline in business fixed investment beginning in early 2001; the terrorist attacks of September 11th; the ensuing ‘War on Terror’ and concerns about further attacks; the slow growth, and even recession, in many industrialized countries that curtailed US exports; and the revelation of corporate accounting scandals years in the making that depressed the stock market. Thanks to the policies that were put in place and the inherent resilience of US workers and businesses, the economy has overcome these obstacles and is again on a solid expansionary path.

The *Japanese* economy is in the midst of a recovery from its long-lasting economic downturn and is now entering a new forward leaning stage. Japan was in harsh economic environment of negative growth with large amounts of non-performing loans (NPLs) when the intensive adjustments for structural reform started. In the process of structural reform, the Japanese economy’s recovery was led by private demand without dependence on fiscal stimulus. There are signs that booms in the corporate sector are having a positive impact on households through employment’s recovery. This, combined with stabilization of the financial system and increase in stock prices, has led to improvements in consumer confidence. As a result, the average annual growth rate for the economic recovery phase since the beginning of 2002 is 2.9 percent of which private demand accounts for 2.3 percent, indicating that the growth is led by private demand. The real GDP growth rate in FY2003 is 3.2 percent.

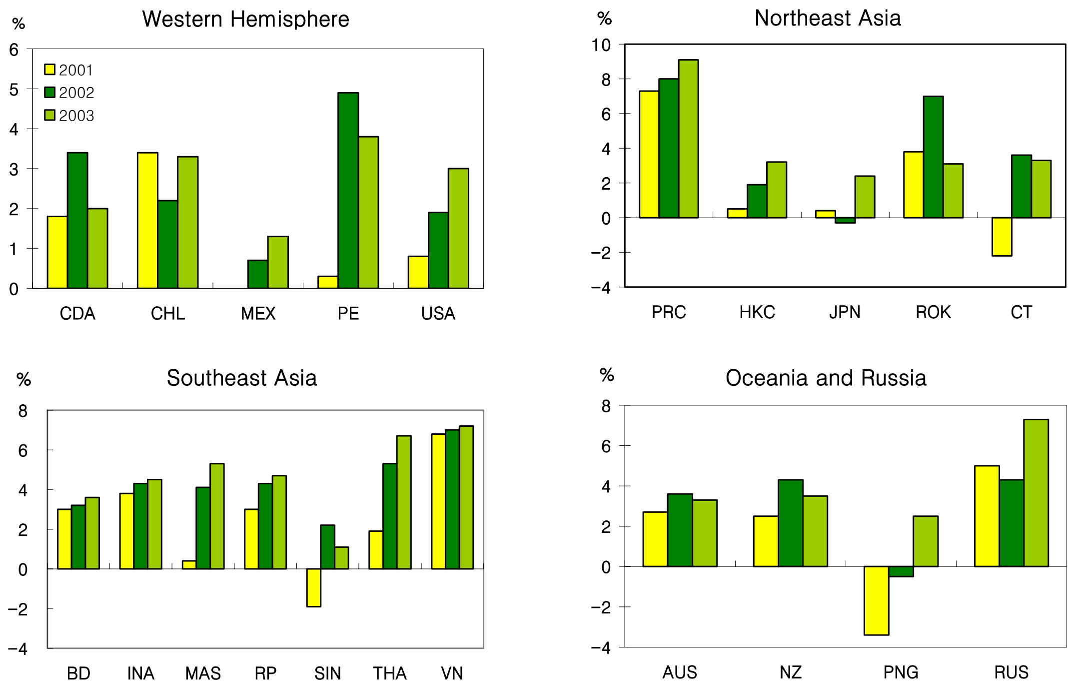
Table 1.1
Real GDP Growth (percent)

	1998	1999	2000	2001	2002	2003
Western Hemisphere						
Canada (CDA)	4.1	5.5	5.2	1.8	3.4	2.0
Chile (CHL)	3.2	-0.8	4.5	3.4	2.2	3.3
Mexico (MEX)	5.0	3.6	6.6	0.0	0.7	1.3
Peru (PE)	-0.6	0.9	2.8	0.3	4.9	3.8
The United States (US)	4.2	4.4	3.7	0.8	1.9	3.0
Northeast Asia						
China (PRC)	7.8	7.1	8.0	7.3	8.0	9.1
Hong Kong, China (HKC)	-5.0	3.4	10.2	0.5	1.9	3.2
Japan (JPN)	-1.1	0.1	2.8	0.4	-0.3	2.4
Korea (ROK)	-8.3	9.4	5.5	3.8	7.0	3.1
Chinese Taipei (CT)	4.6	5.4	5.9	-2.2	3.6	3.3
Southeast Asia						
Brunei Darussalam (BD)	-4.0	2.6	2.8	3.0	3.2	3.6
Indonesia (INA)	-13.3	0.8	4.9	3.8	4.3	4.5
Malaysia (MAS)	-7.4	6.1	8.3	0.4	4.1	5.3
The Philippines (RP)	-0.6	3.4	4.4	3.0	4.3	4.7
Singapore (SIN)	-0.9	6.9	9.7	-1.9	2.2	1.1
Thailand (THA)	-10.5	4.4	4.6	1.9	5.3	6.7
Viet Nam (VN)	5.8	4.8	6.8	6.8	7.0	7.2
Oceania						
Australia (AUS)	5.4	4.5	3.3	2.7	3.6	3.3
New Zealand (NZ)	-0.2	4.0	3.9	2.5	4.3	3.5
Papua New Guinea (PNG)	-3.8	7.6	-0.8	-3.4	-0.5	2.5
Russia (RUS)	-5.3	6.4	10.0	5.0	4.3	7.3
APEC	**2.0**	**3.6**	**4.0**	**0.7**	**2.4**	**3.5**
WORLD	2.2	3.1	4.0	1.4	1.7	2.7
WORLD*	2.8	3.7	4.7	2.4	3.0	3.9

Note:
The APEC-wide and sub-regional averages were calculated using the previous year's nominal GDP, valued at market exchange rates, as weights.
* Using the previous year's GDP valued at Purchasing Power Parity (PPP) exchange rates as weights.

Sources: Individual Economy Reports.
IMF, International Financial Statistics, August 2004
IMF, World Economic Outlook, September 2004

Fig 1.1 Real GDP Growth



The domestic economy of *China* continued to grow rapidly. China's GDP in 2003 reached US$1,409.91 billion, an increase of 9.1 percent in real terms, and 1.1 percent higher growth than in 2002. Investment in fixed assets enjoyed a relatively substantial growth. It was particularly noteworthy that over-investment in some industries has been contained by macroeconomic measures taken by the Chinese government. The investment in fixed assets for the whole economy in 2003 reached US$665.94 billion, which was 26.7 percent over the previous year. Consumption demand went up steadily with the continued improvements in living standards. The total retail sales of consumer goods were US$553.87 billion, a growth of 9.1 percent year-on-year. When measured in price factor, the growth rate reaches 9.2 percent. The role net exports played in stimulating economic growth diminished. The favorable balance of trade in 2003 reached US$25.6 billion, which was US$4.8 billion lower than that of the previous year. The scope of foreign investment continued to expand, and the quality of foreign investment utilization constantly improved. A total of US$53.5 billion in foreign direct investment (FDI) was actually utilized, a year-on-year increase of 1.4 percent.

In 2003, the *Korean* economy's growth rate fell to 3.1 percent per year from 7.0 percent in 2002, due to sluggish domestic demand and some unexpected adverse effects. The growth rate hit the record low of 2.2 percent during the second quarter. However, the rate bounced back to 2.4 percent in the third quarter and finally recorded 3.9 percent in the fourth quarter. This poor economic performance was due to unfavorable internal factors such as sagging consumption and investment, while external factors like export have been sustaining the economy. Consumption decreased from early 2003 due to a surge in the number of credit delinquents and the lowering of the household debts ceiling. Credit delinquency and household debt are the major challenges for the government to surmount this year. Investment has also been in the doldrums, as business sentiment has yet to recover due to somewhat hostile labor-management relations, domestic political uncertainties and external issues such as the situation in Iraq. Exports, on the other hand, have recorded double-digit growth since the first quarter of 2003, thanks to the recovery of the global economy and the pick up in major industries such as IT, automobiles, steel and shipment. In the first quarter of 2004, while Korea's growth momentum was being built as evidenced by the GDP growth rate of 5.4 percent year-on-year on the back of brisk export, recovery in domestic demand such as private consumption and facility investment is likely to occur later than expected.

The economy of *Hong Kong, China* went through a sharp gyration during 2003, with an abrupt setback caused by the spread of severe acute respiratory syndrome (SARS) in the second quarter. Yet this was followed by a speedy and broad-based recovery in the third and fourth quarters. For 2003 as a whole, GDP still grew appreciably by 3.2 percent in real terms, better than the 1.9 percent growth in 2002. The recovery of the economy of Hong Kong, China then broadened further to a full-fledged upturn in the first half of 2004, registering growth of 7.0 percent and 12.1 percent in the first and the second quarters, on the back of buoyancy in both domestic and external demand. For 2004 as a whole, GDP is forecast to grow notably, to 7.5 percent in real terms, from the 3.2 percent growth in 2003.

The *Chinese Taipei* economy improved steadily in the early months of 2003, but the SARS outbreak caused it to dip sharply in the second quarter. With a pick-up in export growth and the successful containment of the SARS epidemic, economic growth rebounded to a positive growth rate of 4.87 percent in the latter half of 2003. However, because of the second-quarter contraction, the real GDP growth rate for the whole of 2003 slipped to 3.31 percent from 3.59 percent the previous year. Per capita GNP increased to US$13,156. Foreign demand contributed three-fourths of economic growth. The recovery was spurred by global as well as short-term and long-term domestic forces

In 2003, *Indonesia's* economic performance developed favourably, underpinned by prudent monetary and fiscal policies as well as continued structural reforms. The strengthening exchange rate, subdued inflation, and lower interest rate have all contributed to providing an environment conducive for growth. This favourable condition has successfully restored investors' confidence in the economy. Real GDP in 2003 grew by 4.5 percent particularly driven by consumption, although there were also signs of increasing exports and investments. Indonesia's economy continued to maintain high growth, posting 4.3 percent in the first half of 2004. The growth was still driven mainly by consumption. Investment and exports also started to pick up, encouraged by domestic demand and expansion in world trade volume, but they still have a limited role in supporting domestic economic growth. On the supply side, the economy was supported by growth in most sectors with the highest contributions originating from manufacturing, trade, and agriculture.

The *Malaysian* economy accelerated its growth momentum in the second quarter of 2004, increasing at a pace of 8.0 percent (Q2 2003: 4.6 percent), the strongest quarterly growth since the third quarter of 2000. Growth continued to be broad-based, led by the manufacturing and services sectors. Private sector expenditure was more robust and reinforced by buoyant growth in external demand. Domestic demand, led by the private sector, remained sturdy and contributed significantly to overall economic growth. As consumer sentiment remained positive and investor confidence gained momentum, aggregate domestic demand strengthened further by 8.1 percent in the second quarter. Private consumption expenditure picked up by 11.4 percent, due to higher disposable income arising from firm commodity prices and, stronger export earnings as well as better employment prospects and positive wealth effects from favourable stock market conditions. Public consumption registered a moderate growth of 7.1 percent, in line with the Government's fiscal consolidation policy. Total investment expenditure continued to increase by 3.5 percent, underpinned by stronger private investment activities following a continued decline in the Federal Government's development expenditure.

The Philippines' domestic economy remained resilient in 2003 despite numerous threats to growth. Real gross domestic product (GDP) grew by 4.7 percent, falling within the 2003 growth target of 4.2 to 5.2 percent. GDP growth was also slightly higher than in 2002. Gross national product (GNP) grew by 5.6 percent spurred by a strong surge in the net factor income from abroad (NFIA) which was boosted in turn by a 6.6 percent increase in the incomes of overseas Filipino workers. Growth was broad-based. Agriculture, industry (except public construction) and services all grew. The service sector still led the growth in GDP for 2003 with a 5.8 percent growth rate, higher than the 5.1 percent growth posted in 2002, and well within its growth target of 5.2 to 6.2 percent for the year. The finance sector and ownership of dwellings and real estate recovered, while transportation, communications and storage and trade services grew steadily. On the demand side, strong private consumption expenditures and investments underpinned growth. Greater per capita income and low inflation fuelled a strong growth in private consumption of 5.3 percent, the highest growth recorded since 1990. Growth was driven by increased demand in transportation and telecommunication, utilities and food. Government consumption expenditure registered a slight increase at 0.5 percent following the adoption of tight fiscal policy. Gross domestic investments turned around from a 5.0 percent decline in 2002 to a 0.1 percent increase in 2003. Real investments in durable equipment grew by 8.5 percent almost twice the growth registered in 2002 and arising from significant investments on machineries for agriculture, mining, construction as well as pulp and paper, and railway and water transport equipment. On the other hand, growth of public construction slackened to 2.9 percent in 2003

The *Singapore* economy expanded 1.1 percent in 2003, half the pace of 2002. This was mainly due to the global economic uncertainties in the first half of 2003, as well as the impact of SARS on Singapore's tourism industry. All major sectors, except the wholesale and retail trade and financial services, deteriorated from 2002. However, the economy showed clear signs of turning around in the second half of 2003. In the third and fourth quarters, GDP expanded by 1.7 percent and 4.9 percent respectively compared to the previous year. On an annualized quarter-on-quarter basis, GDP grew by 16.1 percent and 11.0 percent respectively. The recovery was reflected in increased exports, investments, and employment.

In 2003, the *Thailand* economy continued to expand well despite the negative effect of severe acute respiratory syndrome (SARS) epidemic. GDP growth in 2003 reached 6.7 percent, and was one of the best economic performances in Asia. The main economic drivers included strong domestic demand of private consumption and investment, as well as robust export growth.

After the 1997–1998 financial crises, *Viet Nam's* economy has gradually resumed its high growth rate. According the preliminary estimates, the GDP growth rate in 2003 is about 7.2 percent - the highest growth rate since 1997, in which industry increased by 10.3 percent, agriculture by 3.2 percent, service sector, by about 6.6 percent. The main factors leading to this success were the strong domestic demand and a considerably high export growth rate.

The *Australian* economy grew steadily in 2003, reflecting solid growth in consumption and investment and a recovery in the rural sector following the drought in 2002. Real GDP increased by 3.3 percent in 2003 following growth of 3.6 percent in 2002. The growth of household spending was very rapid in late 2003, and was a key contributor to overall economic growth in the year. Consumption expenditure was underpinned by strong increases in wealth. Solid employment growth and a falling unemployment rate also supported household incomes and thus consumption growth over 2003. The external sector subtracted from GDP growth in 2003, reflecting a combination of strong domestic demand and relatively weak world growth. Net exports subtracted 2.8 percent from GDP growth in 2003, after subtracting 2.3 percent in 2002.

The *New Zealand* economy is continuing its strong growth performance of the past couple of years. Real GDP growth is solid, with growth of 3.3 percent expected for the year to March 2004 (compared with the 2.8 percent of a year earlier) and the unemployment rate is at a 16-year low. Growth has been dominated by domestic demand, which expanded by 6.6 percent in the 2003 calendar year. Contributing to this strength has been the strong performance of the labor market and increasing household wealth due to rapidly increasing house prices. The economy grew strongly over the second half of the 2003 calendar year, with production-based GDP up 4.1 percent on an annualized basis.

Following tepid growth in 2001, the *Canadian* economy surged ahead in 2002 with real GDP expanding by a robust 3.4 percent in the year, markedly higher than the 2.2 percent growth in the US over the same period. Canada's resilient performance reflected strong economic fundamentals, large tax cuts and an increasingly competitive business sector. During 2003, economic activity slowed because of a series of unforeseen shocks. Severe acute respiratory syndrome (SARS), bovine spongiform encephalopathy (BSE), the blackout in Ontario and the rapid appreciation of the Canadian dollar moderated economic growth to 2.0 percent in 2003. However, while exports suffered as a result of the shocks, domestic demand remained firm through most of the year, supported by low interest rates.

The *Chilean* economy had a recovery in 2003 with a GDP rate of growth of 3.3 percent, in a favorable international environment. Domestic demand experienced a greater expansion of private consumption and investment, in a context of improving labor conditions.

The *Mexican* economic recovery that began in 2003 continued in the first six months of 2004. Activity in the economy's three principal sectors; agriculture and fishing, industrial production; and services, strengthened during the period, and the performance of an increasing proportion of their components improved. The recovery of external demand and the continued stability of domestic demand contributed to improving economic activity and in turn gave rise to improved expectations and stimulated formal sector job creation. A stable financial environment aided the economic recovery, which was attributable in part to the Government's prudent and consistent economic policy. Domestic economic activity, as measured by GDP, grew at a real annual rate of 3.8 percent during the first half of 2004. During the period, economic activity improved in all three principal sectors of the economy. In annual real terms, the agricultural sector grew by 4.9 percent, the industrial sector grew by 3.5 percent and the services sector grew by 4.1 percent.

In 2003, the *Peruvian* economy grew by 3.8 percent achieving 30 months of consecutive growth, mainly associated with sound macroeconomic and growth-promoting policies and a positive international environment. GDP growth was driven by the expansion of non-primary activities such as construction (4.2 percent) and services (4.0 percent). Primary activities grew by 2.8 percent due to the dynamism of metallic mining (7.7 percent) which reflected mainly the increase of production of gold (an historical peak), iron, silver and zinc.

The development of the *Russian* economy was good in 2003 thanks to the positive dynamics of the most important macroeconomic indicators. Output of goods and services expanded, fixed capital investment grew and real household income rose. The GDP growth in 2003 was 7.3 percent as compared with 4.7 percent in 2002. The fact that in 2003 Russia continued to enjoy a current account surplus serves to show that there was a balance between domestic demand and supply, which contained price growth and created the favourable macroeconomic expectations that are considered to be a major factor of moderate price growth. High world prices for Russia's major export commodities led to rise in incomes of companies and considerable overall investment growth. The structure of industrial production in 2003 was as follows: fuel industry was 18.5 percent, ferrous metals 9.8 percent; non-ferrous metals 7.4 percent; electrical power 12.0 percent; chemical 5.5 percent; machinery and metal working 19.9 percent; wood, wood pulp and paper industry 4.2 percent; construction materials 3.1 percent; light industry 1.4 percent; food industry 15.4 percent, other industries 2.8 percent. The biggest contribution to industrial production growth was made by the fuel sector, machine-building and food industry (in 2002, it was the fuel sector, non-ferrous metallurgy sector and food industry).

2.2 Sluggish Improvement in Employment

Brisk economic growth usually brings more jobs and a lower unemployment rate. However, there was little improvement in the employment situation in the APEC region during the year 2003, as a whole unemployment rates did not fall noticeably in most member economies. Some economies, such as Mexico; Hong Kong, China; Indonesia and Singapore, showed higher unemployment rates during 2003.

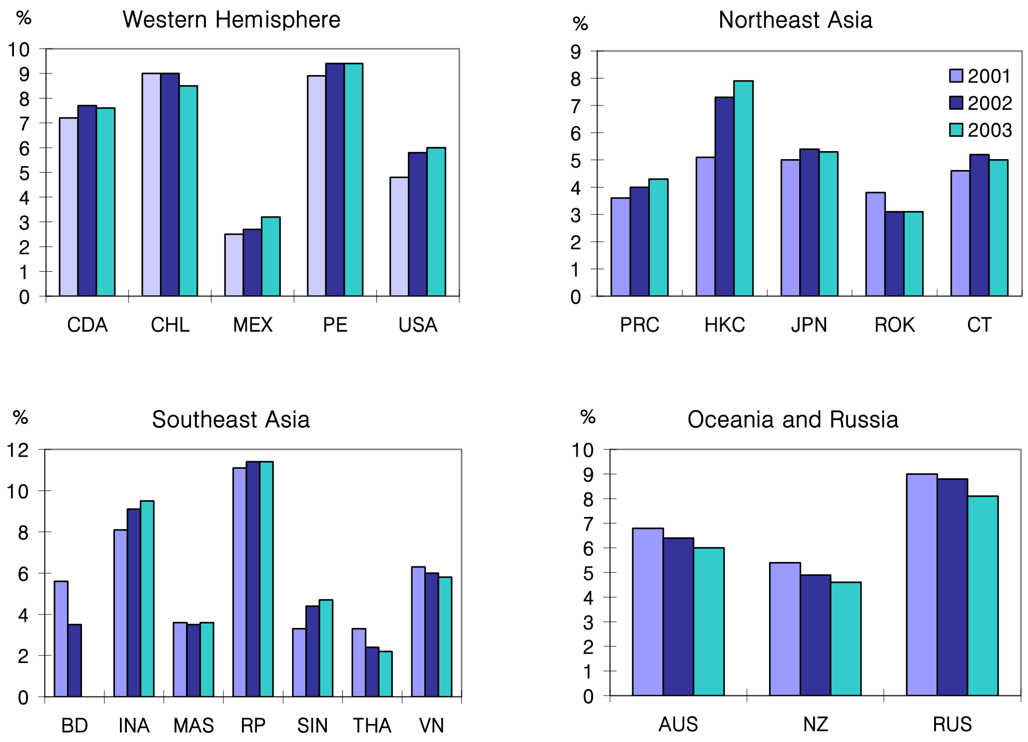
In the *US,* robust growth has meant more jobs for American workers. Since August 2003, payrolls in the US have increased by 1.7 million new jobs. The unemployment rate has fallen from 6.3 percent in June 2003 to 5.4 percent in August 2004. That level is lower than the decade averages for the 1970s, 1980s, and 1990s. Almost all major demographic groups and 45 states have seen a decline in their unemployment rate during the past year. Looking closely at the data by month net year, we could conform the movement of improving employment with higher economic growth. The remarkable productivity performance since the end of 2000 may be in part a temporary development that reflects intense cost cutting by businesses. However, productivity growth has been quite strong since the mid-1990s suggesting that an upward structural shift has taken place. A permanent improvement in productivity growth would be a welcome development: strong productivity growth would eventually translate into strong growth in real wages and standard of living.

Table 1.2
Unemployment Rates (percent)

	1998	1999	2000	2001	2002	2003
Western Hemisphere						
Canada	8.3	7.6	6.8	7.2	7.7	7.6
Chile	6.3	9.8	9.2	9.0	9.0	8.5
Mexico	3.2	2.5	2.2	2.5	2.7	3.2
Peru	7.8	8.0	6.5	8.9	9.4	9.4
The United States	4.5	4.2	4.0	4.8	5.8	6.0
Northeast Asia						
China	3.1	3.1	3.1	3.6	4.0	4.3
Hong Kong, China	4.7	6.2	4.9	5.1	7.3	7.9
Japan	4.1	4.7	4.7	5.0	5.4	5.3
Korea	7.0	6.3	4.1	3.8	3.1	3.1
Chinese Taipei	2.7	2.9	3.0	4.6	5.2	5.0
Southeast Asia						
Brunei Darussalam	4.7	4.5	4.7	5.6	3.5	N.A
Indonesia	5.5	6.4	6.1	8.1	9.1	9.5
Malaysia	3.2	3.4	3.1	3.6	3.5	3.6
The Philippines	10.1	9.8	11.2	11.1	11.4	11.4
Singapore	3.2	3.5	3.1	3.3	4.4	4.7
Thailand	4.4	4.2	3.6	3.3	2.4	2.2
Viet Nam	6.9	7.4	6.4	6.3	6.0	5.8
Oceania						
Australia	7.7	6.9	6.3	6.8	6.4	6.0
New Zealand	7.7	6.3	5.6	5.4	4.9	4.6
Russia	11.9	12.9	10.5	9.0	8.8	8.1

Sources: Individual Economy Reports
IMF, *International Financial Statistics*, August 2004

Fig 1.2 Unemployment Rate



The *Japanese* employment situation was severe as the unemployment rate had remained at a high level for the last few years. However, the number of employees has increased since the end of 2003, following an increase in job openings. The unemployment rate rose from the 4.5 to 5.0 percent range in 1999–2000 to about 5.5 percent in 2001, but then declined and remained within the 5.3 to 5.5 percent range from late 2001 to about the middle of 2003. The unemployment rate has decreased gradually to a 4.6 to 5.0 percent range.

In *China*, adjustments in economic structure, reform of state-owned enterprises, a shift of surplus rural laborers to non-agricultural industries and the coming peak of employment bring greater pressure in China's human resource market. By the end of 2003, the total number of employees was 744.32 million, which was 6.92 million more than the previous year, of which 256.39 million employees were in urban areas, with an increase of 8.59 million year-on-year. By the end of 2003, all laid-off employees found new jobs. During the same period, the urban registered unemployment rate was 4.3 percent, 0.3 percentage points higher than that in 2002. The social security system was further consolidated and improved. By the end of 2003, the number of residents covered by the basic old-age insurance program reached 154.90 million, 7.53 million more than the previous year.

Korea's overall job trends in 2003 showed poor performance reflecting the economic downturn. The number of economically active persons increased by 0.2 percent year on year while that of economically non-active persons rose by 2.4 percent. The participation rate in economic activities stood at 61.4 percent, a 0.5 percent decrease year-on-year. In 2003, the number unemployed was 777,000, an increase of 69,000 compared to the previous year and the unemployment rate reached 3.4 percent posting a 0.3 percent increase.

Hong Kong, China's, labor market remained slack in overall terms in 2003. Yet a progressive turnaround occurred in the second half of the year, following a distinct setback in the first half, mostly in the second quarter. Indicating this, the seasonally adjusted unemployment rate rose from 7.2 percent in the fourth quarter of 2002 to 7.5 percent in the first quarter of 2003, and rose further to 8.6 percent in the second quarter. Nevertheless, as overall economic activity and in particular inbound tourism and local consumer spending bounced up after SARS waned, the seasonally adjusted unemployment rate fell back to 8.3 percent in the third quarter and markedly further to 7.4 percent in the fourth quarter. For 2003 as a whole, the unemployment rate averaged 7.9 percent, which was however still appreciably above the 7.3 percent in 2002. The improvement in labor market conditions continued into 2004. The seasonally adjusted unemployment rate went down to 7.2 percent and 6.9 percent respectively in the first two quarters, and then fell to a 30-month low of 6.8 percent in June–August. Total employment remained on an uptrend alongside the economy, although this was partly offset by a concurrent expansion in the total labor force caused by an increased entry of people into the labor market to search for jobs.

In 2003, *Chinese Taipei* employment rebounded to a growth of 1.26 percent with the steady recovery of the global economy. The unemployment rate fell back to 4.99 percent from the previous year's historic high of 5.17 percent. In Chinese Taipei, knowledge-based employment has been growing in line with the development of the knowledge-based economy, with its ratio of total employment rising from 28.9 percent in 2002 to 29.5 percent in 2003. Between 1992 and 1997, such employment increased at an average annual rate of 4.4 percent. Although it slowed to 2.7 percent between 1998 and 2003, it was still above the economy-wide average.

In *Indonesia*, the progress of the labor market in 2003 remained sluggish, as newly created jobs fell well short of additions of new labor entering the work force. The economic development during 2003 added employment opportunities for as many as 1.1 million workers. However, these additional employment opportunities would not reduce the level of unemployment since the new workers entering the labor market increased by 2.4 million. In 2003, unemployment reached 10.1 million, and the unemployment rate rose from 9.1 percent in 2002 to 9.8 percent in 2003, the highest level of unemployment rate since the 1997 crisis. Looking forward, the increased economic growth anticipated in the next two years is expected to increase the economy's capacity to absorb labor force.

In *Malaysia*, unemployment remained low at 3.7 percent (Q2 2003: 4.0 percent). A total of 14,660 vacancies were reported in the second quarter, representing an increase of 86.7 percent from 7,850 of the previous quarter. On a sectoral basis, vacancies in manufacturing and other services sectors continued to record the highest number, accounting for more than 50 percent of the total vacancies reported.

The *Philippines'* employment was dragged down as bad weather struck during the third quarter claiming a large number of those employed in agriculture while the lingering effects of SARS slowed down employment in services. Total employment grew by 1.9 percent to 30.63 million in 2003 from the level of 30.06 million a year ago. In terms of jobs generated, the service sector led with 331,000 new jobs created, followed by the industrial sector with 145,000 jobs and the agriculture sector with 98,000 jobs. The average unemployment rate stood at 11.4 percent, the same as the 2002 rate. This brings the total number of unemployed to 3.93 million from 3.87 million in 2002. The average underemployment of 17 percent approximates the average underemployment rate in 2002. Total employment from January to July 2004 grew by 4.1 percent to reach 31.56 million. The growth in employment was supported by the recovery in employment in the agriculture, fishery and forestry sector and the continued expansion in services sector employment. The unemployment rate, however, inched up to 12.1 percent from 11.8 percent a year ago despite some easing up in July. The incidence of underemployment also went up to 17.9 percent from 17.5 percent over the same period in 2003.

After a weak first half, the *Singapore* labor market showed signs of turning around in the second half of 2003. For the whole of 2003, employment contracted by 12,900. Retrenchments also came in lower at 16,400 in 2003, compared to 19,100 in 2002. The strong cyclical recovery towards the end of the year, coupled with the post-SARS rehiring, led to a change in the seasonally adjusted unemployment rate from 5.5 percent in September to 4.5 percent in December. For the whole of 2003, unemployment averaged 4.7 percent, compared to 4.4 percent in the previous year.

In *Thailand*, the number of persons employed increased by 2.5 percent during 2003, reflecting strong economic growth. Consequently, the unemployment rate dropped to 1.5 percent in 2003.

As the *Thai* economy would continue to grow in 2004, unemployment rate is expected to remain at a low level.

By mid-2003, in *Viet Nam*, there were 40.5 million persons employed, of which 48.8 percent were females. In 2003, the rise in employment occurred largely in such sectors as aquaculture, the processing industry, construction, tourism, and private and public utilities. The unemployment rate in urban areas was 5.8 percent, meeting the target of below 6.0 percent, but it was still higher than common rates in other economies. In 2004, it is estimated that 1.5 million new jobs will be created: of that number 60,000 will be exported to overseas markets.

In Australia, employment grew by 2.3 percent in 2003, while the unemployment rate fell steadily across the year, from 6.2 percent in January to 5.8 percent in December. Wages, as measured by the Wage Cost Index (WCI), increased by 3.7 percent through the year to the December quarter 2003. Public sector wages increased by 4.9 percent through the year to the December quarter 2003, while private sector wages increased by 3.3 percent.

In *New Zealand*, The past few years of strong growth has seen the economy steadily absorb previously under-utilized labor and capital equipment. This is most readily apparent in the labor market, where the unemployment rate is at a 16-year low, and in industries like construction where prices are rising strongly.

While the labour market slowed down in 2001 in tandem with economic activity, *Canada* recovered rapidly in 2002 as output growth came back to more normal levels. In 2002 the Canadian economy created 560,000 new jobs, the largest number of jobs created over any 12-month period on record since 1976, and the fastest growth rate in 15 years (3.7 percent). Moreover, there were job gains in most sectors of the economy and over 60 percent of these new jobs were full-time. This period also saw a marked increase in labour force participation rates, which tempered the impact of the rapid increase in employment on the unemployment rate. The unemployment rate fell from 9.1 per cent in 1997 to a low of 6.8 per cent in 2000 and stood at 7.5 per cent at the end of 2002. The economy continued to add new jobs in 2003 though at a slower pace than in 2002. Employment increased by 270,800 while the unemployment rate held more-or-less steady around 7.5 percent over most of the year. Employment growth has slowed somewhat this year, but the economy still added 86,100 new jobs over the first five months of 2004. Meanwhile, reflecting the job gains and a decline in the participation rate, the unemployment rate stood at 7.2 per cent in May 2004, its lowest level since July 2001.

Chile's unemployment rate fell to 7.4 percent in the last four months of 2003, declining to its lowest rate for five years. The number of people employed increased 3.1 percent, while the labour participation rate increased by in 2.6 percent, signaling a strong recovery of labor conditions in 2003.

In *Mexico*, increased economic activity, combined with the strong performance of the manufacturing sector during the first half of the year, stimulated formal sector job creation during the first half of 2004. By 30 June 2004, the number of workers registered with the Mexican Social Security Institute (IMSS) (a measure of formal sector employment) totaled 12,414,814, an increase of 224,022 formal sector jobs as compared to 31 December 2003. Notwithstanding the improvement in formal employment figures registered during the first six months of 2004, the open unemployment rate (Tasa de Desempleo Abierta, or "TDA") remained high, averaging 3.7 percent of the economically active population during the first half of the year, 0.9 percent higher than the average for the same period of 2003.

Peru's unemployment rate remained at 9.4 percent in 2003, unchanged from 2002. Urban employment estimated by the Ministry of Labor through the National Survey on Monthly Variation of Employment in firms with 10 employees or more increased by 1.7 percent in 2003, mainly associated with the growth of economic activity.

Russia's employment trend was an increase in the number employed in the economy. The total number of economically active persons in Russia increased from 65.1 million in 2002 to 72.3 million in 2003 (more than 50 percent of all the Russian population). The number of employed

Russians decreased in 2003 by 0.3 million people (from 66 million in 2002 to 65.7 million at the end of the year 2003). In 2003 the number of unemployed persons, calculated according to International Labor Organization (ILO) methodology, was 8.1 percent of economically active persons (8.8 percent in 2002).

2.3 Continued Low Inflation

Even with strong growth of aggregate demand in APEC economies, their price inflation remained very low during 2003. In most member economies, inflation was kept at below 3.0 percent. Russia and Indonesia, especially, showed a trend of sharply falling inflation rates. Some Asian economies, such as Japan; Hong Kong, China; and Chinese Taipei, continued negative inflation, that is, deflation in 2003.

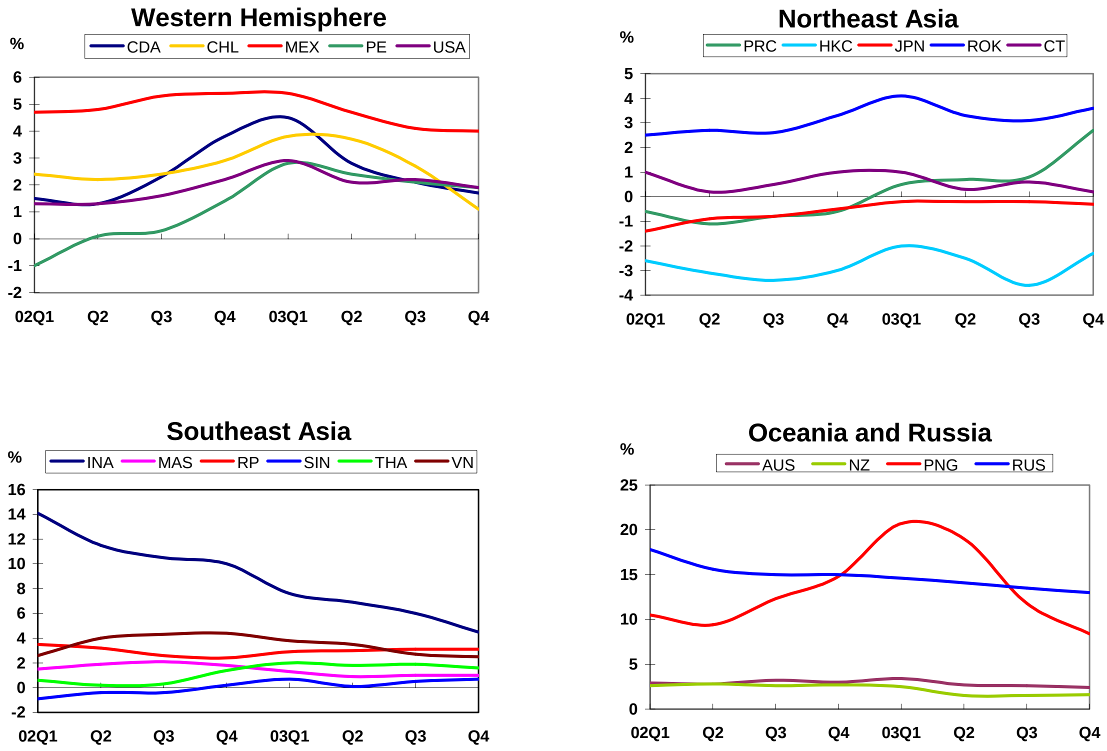
Reflecting higher economic growth, the *US* inflation rate rose from 1.6 percent in 2002 to 2.3 percent in 2003, still a very low level. Inflation has picked up this year, largely because of a surge in energy prices caused by a spike in oil prices, but it remains contained. So far this year, the consumer price index (CPI) has increased at a 3.7 percent annual rate, up from 2.3 percent during 2003. Energy prices increased at a 22 percent annual rate from December to August. Excluding volatile food and energy prices, the core CPI rose at a 2.6 percent annual rate from December to June, which is a step up from the 1.5 percent growth during 2003.

Table 1.3
Consumer Price Inflation (percent)

	1998	1999	2000	2001	2002	2003
Western Hemisphere						
Canada	1.0	1.7	2.7	2.5	2.3	2.7
Chile	5.0	3.3	3.8	3.6	2.5	2.8
Mexico	18.6	12.3	9.0	4.4	5.7	4.0
Peru*	6.0	3.7	3.7	-0.1	1.5	2.5
The United States	1.6	2.2	3.4	2.8	1.6	2.3
Northeast Asia						
China	-0.8	-1.4	0.4	0.7	-0.8	1.2
Hong Kong, China	2.8	-4.0	-3.8	-1.6	-3.0	-2.6
Japan	0.6	-0.3	-0.7	-0.7	-0.9	-0.3
Korea	7.5	0.8	2.3	4.1	2.7	3.6
Chinese Taipei	1.7	0.2	1.3	-0.0	-0.2	-0.3
Southeast Asia						
Brunei Darussalam	-0.4	-0.1	1.3	0.6	-2.3	1.5
Indonesia	77.6	2.0	9.4	12.6	10.0	5.1
Malaysia	5.3	2.8	1.6	1.4	1.8	1.2
The Philippines	9.7	6.7	4.4	6.1	3.0	3.0
Singapore	-0.3	0.0	1.3	1.0	-0.4	0.5
Thailand	8.1	0.3	1.5	1.6	0.6	1.8
Viet Nam	9.2	0.1	-0.6	0.8	4.0	3.0
Oceania						
Australia	0.9	1.5	4.5	4.4	3.0	2.8
New Zealand	0.4	0.5	4.0	1.8	2.7	1.6
Papua New Guinea	13.6	13.2	8.9	10.5	14.8	8.4
Russia	84.4	36.5	20.2	18.6	15.1	12.0

Sources: Individual Economy Reports.
IMF, International Financial Statistics, August 2004

Fig 1.3 Consumer Price Inflation



In *Japan,* price deflation has continued since the mid-1990s. domestic corporate goods prices have been declining. In 2003, the corporate goods price index (CGPI, base year =2000) fell by 0.7 percent from the previous year. The consumer price index (CPI) excluding fresh food, has continued to fall on a year-on-year basis since October 1999. However, the index has stayed flat on a month-on-month basis since Q1 of 2003. At present, although the CGPI has been rising, the CPI is slightly declining compared with the previous year. These movements show that the Japanese economy is in a mild deflationary phase.

In *China*, market prices went up throughout 2003. The general level of consumer prices rose by 1.2 percent over the previous year, with the rate plus 0.9 percent in urban areas and increasing 1.6 percent in rural areas. In the first half of 2004, inflation pressure became heavier. Driven by the rapid growth of investment, the general level of capital goods prices in the market rose by 8.1 percent on the basis of the previous year; and a year-on-year increase of 14.8 percent was noted in the first quarter of 2004. In the same period, the general level of consumer prices rose by 2.8 percent, with the influence of grain prices accounting for 2.4 percent. Moreover the rising prices of iron ore, aluminum oxide and cotton on the international market forced domestic production costs to go up.

In 2003, *Korea's* consumer prices rose by an annual average of 3.6 percent showing its stabilization within the target range and the recorded a 3.4 percent growth compared to the end of the previous year. In addition, core inflation, the barometer of price movements, increased by an annual average of 3.1 percent and hovering around the stabilizing rate of 3.0 percent. 2004 saw difficulties in controlling prices following soaring oil prices. Consumer prices increased 1.5 percent in the first quarter to 3.2 percent from the same period of the previous year. The producer price index (PPI) has maintained its upward trend because of the rise in oil prices. However, while the PPI increased by 3.1 percent in the first quarter year-on-year, its pace of growth lost steam in the second quarter as service charges showed signs of stabilizing.

In *Hong Kong, China*, the composite CPI fell by 2.6 percent in 2003, a smaller decrease than the 3.0 percent fall in 2002. The decline in prices moderated in the first and fourth quarters of 2003, outweighing the accentuated falls in the second and third quarters brought about by the severe impact of SARS on consumer demand, and the associated relief measures implemented by the Government. The moderation was more appreciable towards the year-end, when both property rentals and labour wages tended to stabilize amidst the generally improved economic conditions. Also, in the face of the surge in inbound tourism and a revival in local consumer spending, some retailers and service providers reduced price discounts and other concessions on their goods and services, while others raised prices modestly. Externally, a rebound in the prices of retained imports, under the combined influence of a weaker US dollar and firmer world commodity prices, began to feed through to some of the local retail prices. Consumer price deflation continued to subside in the first half of 2004 upon further revival in economic activity and increase in import prices. The year-on-year decline in the composite CPI narrowed from 1.5 percent in January to a meager 0.1 percent in June. This was followed by renewed increases of 0.9 percent and 0.8 percent respectively in July and August, reversing the continuous downtrend prevailing since November 1998. For 2004 as a whole, the composite CPI is forecast to show zero change.

Chinese Taipei's CPI fell slightly for the third year in a row, at -0.28 percent in 2003. Price deflation was caused by intensifying competition in the domestic market, the effect of bumper production on fruit and vegetable prices, and the falling prices of imported consumer goods and residential rents. The core CPI, excluding fresh food and energy prices, dropped by 0.61 percent, but the wholesale price index rose by 2.48 percent, owing to the rising international prices of oil, raw materials, and steel products.

Indonesia's inflation plunged fell significantly from 10.03 percent in 2002 to 5.06 percent in 2003. The downtrend in inflation was primarily due to lower basic food prices, an ample supply of commodities both domestic and imported, a stable exchange rate and minimal upward adjustment in administered prices. Inflation, however, has started to show an increase. Annual CPI inflation in the third quarter of 2004 stood at 6.27 percent year-on-year. The rising rate of inflation was largely attributable to the increasing aggregate demand, the depreciation of the rupiah and imported inflation as trading partner economies experienced an upward trend in inflation. All these developments have increased public expectations of inflation. The increasing trend of core inflation since the beginning of the year indicates that inflationary pressures have resulted from the demand side.

In *Malaysia* the consumer price index rose by 1.2 percent in the second quarter of 2004 compared to 0.9 percent in the corresponding period last year. The increase was mainly due to higher prices of food, especially meat that rose by 6.7 percent (Q1, 2004: 0.6 percent), attributed to its higher demand following the fear of Avian flu in the region

For two consecutive years, in *the Philippines*, the average inflation rate remained unchanged at 3.0 percent, lower than the target of 4.5 to 5.5 percent. The below target inflation rate for 2003 was attributed mainly to the absence of significant demand-driven upward pressures that could pull up consumer prices and the easing of cost-push inflationary risks. On the supply-side, inflation risks subsided with the mild *El Nino* phenomenon and the downward trend in international oil prices from its peak level in March due to stock-piling. In the first three quarters of 2004, the inflation rate climbed to an average of 4.8 percent compared to 2.95 percent during the same period in 2003. The general uptrend in prices was brought about by increases in basic electricity and fuel charges, high cost of basic raw materials such as flour, and lower production of vegetables as a result of the floods and typhoons.

Singapore's inflation remained benign in 2003. The recovery of economic activity during the later half of 2003, both in Singapore and elsewhere, did not strain productive capacity to generate significant inflationary pressures. The CPI rose by 0.5 percent in 2003, compared with a 0.4 percent decline a year ago. External factors provided the main impetus. More expensive imported goods, especially oil-related products, drove consumer price inflation during the year.

Thailand's headline inflation in 2004 is projected to be 3.1 percent, up from 2.0 percent in 2003, and due mainly to a rise in oil price. On the other hand, core inflation is expected to remain subdued at 1.4 percent.

Though local demand expanded, *Viet Nam's* CPI of a large number of commodities remained stable. Compared with the previous month, the consumer price index in December 2003 went up slightly (+0.8 percent) in all commodity categories. The consumer price index was on the rise at 3.0 percent, but this was lower than the rate of 4.0 percent in December 2002. The inflation rate for the whole of 2003 was estimated to be 3.0 percent. In early 2004, due to the impact of bird flu and the rise in prices of a large number of raw materials including and fuel such as petroleum, steel, and fertilizers, and fuel, such as petroleum, the inflation rate is likely to reach 6.5 percent, higher than the figure set by the National Assembly.

In *Australia*, the CPI increased by 2.4 percent through the year to the December quarter 2003. The major contributors to inflation over this period were food and housing, partly offset by the effect of lower import prices due to the strong appreciation of the Australian dollar over this period.

In *New Zealand*, the overall headline CPI inflation fell to 1.6 percent in 2003 from 2.7 percent in 2002. Furthermore, it registered at 1.5 percent for the March 2004 year, which was comfortably within the Reserve Bank's target band. The headline number, however, masks the very different profiles of tradable and non-tradable inflation. Non-tradable inflation for the year to March 2004 was very strong at 5.0 percent, consistent with very strong domestic demand and capacity pressures. Increasing costs associated with the purchase and construction of new dwellings contributed to this strong non-tradable result. Offsetting this trend, tradable prices fell 1.6 percent over the same period, due in large part to the appreciating New Zealand dollar.

Canada's consumer price inflation has remained within the Bank of Canada's inflation target bands of 1.0 to 3.0 percent for most of the last five years. Inflation drifted outside the upper limit of the target bands in the final months of 2003, boosted in large part by a number of temporary factors (automobile insurance premiums and energy prices) and higher costs for key inputs. Since that time, inflation has moderated considerably as a result of the unwinding of temporary factors, weaker economic activity and the sharp appreciation of the Canadian dollar vis-à-vis its US counterpart.

Chile's price inflation during 2003 was lower than expected, due to the impact of supply factors, such as peso appreciation and less compressed margins in specific sectors, reflecting greater competition and/or efficiency gains in production and distribution chains of non perishable goods and fuels. In December 2003, the annual CPI was 1.1 percent. The annual inflation rate of *Mexico*, as measured by the change in the consumer price index (Indice Nacional de Precios al Consumidor), stood at 4.4 percent for twelve months ending in 30 June 2004, 0.4 percentage points higher than for the year ending in 31 December 2003. This increase was attributable in part to the rising international prices of some commodities and their impact on core and non-core price indices.

Peru's annual inflation, measured by the CPI was 2.5 percent, meeting the target set by the Central Bank (2.5 percent +/- 1 percentage point). Core inflation, an indicator of the actual trend of prices in Peru by excluding high volatility price items was 0.77 percent in 2003. Rising prices of processed foodstuffs, such as rice and edible oil, accounted for most of the annual increase of this indicator.

According to *Russia's* Goskomstat the consumer prices index in 2003 reached 112.0 percent year-on-year, lower than in 2002 (115.1 percent) and in line with the schedule stipulated by the budget guidelines for 2003 (110 percent to 112 percent). Prices of non-food goods (109.2 percent) and foodstuffs (110.2 percent) increased far less than those of services (122.3 percent) in 2003. Prices of petrol, natural gas and electricity as well as transport and communal services cause further increase of prices of nearly all other goods. The exchange rate policy pursued by the Bank of Russia continued to play a favorable role in curbing core inflation. The nominal rise of the ruble against the dollar restrained growth in the prices of imported goods and, consequently, their domestically produced analogues. Consumer price inflation was affected by the dynamics of prices in cost-creating industries. Producer prices in the electric-power industry continued to rise rapidly, far surpassing the industrial average. At the same time, producer price growth in the fuel sector was considerably slower than in 2002.

2.4 Accelerating Trade Growth

Due to high economic growth and a trend of deepening interdependence among the economies, world trade has accelerated in 2003, led by US and Asian economies. According to the OECD *Economic Outlook* (May 2004), world trade volume grew at 4.5 percent in 2003, 1.1 percent higher than the 3.4 percent in 2002. Most APEC economies registered the higher rate of trade growth in 2003. Notably, some Asian APEC economies recorded trade growth at double-digit rates.

In 2003, external trade by the *US*, export as well as import, grew positively. US imports increased by 4.4 percent last year, higher than 3.4 percent in 2002 and reflecting the higher economic growth rate. US exports performed well with positive growth rates over the previous two consecutive years. Improvement in US exports in 2003 was due to broadening economic growth in its major trading partners and the trend since early 2003 of a depreciating US dollar.

In *Japan,* exports started to increase at the beginning of 2002. Growth stopped between the end of 2002 and mid-2003 with the weakening of global economic resilience as the main cause. Since the second half of 2003, exports have been on an upward trend. The factors causing this were a sharp rise in exports to Asia along with the recovery of the IT market and the world economy. Imports have been on an upward trend since the beginning of 2002 following a recovery of domestic demand.

China's foreign trade continued its high growth in 2003. Total volumes of exports and imports for the year reached US$851.2 billion, up by 37.1 percent over the previous year. China now has the fourth largest share of world trade, from fifth in 2002. The total volume of exports reached US$438.4 billion, up by 34.6 percent over the previous year. The total volume of import reached US$412.8 billion, up by 39.9 percent over the previous year. Trade surplus of 2003 reached US$25.6 billion.

Korea's exports for 2003 demonstrated a steady growth reaching US$197.6 billion, an increase of 20.9 percent from the previous year as the global economy mounted a gradual recovery. Imports jumped by 18.05 percent to US$175.4 billion year-on-year due to surging imports of raw materials and intermediate goods as a result of strong export performance. This trend has continued into 2004, leading exports to maintain their growth momentum with rising exports to China and at the same time, resulting in a sharp rise in imports in value terms as a direct consequence of skyrocketing oil prices.

Table 1.4
Change in Trade of Goods and Services (percent)

	Export						Import					
	1998	1999	2000	2001	2002	2003	1998	1999	2000	2001	2002	2003
Western Hemisphere												
Canada	9.1	10.7	8.9	-2.8	1.1	-2.4	5.1	7.8	8.1	-5.0	1.4	3.8
Chile	5.2	7.3	5.1	7.5	1.5	7.8	6.7	-9.5	10.1	4.1	2.4	8.8
Mexico	12.1	12.4	16.4	-3.8	1.5	1.1	16.6	14.1	21.5	-1.6	1.4	-1.0
Peru	5.6	7.6	7.9	7.1	6.8	5.9	2.3	-15.2	3.7	2.6	2.14	3.3
The United States	2.4	4.3	8.7	-5.4	-2.4	1.9	11.6	11.5	13.1	-2.7	3.4	4.4
Northeast Asia												
China*	0.5	6.1	27.8	6.4	22.3	34.6	-1.5	18.2	35.8	8.2	21.2	39.9
Hong Kong, China	-3.8	4.0	16.6	-1.8	9.2	12.9	-6.3	-0.2	16.8	-1.5	7.5	11.3
Japan	-2.4	1.5	12.4	-6.1	8.0	10.1	-6.6	3.3	9.2	0.1	2.0	5.0
Korea	12.7	14.6	19.1	-2.7	13.3	15.7	-21.8	27.8	20.1	-4.2	15.2	9.7
Chinese Taipei	2.4	11.9	17.6	-7.8	10.0	10.9	6.3	4.4	14.5	-13.9	5.8	6.9
Southeast Asia												
Brunei Darussalam	-21.7	31.2	52.7	1.4	-0.7	N.A	-13.7	-3.1	-1.8	14.2	-0.5	N.A
Indonesia	11.2	-31.8	26.5	0.6	-1.0	6.6	-5.3	-40.7	26.0	4.2	-4.0	2.8
Malaysia	0.5	13.2	16.1	-7.5	3.6	11.5	-18.8	10.6	24.4	-8.6	6.1	4.8
The Philippines	-21.0	3.6	17.7	-3.4	3.6	4.4	-14.7	-2.8	4.0	3.5	4.7	10.2
Singapore*	-15.2	5.7	20.1	-10.5	2.7	15.0	-21.1	7.3	22.0	-13.7	-0.5	9.4
Thailand	8.2	9.0	17.5	-4.1	10.9	6.5	-21.6	10.5	27.3	-5.5	11.3	7.3
Viet Nam	1.9	23.3	25.5	3.8	10.0	19.0	-0.8	2.1	33.2	3.4	19.4	26.7
Oceania												
Australia	-0.2	4.7	10.9	1.8	0.3	-2.6	6.0	9.3	7.5	-4.2	11.9	11.0
New Zealand	1.6	8.1	6.4	2.4	5.8	1.3	1.4	12.0	0.1	1.8	8.6	10.2
Papua New Guinea*	-16.1	9.1	7.3	-13.7	-9.5	27.5	-27.0	-0.1	-7.0	-6.4	14.6	-4.6
Russia	1.9	9.5	9.8	2.7	9.9	25.7	-13.6	-9.6	20.2	19.8	14.5	21.4

Note: * Based on merchandise exports and imports.
Sources: *Individual Economy Reports.*
ADB, Asian Development Outlook, September 2004
IMF, International Financial Statistics, August 2004
OECD, OECD Economic Outlook, May 2004.

Hong Kong, China's total exports of goods picked up distinctly with to an 11.7 percent growth in value terms to HK$1,742.4 billion (US$223.8 billion) in 2003. Imports of goods were likewise robust, leaping by 11.5 percent in value terms to HK$1,805.8 billion (US$231.9 billion) in 2003. On balance, the visible trade deficit (reckoned on a GDP basis) widened marginally in absolute terms, to HK$45.0 billion (US$5.8 billion) or 2.5 percent of the value of imports of goods in 2003. Together with an enlarged invisible trade surplus of HK$155.8 billion (US$20.0 billion), a combined surplus of HK$110.8 billion (US$14.2 billion), equivalent to 5.6 percent of the total value of imports of goods and services, was recorded in 2003.

Chinese Taipei's exports of goods and services climbed 10.89 percent, largely due to surging demand for electrical machinery and precision instruments. Imports grew 6.85 percent on the back of rising export-induced and domestic demand. Exports and imports translated into a 2.95 percent contribution by net foreign demand. Chinese Taipei's merchandise exports and imports both registered double-digit growth rates in 2003. The value of merchandise exports grew by 10.5 percent to US$143.5 billion, mainly driven by steady growth in the global economy and the vigorous rebound in the information and communication technology industry worldwide. The value of merchandise imports rose by 12.2 percent to US$118.6 billion, primarily led by stronger derived demand arising from the expansion in exports and the gradual recovery in domestic demand, while also being pushed upward by surging international commodity prices.

Amidst the improvement in the external environment, *Malaysia's* gross exports expanded strongly by 14.2 percent during the first quarter of 2004 (Q1 2003: 12.3 percent), while gross imports increased at a stronger pace of 23.4 percent reflecting buoyant domestic economic activity in the first quarter of 2004.

Singapore's total trade rose by 9.6 percent in 2003 to hit S$474 billion, following a 1.5 percent increase in 2002. The second half of the year saw a quick recovery with especially robust growth in the fourth quarter, due to improvements in the external environment and the pickup in global electronics demand.

In the *Philippines*, merchandise exports grew by 5.4 percent propped up by increased exports of crude coconut oil, gold, prepared tuna, sugar and copra. Exports of semiconductors and microcircuits, however, fell to 3.7 percent. Exports of non-factor services declined by 2.2 percent as the substantial increase in receipts from miscellaneous services, particularly call centers and insurance companies, failed to offset the slowdown in travel and government services. Total imports continued to support growth particularly investments in durable equipment such as electrical machinery and transport equipment. The sluggish performance of the export sector during the early part of 2003 caused the trade-in-goods balance to post a deficit of US$1,253 million, a reversal from its surplus of US$407 million in 2002. Specifically, exports of electronic products contracted to US$18,255 million last year from US$18,583 million in 2002. Similarly, exports of garments declined by 5.1 percent to US$2,269 million from US$2,391 million in 2002. On the other hand, exports of machinery and transport equipment expanded by 1.7 percent last year. Meanwhile, total imports reached US$36,095 million, up by 6.3 percent. Imports of capital goods (41.6 percent) as well as raw materials and intermediate goods (40.4 percent) accounted for the bulk of imports signifying a resurgence of economic activities. Likewise, imports of capital goods, primarily by the telecommunication sector, rose by 15.9 percent for 2003.

Although the avian influenza slightly dampened *Thai* export performance in the first quarter of 2004, for the whole year, the value of exports of goods and services is expected to grow robustly by 15.3 percent to US$89.9 billion, owing to the trading partners' improved economies. At the same time, the value of import of goods and services in 2004 is projected to increase strongly by 21.8 percent to US$90.0 billion. Major supporting factors include a continued appreciation of the baht as well as increasing imports after subsequent high level of economic expansion.

In 2003, *Viet Nam's* export turnover was estimated to be US$19.9 billion– that is 19.0 percent higher than that figure of the year 2002, in which the exports value of domestic sector was US$9.9 billion, an increased of 11.7 percent; and FDI was US$10 billion, an increased of 27.2 percent.

In 2003, *Australia's* export volumes fell by 2.6 percent, while import volumes increased by 11.0 percent. The terms of trade increased by 3.8 percent in 2003, following a 2.6 percent rise in 2002. The trade deficit widened to A$23.6 billion in 2003, an increase of A$13.5 billion.

With the appreciation of the *New Zealand* dollar, the price of imported goods has fallen. This has provided a boost to both real private consumption and real business investment as consumers have taken advantage of low-priced consumption goods while businesses have benefited from lower-priced capital equipment. Computer prices, in particular, have fallen dramatically in real terms. Increased demand for imported goods by both households and businesses has resulted in strong growth in import volumes, which grew 10.2 percent over the 2003 calendar year. While the appreciation of the exchange rate has enabled the purchase of cheaper imported goods, it has also reduced export earnings. Total export earnings fell 6.5 percent in the year to December 2003. This fall was driven by the lower New Zealand dollar prices received by exporters, rather than export volumes, which grew by 1.3 percent in the year to December 2003. Overall, the strength of the domestic economy, the associated demand for imports and relatively weak export growth has resulted in a widening gap between the contribution of domestic demand and net exports to growth.

In *Chile* external trade flows reached important growth rates, pushing the economy to a dynamic performance. Growth in exports that represented 34.0 percent of GDP surged at a rate of 7.8 percent, especially the mining, fruits, forestry, fishing and chemical sectors, and imports grew faster than the previous year. The signing of the Association Treaty between Chile and the European Union earlier in 2003, allowed an expansion of the market for Chile's exports. Chile's merchandise export volumes rose 7.5 percent. Copper exports rose about 5.8 percent by volume. Import volumes rose 9.5 percent, mainly reflected in increased intermediate goods.

During the first half of 2004, improved global economic conditions, in particular in the United States, helped *Mexico's* external trade performance. In addition, the rise in international oil prices generated an increase in revenues from oil exports. Total merchandise exports in the first half of 2004 were US$90,871 million, 14.2 percent higher than for the same period of 2003. Oil exports were US$10,816 million, 17.7 percent higher than for the same period of 2003. In the first half of 2004, non-oil exports totaled US$80,055 million, 13.7 percent higher than for the same period of 2003. This increase was primarily attributable to the performance of manufacturing exports, which increased 13.5 percent. Within manufacturing exports, *maquiladora* and other manufacturing exports increased 13.8 percent and 13.0 percent, respectively. During the first half of 2004, total merchandise imports were US$92,226 million, 13.7 percent higher than for the same period of 2003. Imports of intermediate goods by the *maquiladora* industry totaled US$32,293 million, 17.2 percent higher than for the same period of 2003. Consumer goods imports totaled US$11,149 million in the first half of 2004, 13.1 percent higher than for the same period of 2003, due primarily to an increase in real wages. Imports of intermediate goods, excluding the *maquiladora* industry, increased 13.0 percent, to US$38,460 million. Finally, imports of capital goods imports in the first half of 2004 totaled US$10,324 million, a 7.1 percent increase as compared to the same period in 2003.

Peru's trade balance recorded a surplus of US$731 million, the second surplus after 11 years of deficit, reflecting the dynamism of export growth by 16 percent mainly associated with better terms of trade of mining exports, larger volumes of gold shipped and higher values of garments and farm products exports. Imports grew by 11 percent, mainly due to higher oil prices as well as larger imports of durable consumer goods intermediate and capital goods for the industry.

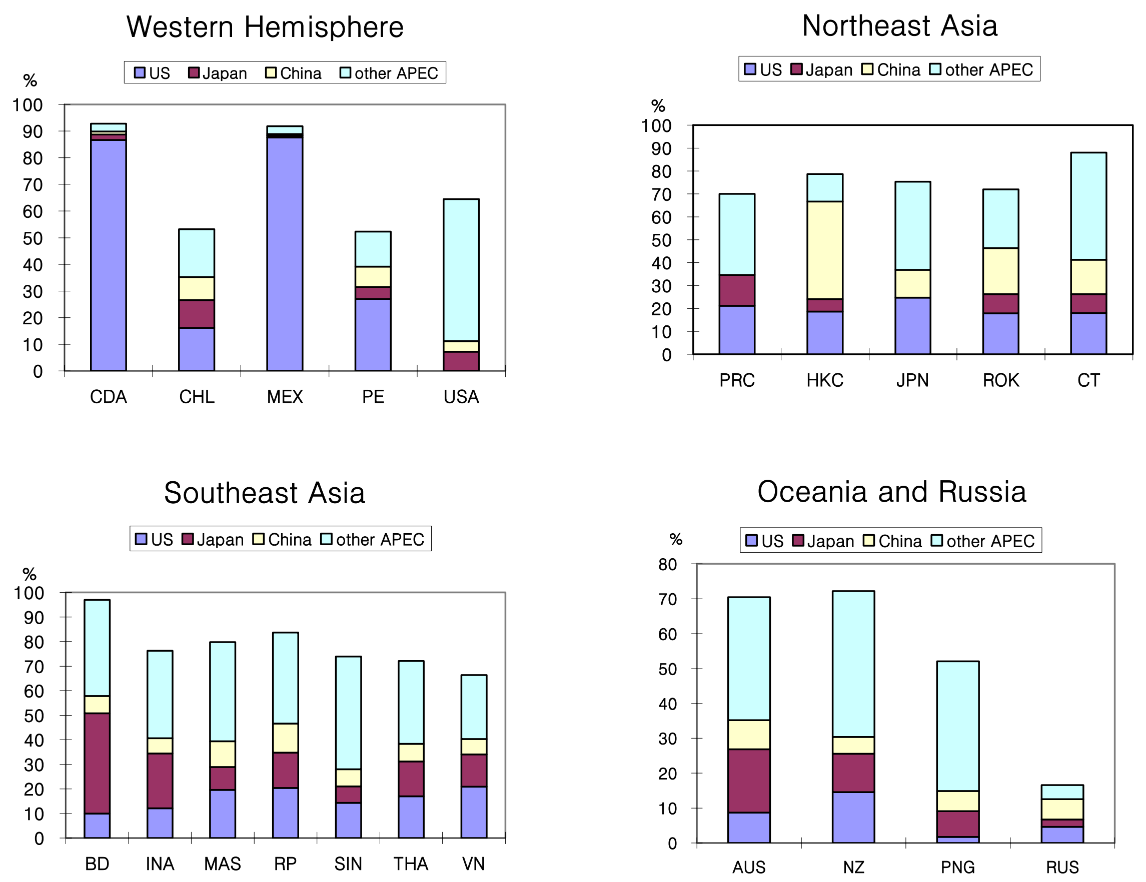
Russia's total merchandise exports in 2003 increased by 26.7 percent (5.3 percent in 2002) and amounted to US$135.9 billion. Exports' share in total sales of industrial goods in actual prices in 2003 was 25.1 percent (29.6 percent at 2002 prices) compared to 25.0 percent a year before. The situation in the world's commodity markets in 2003 was considerably better for Russian exports than in 2002. World prices of major Russian exports rose 16.3 percent on average. The price of Urals crude grew 15.5 percent to US$27.3 per barrel and Brent was up 15.4 percent to US$28.8 billion per barrel. The price of petrol rose by 23.4 percent, diesel fuel by 24.8 percent and fuel oil 12.8 percent. Natural gas prices in Europe jumped 28.0 percent and non-ferrous metal prices rose 15.5 percent on average (the price of aluminum was up 6.0 percent, copper up 14.1 percent and nickel up 42.1 percent).

Table 1.5
Direction of APEC Trade (percent)

To / From	APEC									
	Western Hemisphere		**Northeast Asia**		**Southeast Asia**		**Oceania**		**APEC Total**	
	1991	**2003**	**1991**	**2003**	**1991**	**2003**	**1991**	**2003**	**1991**	**2003**
Western Hemisphere										
Canada	77.0	87.3	8.9	4.4	1.1	0.6	0.5	0.4	87.5	92.8
Chile	20.8	24.4	28.9	26.9	1.6	1.4	0.3	0.6	51.5	53.1
Mexico	21.6	89.8	26.1	1.7	1.6	0.2	0.3	0.1	49.6	91.8
Peru	28.8	34.5	20.8	16.1	1.1	1.1	0.2	0.6	50.9	52.3
The United States	29.0	37.5	22.0	18.6	4.9	6.2	2.3	2.1	58.3	64.5
Northeast Asia										
China	10.0	23.5	64.9	38.1	5.9	6.8	0.9	1.6	81.7	70.0
Hong Kong, China	25.8	20.5	37.6	50.9	6.8	5.9	1.6	1.4	71.8	78.6
Japan	32.9	27.3	20.4	32.7	12.0	12.9	2.4	2.5	67.7	75.3
Korea	30.2	22.3	28.1	38.2	10.3	9.7	1.6	1.8	70.2	72.0
Chinese Taipei	32.2	25.0	30.1	46.0	9.9	15.0	2.0	1.9	73.1	88.0
Southeast Asia										
Brunei Darussalam	1.1	10.1	75.7	60.9	19.9	14.5	2.8	11.5	99.5	97.0
Indonesia	12.7	13.3	54.0	42.4	11.3	17.4	2.2	3.2	85.7	76.3
Malaysia	18.0	23.2	29.3	31.3	29.0	22.6	2.0	2.7	78.2	79.7
The Philippines	37.6	23.2	31.2	44.5	7.2	14.5	1.3	1.3	77.3	83.6
Singapore	21.3	15.1	22.8	30.6	24.0	24.3	3.1	3.8	71.3	73.9
Thailand	23.0	18.8	27.6	31.6	11.7	18.6	1.6	3.1	64.0	72.1
Viet Nam	0.0	22.1	69.6	25.7	22.4	11.4	0.2	7.1	92.2	66.3
Oceania										
Australia	12.1	10.8	46.2	40.4	12.6	11.1	6.6	8.1	77.5	70.4
New Zealand	16.7	18.2	28.4	23.7	7.3	7.9	23.1	22.4	73.4	72.2
Papua New Guinea	2.1	1.8	33.4	14.7	7.4	7.3	40.88	28.2	83.7	52.1
Russia	2.2	5.0	11.5	10.2	1.5	1.3	0.0	0.0	15.2	16.5
APEC	**30.6**	**33.6**	**26.1**	**28.2**	**8.6**	**8.9**	**2.2**	**2.1**	**67.5**	**72.8**

Source: IMF, Direction of Trade Statistics, August 2004. (www.imf.org)

Fig 1.4 Market Composition of APEC's Export (2003)



Looking at the trade data of APEC as a whole since the inception of APEC, the trend has been a rising ratio of intra-APEC trade. Rapid expansion of intra-regional trade amongst APEC economies is strengthening their autonomous impetus to APEC trade and growth. APEC export dependency on APEC markets themselves was high at 72.8 percent in 2003, which was slightly lower than the 73.7 percent in 2002 but was much higher than the 67.5 percent in 1991. This implies that only 27.2 percent of APEC exports went to markets outside APEC in 2003, compared to 32.5 percent in 1991. In case of 2003, most APEC members are exporting more than 70 percent of their goods to other APEC members. Comparing the numbers between 1991 and 2003, the degree of dependence on the markets of Northeast Asian members has risen rapidly from 26.1 percent to 28.2 percent, and the degree of dependency on Western Hemisphere economies has risen significantly from 30.6 percent to 33.6 percent.

APEC's share in world trade has risen over the last decade, this reflects the long-term trend of higher economic growth, primarily export-led, in APEC economies compared to other region. During the 1990s, APEC's share in world exports has gone up to 48.8 percent in 2000, about 8 percent higher than that in 1991. Total imports of APEC members shared more than half of the world imports in 2000, compared to 40.3 percent in 1991. During the same period, the European Union's share has fallen significantly. Also we confirm the trend of the industrial economies' share falling and the developing economies' share rising, especially of Asian developing economies, most of which are members of APEC. However, since 2001, APEC's share in world trade has stopped rising and has fallen slightly. This was largely a reflection of the poor trade performance of the United States and Japan in the last three years. Especially, exports volumes of the US and Japan in 2003 remained below their levels in 2000.

Table 1.6
Composition of World Trade by Region (percent)

	1991	1998	1999	2000	2001	2002	2003
Export							
Industrial Economies	70.9	67.4	66.3	62.9	63.2	62.1	61.6
Developing Economies	29.1	32.6	33.7	37.1	36.8	37.9	38.4
Africa	2.3	1.7	1.8	2.0	1.9	1.9	2.0
Asia	14.6	18.1	18.6	19.9	19.3	20.2	20.5
Europe	4.4	5.2	4.9	5.4	5.9	6.2	6.9
Middle East	3.9	2.7	3.2	4.4	4.3	4.4	N.A
Western Hemisphere	3.9	5.1	5.2	5.6	5.6	5.3	4.7
Oil Exporting Economies	5.1	3.6	4.2	5.5	5.1	4.9	N.A
Non-Oil Developing Economies	24.0	29.0	29.5	31.7	31.7	32.9	34.1
APEC	**40.9**	**45.8**	**47.0**	**48.8**	**46.8**	**46.0**	**44.7**
EU	**41.7**	**42.6**	**41.0**	**37.5**	**39.2**	**39.7**	**40.6**
Import							
Industrial Economies	71.0	67.2	67.9	66.1	65.7	64.9	64.2
Developing Economies	29.0	32.8	32.1	33.9	34.3	35.1	35.8
Africa	2.0	1.9	1.7	1.6	1.7	1.7	N.A
Asia	14.7	15.8	16.5	18.2	17.6	18.5	19.2
Europe	4.8	6.3	5.4	5.5	5.9	6.4	7.0
Middle East	3.5	2.9	2.8	2.8	3.2	3.2	N.A
Western Hemisphere	4.0	6.2	5.8	5.9	6.0	5.4	4.8
Oil Exporting Economies	3.8	2.8	2.6	2.6	2.9	2.8	N.A
Non-Oil Developing Economies	25.1	30.1	29.5	31.3	31.4	32.3	33.0
APEC	**40.3**	**45.5**	**47.8**	**50.8**	**49.2**	**49.2**	**47.7**
EU	**42.7**	**40.1**	**39.0**	**36.1**	**36.7**	**36.7**	**37.6**

Source: IMF, International Financial Statistics August 2004

2.5 Persisting External Imbalances

Reflecting overall economic performances, external imbalances, measured by the percentage of current account balances to their GDP, widened in 2003 from those in the previous two years. Most Asian members and Russia recorded large surpluses and most showed rising ratios of current account surpluses to their GDP, which were mainly due to better performance of their merchandise exports. On the other hand, with the exception of Canada and PNG, members in the Western Hemisphere and Oceania showed large deficits. In 2003, the US current account deficit increased slightly to 4.9 percent from 4.8 percent of GDP in 2002, with a deficit of US$542 billion in 2003 and US$481 billion in 2002. However, the current account deficit has recently narrowed after peaking in the second quarter of 2004. This recent tendency of narrowing current account deficits has been largely due to the decline of the US dollar over the past two years.

The US current account deficit has increased to a historical high for the recent years. Following a US$480.9 billion deficit in 2002, it registered US$541.8 billion in 2003, with 4.9 percent of GDP. This was basically reflecting a higher domestic demand than foreign demand for US goods and services. The US is consuming and investing more than it produces. The US has run deficits on its current account for the last two decades.

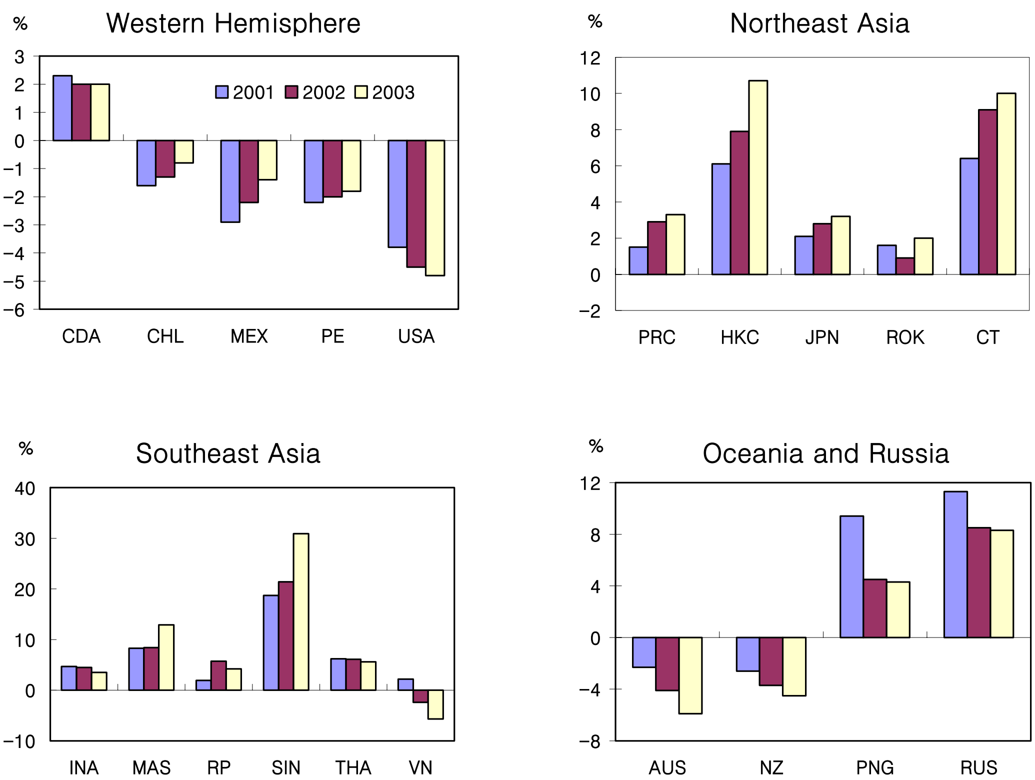
In *Japan's,* balance of payments for 2003, the current account surplus registered 15.8 trillion yen, an increase from the surplus of 14.1 trillion yen in 2002. This reflects a higher surplus in the trade account, and a lower deficit in the service account caused by the decrease in overseas travel due to SARS. The capital and financial account recorded a net inflow of 7.7 trillion yen, a change from the net outflow of 8.5 trillion yen in 2002, and primarily reflecting the large inflow to the financial account. The year-on-year growth in reserve assets was 21.5 trillion yen, up from 5.8 trillion yen in 2002.

Table 1.7
Current Account Balances (percent of GDP)

	1998	1999	2000	2001	2002	2003
Western Hemisphere						
Canada	-1.2	0.3	2.7	2.3	2.0	2.0
Chile	-4.9	0.1	-1.2	-1.6	-1.3	-0.8
Mexico	-3.8	-2.9	-3.1	-2.9	-2.2	-1.4
Peru	-5.9	-2.8	-2.9	-2.2	-2.0	-1.8
The United States	-2.4	-3.2	-4.2	-3.8	-4.5	-4.8
Northeast Asia						
China	3.0	1.1	1.9	1.5	2.9	3.3
Hong Kong, China	1.5	6.4	4.3	6.1	7.9	10.7
Japan	3.0	2.6	2.5	2.1	2.8	3.2
Korea	11.6	5.5	2.3	1.6	0.9	2.0
Chinese Taipei	1.3	2.8	2.9	6.4	9.1	10.0
Southeast Asia						
Brunei Darussalam	53.8	62.6	92.8	91.6	86.5	N.A
Indonesia	4.3	4.1	3.4	4.7	4.5	3.5
Malaysia	13.2	15.9	9.4	8.3	8.4	12.9
The Philippines	2.4	9.5	8.4	1.9	5.7	4.2
Singapore	22.7	18.6	14.3	18.7	21.4	30.9
Thailand	14.4	12.4	9.3	6.2	6.1	5.6
Vietnam	-4.6	4.1	3.5	2.2	-2.4	-5.7
Oceania						
Australia	-5.0	-5.7	-4.0	-2.3	-4.1	-5.9
New Zealand	-4.1	-6.4	-4.9	-2.6	-3.7	-4.5
Papua New Guinea	1.6	4.3	10.1	9.4	4.5	4.3
Russia	0.1	12.6	18.0	11.3	8.5	8.3

Sources: Individual Economy Reports
ADB, *Asian Development Outlook*, September 2004.
IMF, *International Financial Statistics*, August 2004
OECD, *OECD Economic Outlook*, May 2004.

Fig 1.5 Current Account Balances (percent of GDP)



China's current account surpluses continued the rising trend, growing to 47.6 billion dollars in 2003. Main components of surpluses were a big surplus of merchandise trade, US$25.6 billion in 2003. Although China's international tourism suffered from SARS, China had a substantial surplus on the services trade. China's foreign exchange reserves continued to increase. By the end of 2003, the total amount of the foreign reserves was 403.25 billion US dollars, increased of US$116.84 billion over the previous year. By the end of 2003, China recorded balance of the foreign debts amounted to US$193.63 billion, US$22.28 billion more than the previous year and up by 13 percent. Long-term and mid-term debts were US$116.59 billion, accounting for 60.21 percent, and US$1.03 billion more than the previous year. Short-term debt reached US$77.04 billion, accounting for 39.79 percent, US$21.25 billion more than the previous year.

Korea's current account surplus in 2003 was US$12.32 billion recorded its sixth consecutive annual surplus since 1998. Breaking it down by category, merchandise trade surplus (US$22.16 billion) rose significantly and a slight improvement was made on deficits in trade in services (US$7.61 billion), and the current account surplus rose by US$6.93 billion compared to the US$5.39 million in 2003. The capital account balance recorded an inflow surplus of US$13.13 billion due to the increasing capital inflow for securities investment by foreigners in 2003. While the financial account recorded a influx surplus of US$14.53 billion because of rising securities investment by foreigners, while other capital and financial accounts posted a outflow surplus of US$1.4 billion owing to rising emigration fees. As of the end of the first quarter of 2004, Korea's total foreign debts was US$169 billion, an increase of US$ 8.1 billion from the end of 2003, while foreign bonds amounted to US$242.9 billion, up by US$17 billion. On the other hand, Korea's net lending hit 73.9 billion dollars, up by 8.9 billion dollars, from the end of 2003 maintaining its status since June 2000 as a net creditor economy.

Hong Kong, China's overall balance of payments switched back to positive in 2003, with a surplus of HK$7.6 billion (US$1.0 billion) or equivalent to 0.6 percent of GDP in the year. This contrasted against a deficit of HK$18.5 billion (US$2.4 billion) or equivalent to 1.5 percent of GDP in 2002.

While this turnaround was primarily attributable to a strong inflow of funds into Hong Kong, China, a surge in net inflow of external factor income and an enlarged invisible trade surplus in that quarter also contributed. Analyzing its components, current account surplus in 2003 widened to HK$130.3billion (US$16.7 billion), equivalent to 10.7 percent of GDP, while net outflow of financial non-reserve assets in the capital and financial account fell to HK$143.9 billion (US$18.5 billion) or 11.8 percent of GDP in the same year. Hong Kong, China's external debt position remained sound in 2003, with most of its external debt being associated with normal operations of the banking sector and with inward direct investment. The Government had no external debt in 2003.

Chinese Taipei's balance of trade for 2003 showed a surplus of US$24.9 billion, its highest such surplus on record. In 2003, Chinese Taipei's services-trade deficit widened slightly to US$3.2 billion from the previous year's US$3.1 billion. Much of this gap resulted from the sharp decrease in travel receipts caused by the SARS outbreak. The current account balance reached a surplus of US$28.6 billion in 2003, which was equivalent to 10 percent of GDP. A huge inflow of US$6.3 billion was recorded on the financial account, following two previous years of inflows, mainly owing to increased liabilities in the banking and private sectors. The overall balance of payments posted a surplus of US$37.1 billion in 2003, due to a sizable current account surplus and a huge financial account inflow. *Chinese Taipei's* total external debt substantially increased, by 40 percent, from US$45.0 billion in 2002 to US$63.0 billion in 2003. Most of the increase was in private debt, and was mainly attributable to an increase in euro-convertible bonds (ECBs) issued by local firms to raise funds from the international market. External public debt has remained consistently low since 1998, with less than US$200 million outstanding at the end of 2003.

In 2003, *Indonesia's* current account recorded another year of surplus, reaching US$7.7 billion. On the other hand, the capital account remained in deficit at around US$1.7 billion, lower than the previous year, owing to stronger inflows from both public and private sources. The overall balance of payments for the whole year 2003 recorded a surplus of around US$4.2 billion, contributing to the stronger build-up of official reserves which reached US$36.2 billion. By end of the third quarter 2004, the reserves decreased to US$34.8 billion, which is still comfortable for 5.8 months of imports and official debts repayments. With the full support of prudent and consistent fiscal and monetary policy, the Indonesian Government remains committed to repaying maturing foreign debts. As Indonesia sovereign debt indicators are improving, Indonesia's external debt and debt service ratio remain on a declining path. External debt as a percentage of GDP fell to around 64 percent by the end of 2003, slightly lower than the median ratios for comparably-rated countries, and significantly below its peak of almost 150 percent in 1998.

Amidst the improvement in the external environment, *Malaysia's* gross exports expanded strongly, by 25 percent, during the second quarter of 2004 (Q2 2003: 10.8 percent), while gross imports increased at a stronger pace of 32.2 percent reflecting buoyant domestic economic activity in the second quarter of 2004. As of 15 September 2004, Malaysia's international reserves rose further to its highest level to reach RM210.7 billion (US$55.4 billion), sufficient to finance 7.2 months of retained imports and are five times the short-term external debts.

The Philippines' overall balance of payments for 2003 ended with a surplus of US$111 million, lower than the 2002 surplus of US$663 million. The balance of payments posted a surplus mainly because of the sustained current account surplus of US$3,347 million. And the level of gross international reserves (GIR) for 2003 was equivalent to 4.7 months of payment of services, income and imports of goods. As of the end of December 2003, the Philippines' total outstanding debt stood at US$57,395 million, a 7.0 percent increase from the 2002 total of US$53,645 million.

Singapore's overall balance of payments rose to S$12 billion in 2003, up significantly from S$2.3 billion in 2002. The increase in the surplus could be attributed to the larger current account surplus, which more than offset the rise in outflows from the capital and financial accounts. In line with these developments, Singapore's official foreign reserves rose by S$20 billion to reach S$163 billion as of the end-2003 (or 8.8 months of current imports).

Following stronger import growth than export growth, the *Thai* trade balance in 2004 is, therefore, forecast to register a slight deficit of US$0.1 billion. Nevertheless, the current account balance is expected to show a surplus of US$5.3 billion, or 3.1 percent of GDP. International reserve is projected to remain at a high level of US$42.4 billion (or 5.7 months of imports and 4.6 times short-term external debt). As of February 2004, *Thailand's* external debt registered US$51.1 billion, down from the peak of US$ 102.2 billion in 1999. The drastic decline mainly resulted from the acceleration in private external repayments.

Australia's current account deficit increased sharply to 5.9 percent of GDP in 2003, up from 4.1 percent of GDP in 2002. The increase was mainly attributed to the decline of merchandise exports.

New Zealand's current account balance has deteriorated since 2002, largely due to a sharp increase in its imports. In addition to this import surge, a slowdown of export growth in 2003 caused the NZ current account deficit to rise to 4.5 percent of GDP.

Canada's current account has improved dramatically from the deficits in the 1990s, consistent with significant improvements in government finances. In 2003, the current account balance as a share of GDP stood at 2.0 percent, up from 0.3 percent of GDP in 1999. In the first quarter of 2004, the current account surplus increased further to 3.0 percent of GDP. Thanks in part to the current account surpluses, supported by the improvement in fiscal balances over recent years, Canada's net foreign debt as a share of GDP is down to close to its lowest level since the 1950s, from a peak of 44 percent of GDP in 1993 to below 17 percent in the fourth quarter of 2003.

In 2003, *Chile's* current account balance posted a deficit of US$593.8 millions. Meanwhile, the trade balance posted a US$3,015.3 millions surplus with exports of good of US$21,046.0 growing 15.8 percent from the previous year, and imports of US$18,030.7 rising 13.3 percent in 2003. The other current account components services, income and transfers-posted total negative flows of US$3.609,1 million in 2003, reducing the year's current deficit by US$291,3 million. Chile's gross external debt posted US$43.4 billion in 2003, growing 5.9 percent from previous year. The private sector held 78.6 percent of the debt, while 17.5 percent of total debt corresponds to short-term debts and 82.5 percent to medium- and long-term obligations.

The *Mexican* trade balance registered a deficit of US$1,354 million in the first half of the year. Excluding oil exports, the trade deficit was US$12,171 million, 13.9 percent higher than in the first half of 2003. The factor services balance registered a deficit of US$7,194 million in the first half of 2004, 6.2 percent higher than in the first half 2003. The non-factor services balance registered a deficit US$1,835 million in the first six months of 2004, 2.9 percent higher than in the same period of 2003.The current account deficit for the first half of 2004 was US$2,274 million, US$1,278 million lower than that observed in the first half of 2003. This decline resulted from a US$1,614 million, or 24.8 percent, increase in transfers, as well as a US$418 million, or 6.2 percent, decline in the factor services balance. The moderate current account deficit was completely financed by long-term resources in the first half of 2004. In the first half of 2004, the capital account registered a surplus of US$4,904 million. This surplus was primarily the result of inflows channeled to the private sector, the main component of which was foreign direct investment (FDI). During the first half of the year, FDI totaled US$10,292 million. During the same period, the public, private and banking sectors reduced their external indebtedness levels by US$2,300 million, US$1,093 million, and US$246 million, respectively. Foreign portfolio investment in the Mexican Stock Market declined by US$2,652 million in the first half of 2004, while portfolio inflows to the money market increased by US$2,175 million. Furthermore, assets held by residents abroad increased by US$1,272 million in the first half of 2004.

In 2003, *Peru's* current account deficit of the balance of payments dropped from 2.0 percent to 1.8 percent of GDP. The smaller deficit was attributable to a higher surplus in trade balance, partially compensated by the larger deficit in investment income. *Peru's* medium and long-term external debt, including bonds, totaled US$29,732 million or 49.1 percent of GDP, an increase of US$1,860 million over 2002. Public sector medium and long-term debt went up by US$2,053 million compared to 2002, of which US$933 million was due to a net increase of indebtedness and US$1,120 million to the depreciation of the US dollar, mainly against the yen and the euro.

Over 2003, *Russia's* favourable trade balance amounted to US$60.5 billion, approaching the 2000 level. Major factors for the favorable balance in 2003 were the increased business activity in the economy and increase of domestic demand as well as a favourable world situation as a whole. In

2003 the official foreign exchange reserves increase to US$26.2 billion (in 2002 they were US$11.4 billions). By the start of 2004 Russia's gold and foreign exchange reserves amounted to US$76.9 billion and their value would finance more than nine months of goods and services importation in 2003.According to data from the Central Bank of Russia, by the end of 2003 the gross external debt of Russia amounted to US$182.1 billion. External indebtedness of Russia's private sector rose by US$27.1 billion. In particular, the foreign debts of Russia's non-financial companies increased in 2003 by US$16.5 billion to US$50.5 billion (27 percent of the Russian total foreign debt), while those of Russian banks went up by US$10.6 billion to US$24.8 billion (13.6 percent of Russia's total foreign debt). In 2003 Russia’s total public foreign debt went up by US$1.6 billion from US$105.2 billion to US$106.8 billion.

2.6 Foreign Exchange Markets

The *US dollar* has depreciated considerably from the second quarter 2002 to January 2004. Since early 2004, however, the US dollar has showed a trend of stabilizing relatively. Although the decline of the US dollar during the period has been conspicuous against the euro, it also showed its weakness against most APEC members’ currencies up to early 2004. The exchange rate of the US dollar to the euro changed from 0.862 in January 2002 to 1.26 in December 2003. During this period, the dollar lost 31.6 percent of its value against the euro. For the year 2003 alone, the US dollar lost substantially its value against the Japanese yen, the Canadian dollar, the Australian dollar, and the New Zealand dollar. In terms of the IMF real effective exchange rate (REER) index, which IMF calculates taking into account the nominal dollar exchange rates with respect to major currencies and differences in inflation rates between the US and other economies, the US dollar depreciated 23.3 percent during the period between February 2002 and February 2004, and appreciated 3.5 percent for the period of February to June 2004.

The *Japanese yen* sharply appreciated against the U.S. dollar, from the 120 level in early August 2003 to the 105 level in early February 2004. It reached the 103 level in early April. The government had intervened in the foreign exchange market operating over 20 trillion yen in total in 2003 and over 14 trillion yen in the first quarter of 2004. The yen against the US dollar has moved close to the 110 level since June.

The exchange rate of the *Chinese Renmibi* (RMB) was kept stable. By the end of 2003, one US dollar was equal to 8.2767 RMB, a 6 basic points appreciation, in comparison with that of the end of 2002.

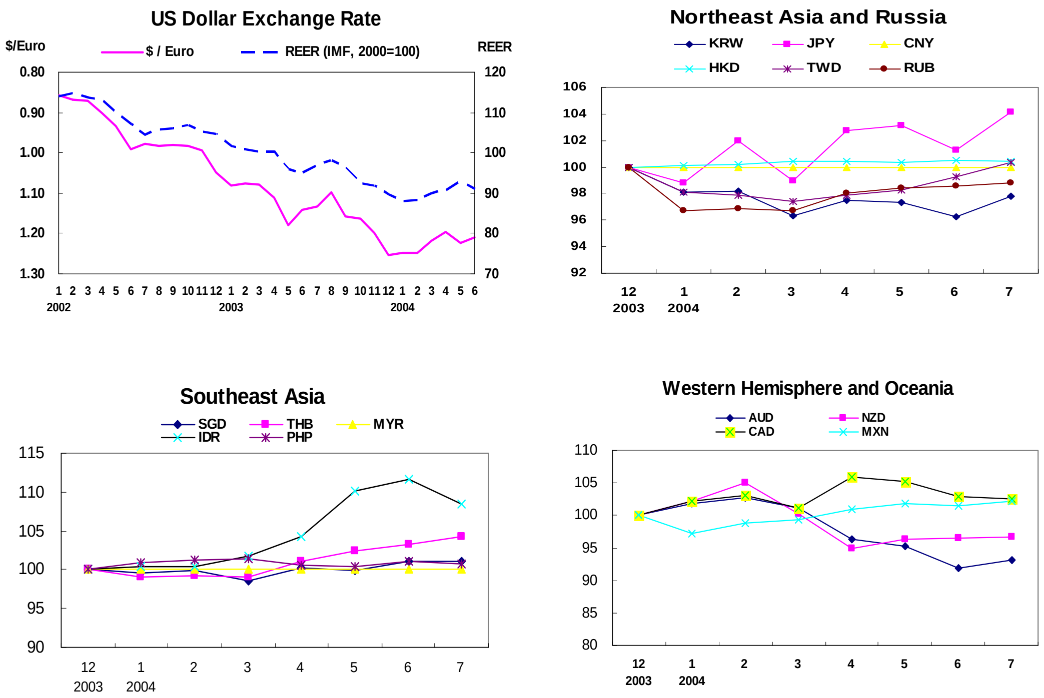
Under the linked exchange rate regime, the *Hong Kong dollar* remained stable and stayed close to the convertibility rate.

Table 1.8
Foreign Exchange Rates* (Local Currency Unit/US dollar)

	1999	2000	2001	2002	2003	June 2004
Western Hemisphere						
Canada (CAD)	1.44	1.50	1.59	1.58	1.29	1.34
Chile (CLP)	530.07	572.68	656.20	712.38	599.42	636.59
Mexico (MXN)	9.51	9.57	9.14	10.31	11.24	11.51
Peru (PEN)	3.51	3.53	3.44	3.51	3.46	3.49
The United States (USD)**	1.01	0.94	0.88	1.05	1.26	1.22
Northeast Asia						
China (CNY)	8.28	8.28	8.28	8.28	8.28	8.28
Hong Kong, China (HKD)	7.77	7.80	7.80	7.80	7.76	7.80
Japan* (JPY)	102.04	114.87	131.50	118.74	107.31	108.86
Korea (KRW)	1,138	1,265	1,314	1,186	1,193	1,156
Chinese Taipei (TWD)	31.40	33.07	34.95	34.60	33.93	33.52
Southeast Asia						
Indonesia (IDR)	7,085	9,595	10,400	8,940	8,465	9,415
Malaysia (MYR)	3.80	3.80	3.80	3.80	3.80	3.80
The Philippines (PHP)	39.09	44.19	50.99	51.60	54.20	55.94
Singapore (SGD)	1.67	1.73	1.85	1.74	1.70	1.72
Thailand (THB)	37.47	43.27	44.22	43.15	39.59	40.89
Viet Nam (VND)	14,028	14,514	15,084	15,403	15,646	15,745
Oceania						
Australia (AUD)	1.54	1.82	1.96	1.75	1.33	1.45
New Zealand (NZD)	1.92	2.27	2.38	1.89	1.51	1.59
Papua New Guinea (PGK)	2.70	3.03	3.07	4.00	3.33	3.23
Russia (RUB)	27.00	28.16	30.14	31.78	29.45	29.03

Note: * end of period
** US Dollar/Euro
Source: IMF, *International Financial Statistics,* August 2004

Fig 1.6 Foreign Exchange Rate



The *Korean won* appreciated by 0.22 percent against the US dollar in 2003. The won exchange rate stood at 1,197.8 won to the US dollar compared to the end of the previous year (1,200.4 won). During the first half of 2004, the won began to appreciate due to the massive inflow of funds from securities investment by foreigners and the fall in the yen-dollar exchange rates. As of the end of June, the exchange rate was 1,152.5 won, down by 3.93 percent from the end of 2003.

From January to mid-April of 2003, alternating bullish and bearish influences, such as the US-Iraq situation, the weakening of the US dollar, and inflows of foreign funds to the *Chinese Taipei* stock market, resulted in the NT$/US$ exchange rate fluctuating between 34.4 and 34.8. However, the NT dollar started to appreciate in May as market participants suspected the US government's departure from the "strong US dollar policy". At the end of 2003, the NT dollar closed at 33.978 against the US dollar. Compared with the rate of 34.753 registered at the end of 2002, the NT dollar appreciated slightly by 2.28 percent in 2003.

In 2003, the *Indonesian rupiah* exchange rate has been more stable than at any time since the economic crisis in 1997, reaching around Rp8,420 per US dollar at the end of December 2003. The rupiah appreciated more than 8.0 percent in 2003 owing to improved economy risk, strengthened international reserves, attractive interest rate differential and global depreciation of the US dollar. Although the rupiah exchange rate tended to depreciate in the first half of 2004, it began to rebound since the beginning of the third quarter. After it experienced a 6.0 percent (quarter-on-quarter) depreciation in the second quarter, the rupiah exchange rate became more stable in the third quarter 2004 as reflected in the declining of the rupiah volatility. Depreciation of the rupiah stemmed mainly from high corporate demand for US dollar, while foreign exchange supply conditions in the market were still limited. The pressures on the rupiah also came from market sentiment related to the continuing appreciation of the US dollar and the oil price hike.

In the second quarter of 2004, the performance of the *Malaysian ringgit* was generally positive against the major and regional currencies as the US dollar strengthened, following expectations of interest rate increases. The ringgit appreciated in the range of 1.3 percent to 3.8 percent against the major currencies and in the range of 0.3 percent to 9.4 percent against most regional currencies. The depreciation of most regional currencies was due to concerns over a slower Chinese economy, and higher oil prices as well as uncertain political developments in specific economies.

The average *Philippine peso* exchange rate for 2003 stood at P54.20/US$, higher than the 2002 average of P51.60/US$, or a depreciation of 4.8 percent. Both domestic and external factors including increased demand for dollars, political uncertainties and the Iraq situation, among others caused the volatility in the movement of the peso against the US dollar. The peso, however, was less volatile despite its depreciation. The annual standard deviation stood at P0.98, lower than 2002 level of P1.13. The continued inflow of remittances from overseas Filipino workers (OFWs) helped ease US dollar liquidity in the foreign exchange market and allowed the peso to broadly stabilize towards the end of the year.

The weakness of the US dollar during the year saw the *Singapore dollar* close 2003 at a level 2.1 percent higher against the US dollar and Malaysian ringgit compared to levels at the end of 2002. During the year, the Singapore dollar also rose 2.7 percent against the Korean won. The Singapore dollar weakened against most other major currencies in 2003. It fell by 0.2 percent against the new Taiwan dollar, 8.0 percent against the Japanese yen, 8.1 percent against the pound sterling and 14.9 percent against the euro.

The *Thai baht* continued its appreciation trend in 2003. The baht appreciated from 39.71 baht per US dollar at the end of 2003 to 39.44 baht per US dollar at the end of April 2004.

In 2003, the *Vietnamese dollar (VND)* depreciated only slightly against the US dollar at nearly the same level as 2002. In conditions of low inflation and depreciation of the US dollar against other hard currencies, the competitiveness of Vietnamese goods via the exchange rate was maintained.

Australia has had a floating exchange rate since 1983. The Reserve Bank of Australia (RBA) undertakes foreign exchange market operations for its clients and on its own account. Operations on the RBA's own account include interventions aimed at influencing the exchange rate. During 2003, the Australian dollar appreciated (in nominal terms) by 32.5 percent against the US dollar. It appreciated by 10.4 percent against the euro and by 19.4 percent against the Japanese yen. The appreciation of the Australian dollar against these currencies contributed to a 22.9 percent increase in the trade-weighted index.

The *Canadian dollar* has, over recent time, experienced downward pressure as a result of weakness in world commodity prices and flight to quality towards the US dollar. The Canadian dollar began 2001 at around 67 US cents but trended down to close to 64 US cents by the end of 2002. Since then, however, the Canadian dollar has gained significant strength vis-à-vis the US dollar. Over the course of 2003 the Canadian dollar appreciated more than 20 percent against its US counterpart, returning to levels last reached in late 1993.

In *Chile,* the floating exchange rate mechanism has continued to ensure that the exchange rate is the main variable when correcting for domestic and external changes affecting Chile's economy. Thus, the US dollar's weakness in the main financial markets, better financial conditions, and the improved terms of trade associated with trends in the copper price, explain most of the real appreciation experienced by *Chile's peso*. The US dollar has weakened significantly against the peso, reaching between 570 and 580 Chilean pesos per US dollar for the first time since late 2000. This shift has brought a peso appreciation against the dollar of about 18.9 percent between March and December 2003.

During the first quarter of 2004, the *Mexican peso* strengthened moderately with respect to the dollar as a result of improvements in factors that traditionally affect currency risk perceptions and, in turn, the value of the peso. For example, expectations of a recovery in the global economy and increased foreign investment inflows resulting from the Bancomer and Apasco transactions all contributed to the strengthening of the value of the peso as compared to the U.S. dollar. Despite temporary declines in the value of the peso during April and May 2004 attributable to expectations of interest rate increases in the United States, at 30 June 2004 the peso stood at Ps.11.5130 per US$1.00, a depreciation of only 2.5 percent as compared to 31 December 2003.

In 2003, *Peru's* free-floating exchange rate regime for the *nuevo sol* was maintained. As of December 2003, the S/US$ exchange rate was S/. 3.472, down 1.2 percent from a year ago, in a situation where most of Peru's main trade partners' currencies have consistently appreciated against the US dollar. In real terms, the nuevo sol depreciated by 7.5 percent as nominal exchange rate went down by 1.2 percent and domestic inflation and external price index increased 2.5 and 11.5 percent, respectively.

In 2003, *Russia* continued to pursue a floating exchange rate policy for the *ruble*. Over the year the exchange rate remained relatively stable. On the whole, the supply of foreign exchange on the market prevailed over demand. For the most part of the year the dynamics of the exchange rate of the ruble were characterized by a growth trend. There was ruble revaluation against US dollar in 2003, while the ruble devalued against the euro. On the whole, ruble real appreciation in comparison with US dollar reached 13.6 percent in 2003 against 2002 and 9.8 percent compared to December 2002, while ruble depreciated in real terms compared to the euro by 4.7 percent in 2003 as against 2002 and by 0.5 percent compared to December 2002. The favorable price situation for Russia in the world's oil market predetermined the continuing and persistent excess supply of foreign exchange over demand in the domestic foreign exchange market.

2.7 World Oil and Commodity Market

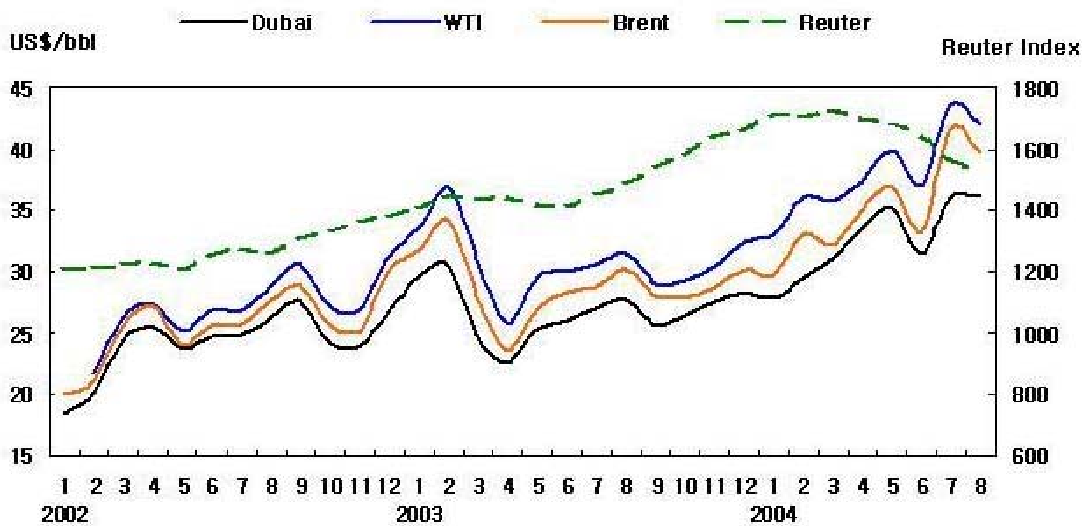
As the pace of global economic activity picked up and the US dollar depreciated against other major currencies up to February 2004, the overall index of primary commodity prices (in US dollar terms) rose substantially up the first quarter of 2004. Comparing the monthly figures of the Reuter Index of Commodity Prices, the Index on March 2004 was 1730.5 about 57 percent higher than it was in October 2001. The surge in primary commodity prices was broad-based, with oil and natural gases and non-energy products contributing to the rise. World oil prices have risen steadily from April 2003 to August 2004. West Texas Intermediate (WTI) especially soared to its historical record with its price exceeding US$50 a barrel since August 2004, compared to a range around US$10 in 1998 and below $20 in November 2001. The increase in crude oil prices is attributable to several reasons, such as delays in restoring Iraq's oil production, an unexpected fall in Organization of Oil-exporting Countries (OPEC) oil supply, and a rise in oil demand and thus a lowering of commercial oil inventories. The depreciation of the US dollar also contributed to the rise in the dollar-denominated crude oil price. The international Energy Agency (IEA) predicted at the beginning of 2004 that world demand of oil would be less than 80 million barrels a day, but later adjusted its forecast to 82.2 million barrels a day. The political and labor situation disturbed oil production in some oil exporting countries such as Iraq, Nigeria, Venezuela and Saudi Arabia. Entering September 2004, the pressure was off the oil market. According to the IEA's analysis, world oil supply rose by 300,000 barrels per day in August to 83.6 million barrels per day, which exceeded recent world demand of 82.2 million barrels per day. With the supply shortage disappearing in the world oil market, oil prices stabilized at around US$40 per barrel of U.K. Brent or WTI. Looking forward, many institutions, including the IEA, forecast that crude oil prices would remain around US$40 per barrel for a considerable period. They evaluated there was a very low possibility of further supply disturbances and an oil crisis situation such as occurred in the mid-1970s and early 1980s. According to their analyses, crude oil prices will remain around US$40 per barrel for the time being. Non-energy commodity prices rallied in the second half of 2003 and early 2004, reflecting the sharp rise of demand mainly in the US and China, and thus falling inventory levels for specific commodities, while nearly all major commodities accounted for the substantial increase in non-energy prices. Looking forward, non-energy commodity prices are expected to remain firm in US dollar terms as the global economy sustains its considerable recovery momentum during the second half of 2004 and 2005

Table 1.9
Oil and Non-Oil Commodity Prices

	1999	2000	2001	2002	2003	August 2004
Spot Oil Prices ($/barrel)*						
Dubai Fateh	22.76	20.52	17.91	26.75	28.40	36.17
West Texas Intermediate	25.71	26.75	20.88	31.25	32.46	42.11
U.K Brent	25.21	23.54	20.44	30.01	30.18	39.80
Reuter Index on Commodity Prices**	1,360.4	1,386.3	1,246.1	1,370.2	1,493.5	1,649.4

Note: * end of period
** period average

Fig 1.7 Oil Prices and Commodity Price Index



3. POLICY RESPONSE AND ECONOMIC PROSPECTS

3.1 Supportive Fiscal Policy

For the last two years, most member economies have kept expansionary fiscal policy stances to stimulate economic recovery. *The US* has been the most aggressive economy in terms of fiscal stimulus. Most member economies have showed growing fiscal deficits, implying less room for further fiscal maneuvering to support recovery.

In each of the past three years, the *U.S* Administration proposed, and Congress enacted, significant tax relief measures designed to overcome the obstacles to job growth and push the economy onto a positive, self-sustaining trajectory. In June 2001, the president signed the *Economic Growth and Tax Relief and Reconciliation Act*. It lowered marginal income tax rates; reduced the marriage tax penalty; and created a new, lower, 10 percent tax bracket, among other changes. In March 2002, the President signed the *Job Creation and Worker Assistance Act* to reverse the weakness in business capital spending and to aid the unemployed. In May 2003, the President signed another extension of unemployment insurance benefits and the Jobs and *Growth Tax Relief Reconciliation Act*. The Act provided significant additional stimulus to consumer and business spending. The substantial stimulus to consumer and business spending provided by the three bills helped return the economy to a solid growth path. Tax relief, which totaled US$69 billion in fiscal year 2001, increased in the following three years to reach US$272 billion in 2004, nearly 2.5 percent of GDP, and, including the president's proposed tax relief extensions, is slated to ease back to US$170 billion in 2005.

Japanese public finance is confronted with a severe situation with national and regional long-term debts amounting to approximately 700 trillion yen at the end of FY 2003, which is about 140 percent of the nominal GDP. As for medium-term fiscal management, the government has set medium-term fiscal goals. The measures to achieve these goals include: until FY 2006, the government maintains its expenditure (ratio of general expenditure to GDP) at or below its FY2002 level. By FY2006, with the continuing efforts of both central and local governments to reduce expenditure, based on assessment of necessary public services and expenditure levels, as well as on the status of economic revitalization and fiscal conditions, the government will judge what tax measures are required. Beyond FY2007, the government aims to achieve a primary surplus (excluding social security) in the early 2010s by continuing its efforts to improve fiscal balance and realization of sustainable economic growth led by private demand.

Last year, in *China*, finance played a more important role in macro-control and in safeguarding the economy. The Chinese government continued to follow a proactive fiscal policy to promote sustained and rapid growth of the domestic economy. In 2003, total fiscal revenue reached US262.07 billion up by 14.7 percent year-on-year; national expenditures totaled US$297.30 billion 11.6 percent year-on-year. The deficit in the central budget was held to US$38.64 billion as approved at the First Session of the Tenth NPC.

The *Korean* government adopted expansionary fiscal policies to remove economic uncertainties in 2003. Speeding up budgetary expenditures will help restore confidence by demonstrating that the government has adopted a proactive approach to dealing with the economic situation. The government front-loaded its budget spending in the first half of 2004. Supplementary budget of 4.2 trillion won (US$3.5 billion) and 3 trillion won (US$2.5 billion) were approved in the second half of 2003. The frontloading was estimated to increase real GDP by 0.2 percent point and the two supplementary budgets are projected to increase the GDP by 0.5 percent point. In spite of expansionary policies last year, the Korean government recorded a consolidated fiscal balance surplus. Considering the degree of fiscal soundness, the Korean government has a wide choice of fiscal policies to boost the economy. It was and will be possible to implement aggressive government spending while maintaining sound fiscal management. During the second half of 2004, the government will continuously strive to increase fiscal spending which is conducive to recovery in domestic demand. Fiscal spending is expected to hit 4.5 trillion won by fully utilizing reserve funds. Fiscal expenditures will be funneled mainly to vulnerable groups such as struggling SMEs and low-income families.

Table 1.10
Budget Balances (percent of GDP)

	1998	1999	2000	2001	2002	2003
Western Hemisphere						
Canada	0.1	1.6	2.9	1.1	0.3	0.6
Chile	0.4	-1.4	0.1	-0.3	-0.8	-0.8
Mexico	-1.2	-1.1	-1.1	-0.7	-1.2	-0.6
Peru	-0.9	-3.2	-3.3	-2.6	-2.3	-1.8
The United States	1.0	1.6	2.3	0.4	-2.4	-4.8
Northeast Asia						
China	-1.5	-2.1	-2.8	-2.6	-3.0	-2.7
Hong Kong, China	-1.8	0.8	-0.6	-5.0	-4.9	-3.3
Japan*	-7.5	-8.6	-7.0	-6.6	-8.0	N.A
Korea	-4.2	-2.7	1.3	1.3	3.8	1.3
Chinese Taipei	0.7	-0.5	-2.4	-3.9	-3.6	-3.5
Southeast Asia						
Brunei Darussalam	1.6	0.7	17.4	6.0	-4.2	N.A
Indonesia	-1.6	-3.7	-1.6	-2.8	-1.5	-2.1
Malaysia	-1.8	-3.2	-5.8	-5.5	-5.6	-5.3
The Philippines	-1.9	-3.8	-4.1	-4.1	-5.3	-4.6
Singapore	3.4	3.5	2.5	-1.8	-0.1	-1.1
Thailand	-2.5	-2.8	-2.3	-2.6	-2.9	-0.7
Viet Nam	2.5	5.0	5.0	5.0	5.0	5.0
Oceania						
Australia**	0.2	0.7	2.1	0.9	-0.1	1.0
New Zealand	2.1	1.7	1.4	1.2	1.9	1.5
Papua New Guinea	-1.8	-2.6	-2.0	-3.6	-4.2	-1.3
Russia	-5.9	-0.9	1.1	2.7	1.3	1.7

Note: * Refers to fiscal year (April to March)
**Refers to financial year eg 2003 is the financial year 2002–2003
Sources: *Individual Economy Reports*
ADB, *Asian Development Outlook*, September 2004.
OECD, *OECD Economic Outlook*, May 2004.

In *Hong Kong, China*, the financial results for 2003–04 (ending on March 31) showed a deficit of HK$40.1 billion or 3.3 percent of GDP in 2003 as compared with the original budget deficit of HK$67.9 billion. The 2004–05 budget forecasts a deficit of HK$42.6 billion, equivalent to 3.4 percent of the forecast GDP for 2004. Budgeted government expenditure showed a growth of some 6.5 percent in real terms over 2003–04.

In recent years, the sluggishness of *Chinese Taipei's* economic and various tax-cutting measures have squeezed government revenue, and the growth of social expenditure and massive funding required for reconstruction after the devastating earthquake of 21 September 1999 have greatly increased the burden of government expenditure, resulting in a substantial widening of the fiscal deficit. In 2003, the ratio of the public deficit to annual expenditure stood at 20.2 percent, or 3.6 percent of GDP. With the government depending increasingly on raising public debt to cover expenditure, outstanding debt climbed to 31.2 percent of gross national product (GNP). To improve this situation, the government has been actively seeking ways to augment its sources of revenue while scaling back on expenditures. Toward this end, in September 2001 the government set up a Fiscal Reform Committee, which presented recommendations that were incorporated into a Fiscal Reform Plan launched by the government on 22 April 2003. All government authorities are required to take appropriate measures to put the plan into effect with the aim of achieving a balanced budget within five to ten years.

Indonesia's fiscal policy in 2003 is directed toward expanding fiscal stimulus while maintaining fiscal sustainability. The budgetary deficit in 2003 is recorded at 2.1 percent of GDP, which met the initial budgeted amounts. While the 2003 deficit is higher than that of 2002, which reached 1.5 percent of GDP, the government's fiscal measures are still those of fiscal consolidation such as improving tax revenue, reducing government debt gradually and reducing some subsidies. In 2004, fiscal policy will continue to target a lower deficit and sound debt management. Initially the budget deficit is targeted to be 1.2 percent of GDP. However, due to the recent sharp increase in world oil prices that pushed up fuel subsidy amount, the Government increased the deficit target to 1.3 percent of GDP. The government is still committed to a balanced budget in 2006.

In *Malaysia,* revenue collection during the second quarter of 2004 increased slightly by 2.9 percent to RM21.8 billion (Q2 2003: RM21.2 billion). RM48 billion was expended by the Federal Government in the first half year or 39.1 percent of the total revised budget of 2004 (first half 2003: RM51.9 billion or 45.3 percent). Operating expenditure as a percentage of total revised allocation was 21.5 percent. This is lower than the 29.5 percent in the corresponding quarter of 2003, and essentially due to the implementation of the Package of New Strategies in May 2003. Development expenditure as a percentage of total revised allocation was sustained at 23.4 percent (Q2 2003: 23.1 percent). The overall budget deficit in 2004 is expected to narrow to 4.5 percent of GDP compared to 5.3 percent in 2003.

In the *Philippines*, the enforcement of revenue reform measures and prudent spending management policies of the government contained the budget deficit in 2003 to P199.9 billion, which is still below the target of P202 billion for the year. The deficit accounted for about 4.6 percent of GDP.

In *Singapore*, an expansionary fiscal policy stance was maintained in 2003. The Government introduced two off-budget fiscal packages to support the economy, helping households and businesses survive the impact of SARS.

FY2003 was the first year *Thailand* registered a budget surplus after the financial crisis. The budget surplus and public sector surplus were at 0.4 percent and 0.8 percent of GDP respectively. Strong revenue performance has continued in FY2004. The overall budget balance is expected to be in a slight deficit in FY2004. Realizing the importance of fiscal sustainability, the Thai government is also committed to keep the public debt to GDP ratio below 55.0 percent while debt servicing in the budget would not be higher than 16.0 percent.

By maintaining its considerable growth rate, *Vie Nam's* budget revenue in 2003 was 11.0 percent higher than that in 2002. Revenue from FDI enterprises increased by 30 percent; and tax payments from non-state businesses increased by 28.5 percent. Total budget expenditure went up

14.1 percent compared with 2002, of which development investment increased by 6.7 percent; current expenditure rose by 4.9 percent. Borrowing made from domestic (75 percent) and foreign (25 percent) sources up the budget deficit. The budget deficit rate was estimated to account for 5 percent GDP.

Following the large *Australian* Government budget deficits recorded in the first half of the 1990s, the budget was returned to cash surplus in 1997–98. The 2004–05 budget provides the seventh cash surplus since that time. In the 2004–05 financial year, the Australian Government is expected to have an underlying cash surplus of 0.6 percent of GDP (or 0.4 percent measured on an accruals basis). This is higher than the projected cash surplus of 0.3 percent of GDP (or a 0.1 percent deficit on an accruals basis) forecast for 2004-05 in the 2003–04 budget, and primarily reflecting stronger revenue collections.

New Zealand has been running an operating surplus since the June 1994 fiscal year. Government operating expenses fell as a percentage of GDP from 41.6 percent in 1992-93 to 32.4 percent in the 2002-03 financial year. The operating balance before revaluations and accounting changes (OBERAC) is estimated to be 4.3 percent of GDP for 2003-04, decreasing to 3.2 percent of GDP in 2007-08, reflecting the effects of the significant new spending announced in the 2004 Budget.

Thanks to sound fiscal management over the past 10 years, *Canada's* federal government has now recorded six consecutive budgetary surpluses – an achievement unique among the G-7 economies. The federal budgetary surplus in 2002-03 was $7.0 billion. A balanced budget or better is expected again for 2003–04, which would mark the seventh consecutive balanced budget, an accomplishment unparalleled since the Confederation. As for Fiscal Consolidation, in 1994, Canada's federal government determined to reduce and eventually eliminate the deficit that had persisted for more than two decades. Deficit reduction targets were established and a prudent approach was implemented to achieve those targets. In four years, the federal government eliminated a deficit of $38.5 billion and placed the federal debt on a permanent downward track.

Chile's public finances have played a counter-cyclical role in 2003, reaching an accountable deficit of 0.8 percent of GDP, consistent with a structural surplus estimated at about 0.8 percent of GDP. For the fourth quarter of 2003, information reveal a slight surplus, thanks to increased income following the VAT increase (from 18 percent to 19 percent), the better economic cycle, and the increase in the copper price, combined with spending cuts which are considered temporary.

During the first half of 2004, the *Mexican* public sector overall balance registered a surplus of Ps.56,757 million, 13.5 percent lower in real terms than that registered in the same period of the previous year. The public sector primary balance, defined as total public sector revenues less expenditures other than interest payments on public debt, registered a surplus of Ps.154,321 million in the first six months of 2004, a 9.5 percent real decline as compared to the figure observed in the same period of 2003. These lower surpluses as compared to the previous year are attributable in part to an advance payment of one month's wages made to education sector workers due to the summer holiday period. Excluding that payment, the public sector overall surplus increased by 23.6 percent and the primary surplus increased by 4.8 percent, both in real terms.

Peru's overall public sector deficit fell to 1.8 percent of GDP in 2003 from 2.3 percent in 2002. This reduction was mainly due to the increase in central government current revenue, from 14.4 to 15.0 percent of GDP that exceeded the central government non-financial expenditure which increased from 14.7 to 14.9 percent of GDP.

Russia's federal budget receipts for 2003, disregarding the single social tax, amounted to 16.7 percent of GDP. The main factors in the growth of federal budget receipts were: growth of the economy; favourable foreign economic situation; implementation of tax reform that allowed expansion of the tax base with a reduction in the tax burden; reforming of customs tariff; and administrative measures to increase the collection of taxes. The federal budget expenses in 2003 (without the single social tax) amounted to 15.0 percent of GDP. The federal budget surplus amounted to 1.7 percent, and the primary surplus was 3.4 percent of GDP.

3.2 Accommodative Monetary Policy

Thanks to low inflationary pressures, most monetary authorities have maintained a policy stance of monetary easing over the past two to three years. This stance limited the depth of downturns and, later, supported recent economic recovery. Short-term policy rates are at historical lows in the US, Japan and elsewhere. Until very recently, some central banks were in the process of cutting policy rates or maintaining lower market rates. A few others have started to raise them. In most cases, economic recovery is consistent with gradual moves towards a more neutral stance.

In the *US,* the monetary policy stance is also changing as the economy improves. The Federal Reserve decided at the end of June to raise the target Federal funds rate by 0.25 percent to 1.25 percent, reflecting its belief that the economy has made the transition from recovery to self-sustaining growth. Like fiscal policy, monetary policy also focused for the last three years on restoring strong, sustained growth. The Federal Reserve reduced the target Federal funds rate 13 times from the start of 2001, when the rate was 6.5 percent, to June 2003, when it was set at 1.0 percent. The Federal Reserve held the funds rate at that level until late June 2004 when it raised the rate 0.25 percent to 1.25 percent. During the past year, market interest rates have risen as economic activity has surged, and, recently, as the monetary authorities have begun to signal that they intend gradually to shift away from a highly accommodative stance.

The Bank of *Japan* (BOJ) has gradually raised the target balance of current accounts held at the BOJ since it adopted a quantitative easing policy in March 2001. In January 2004, the BOJ decided to change the main operating target in its guidelines for money market operations. The target balance of current accounts held at the Bank was raised from “around 27 to 32 trillion yen” to “around 30 to 35 trillion yen”. The growth of the monetary base has been at the 4.0 to 5.0 percent level against the background of ample fund supplies from the BOJ. The growth of M2+CDs has remained at around the 2.0 percent level.

The People’s Bank of *China* continued to pursue stable monetary policy, the regulation of monetary credit has produced positive achievements and the tendency towards rapid growth of monetary credit has been under effective control, providing a stable financial background for the sustainable, rapid and healthy development of China’s economy. By the end of 2003, the balance of the broad money supply (M2) reached US$2670.1 billion, up by 19.6 percent year-on-year. In the first three quarters of 2003, the monetary credit of financial institutions grew more, which was under effective control in the last quarter.

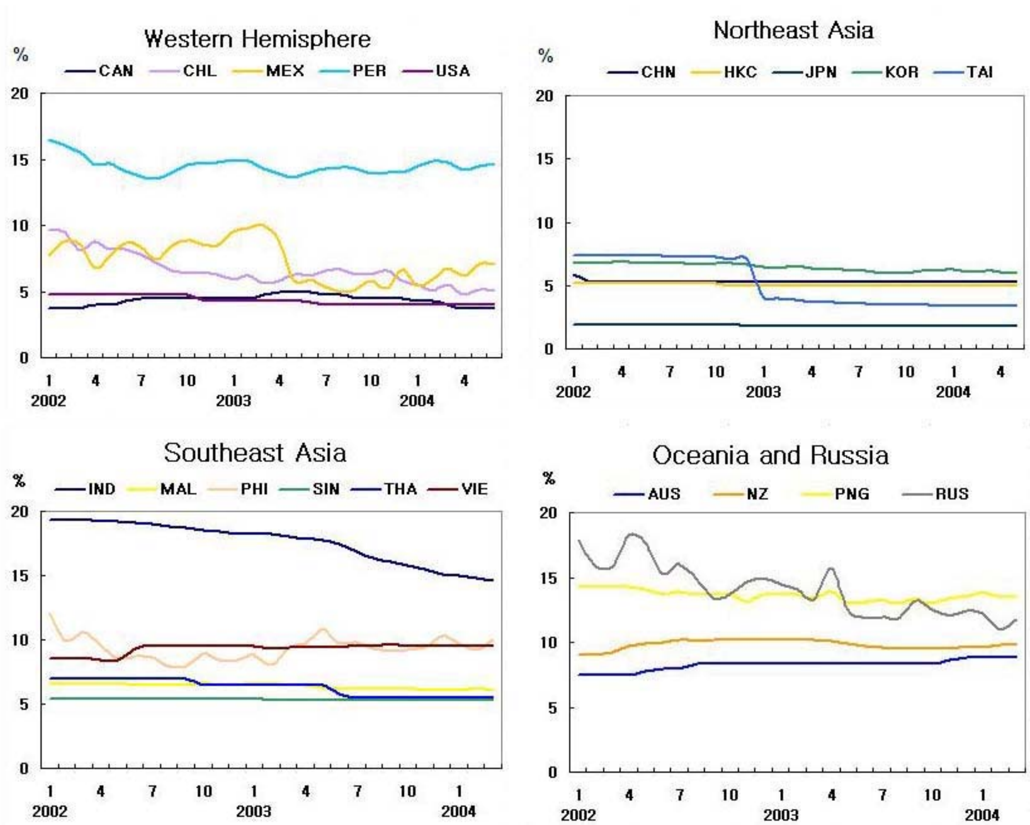
The Bank of *Korea* has set a target range of 2.5 to 3.5 percent for the average rate of increase in core inflation for the three years 2004 to 2006. Recently, consumer and producer price inflation continued to show a relatively rapid rise. This was mainly due to the upswing in prices of international raw materials and seasonal factors but the rise is within the inflation target range. In the financial markets, overall liquidity conditions have been favorable due to subdued demand for funds. However, concern over the deteriorating soundness of some financial institutions, notably a few credit card companies, has grown, and risk aversion from low-rated companies has not yet lessened. Fund-raising conditions have remained unfavorable for small and medium-sized enterprises (SMEs) with a low credit rating. The Korean government aims to resolve issues such as household debt, credit delinquency and difficulties in lending for SMEs smoothly to promote financial market stability. To solve the problem of household debts, the government will induce the extension of debt maturities and the reclassification of short-term loans as long-term loans, thus engineering a ‘soft landing’ of household debts. By strengthening support for credit delinquents through the ‘bad bank’ system and efficiently operating the ‘individual workout’ system, the government plans to step up its efforts to help credit delinquents recover their credit.

Table 1.11
Short-term Interest Rate (percent, per annum)

	1998	1999	2000	2001	2002	2003
Western Hemisphere						
Canada	4.7	4.7	5.5	3.8	2.6	2.9
Chile	16.3	11.0	10.8	7.2	3.9	2.8
Mexico	24.8	21.4	15.2	11.3	7.1	6.2
Peru	19.0	14.9	12.7	8.6	3.2	3.4
The United States	5.4	5.0	6.2	3.9	1.7	1.1
Northeast Asia						
China	6.3	5.6	5.6	5.6	5.6	5.6
Hong Kong, China	8.1	5.8	6.1	3.6	1.8	1.0
Japan	0.7	0.2	0.2	0.1	0.03	0.01
Korea	14.9	4.9	5.1	4.6	4.2	4.0
Chinese Taipei	6.6	4.8	4.7	3.7	2.0	1.0
Southeast Asia						
Brunei Darussalam	N.A	N.A	N.A	N.A	N.A	N.A
Indonesia	64.1	26.0	12.5	17.6	13.0	8.3
Malaysia	9.4	4.1	3.2	3.1	2.9	2.9
The Philippines	15.3	10.2	9.9	9.9	5.4	6.0
Singapore	1.9	2.8	2.8	1.3	0.8	0.8
Thailand	13.6	1.5	1.8	2.1	2.0	N.A
Vietnam	1.2	1.1	0.9	0.8	0.8	N.A
Oceania						
Australia	5.0	5.0	6.2	4.9	4.7	4.9
New Zealand	4.6	5.4	6.7	5.0	5.9	5.3
Papua New Guinea	19.0	22.7	15.7	10.2	15.5	16.1
Russia	41.8	39.7	24.4	17.9	15.7	3.8
LIBOR* (3-months US $)	5.6	5.4	6.5	3.8	1.8	1.2

Note: * London Inter-bank Offer Rates on US Dollar Deposits.
Sources: Individual Economy Reports.
IMF, *International Financial Statistics*, August 2004

Fig 1.8 Short-term Lending Rates



Hong Kong dollar interest rates have increased along with their US counterparts since April 2004. However, the magnitude of the increase has fallen short of US interest rates, reflecting increased fund inflows upon improved market sentiments about the economic outlook. The three-month Hong Kong dollar inter-bank rate rose from 0.07 percent at end-2003 to 1.06 percent in September 2004, while that of the US rose from 1.15 percent to 2.02 percent. Similarly, the best lending rate in Hong Kong, China rose by only 0.125 percent between end-2003 and September 2004, from 5.0 percent to 5.125 percent. By contrast, the US prime rate rose by 0.75 percent over the same period, from 4.0 percent to 4.75 percent.

With inflationary pressures subdued, *Chinese Taipei's* Central Bank has maintained an accommodative monetary stance to shore up domestic demand. In late-June 2003, the Central Bank lowered the discount rate from 1.625 percent to 1.375 percent, the fifteenth consecutive rate cut since December 2000. As a result, market interest rates have remained low.

In *Indonesia*, the stable exchange rate and low inflationary pressures during 2003 have provided room for the central bank to pursue an accommodative and prudent monetary policy through a gradual decrease in the interest rate, thereby delivering positive signals of sustaining economic recovery. The central bank rate's benchmark (1 month SBI rate), declined significantly during 2003 by almost 500 basis points reaching 8.31 percent at end-December 2003. The rate fell further, to around 7.3 percent by end of April 2004. Taking into account economic prospects and several issues confronting by the banking sector specifically, monetary policy in 2004 and 2005 will continue to be directed at achieving the medium-term inflation target of 5.5 percent in 2006. Hence, Bank Indonesia will provide economic liquidity in accordance with the economy's needs by guiding base money to grow by 13.0 to 14.5 percent in 2004 and 11.0 to 12.0 percent in 2005. In addition, to maintain stability in the financial markets, Bank Indonesia will continue to use interest rates as its monetary policy signal. In response to expectation of a higher inflation, Bank

Indonesia will implement a tight bias monetary policy so as to keep medium-term inflation within the target range.

In *Malaysia,* monetary policy continued to remain supportive of economic growth in the second quarter of 2004. Bank Negara Malaysia implemented a new interest rate framework on 26 April 2004, whereby the overnight policy rate (OPR) replaced the 3-month intervention rate as the indicator of monetary policy stance. The OPR was set at the prevailing interbank rate of 2.70 percent and allowed to fluctuate within a margin of + 25 basis points. The new interest rate framework also allowed banking institutions to set their own base lending rates.

The Bangko Sentral ng Pilipinas (BSP) provided the conditions to set the economy afloat in the face of economic uncertainties. The inflation-targeting framework guided the monetary policy. Policy rates were tightened to dampen exchange rate volatility and reduce the risks of potential higher inflation. For 2004, the monetary authorities will ensure that the macroeconomic environment will remain favorable to credit demand and investment activities while guarding against potential risks of inflation.

As inflation remained low last year, in *Thailand* there was further easing of monetary policy to safeguard against uncertainties in economic conditions and support the growth process. Also, since a wider differential between domestic and foreign interest rates can cause volatility in short-term capital movements that may have an adverse effect on economic recovery. The Bank of Thailand decided to lower the 14-day repurchase rate by 0.50 percent per annum from 1.75 percent per annum to 1.25 percent per annum, effective on 27 June 2003. In Thailand, the interest rate remains low, following the excess liquidity of the commercial banks together with the low interest rate environment in the world economy. The 14-day repurchase rate, the policy rate, has been kept at 1.25 percent since June 2003. As of May 2004, the one-year fixed deposit rates were at 1.0 percent, while the minimum lending rate (MLR) was in the range of 5.5 to 5.75 percent.

In *Australia*, the formal objectives of monetary policy require the Reserve Bank of Australia (RBA) to conduct monetary policy in a way that will best contribute to currency stability, the maintenance of full employment, and the economic prosperity and welfare of the people of Australia. In response to expected inflationary pressures arising, the RBA Board increased the target cash rate from 4.75 percent to 5.00 percent in November 2003 and to 5.25 percent in December 2003.

The Reserve Bank of *New Zealand* (RBNZ) is an independent central bank and through the Reserve Bank Act 1989 it is charged with maintaining price stability in New Zealand. The Act requires that there be a Policy Targets Agreement between the Minister of Finance and the Governor of the Reserve Bank. Like other central banks, the RBNZ successively cut rates in the period following September 11, taking the official cash rate (OCR) to 4.75 percent in November 2001. Ongoing strength in the domestic economy saw this stimulus gradually withdrawn over the first half of 2002, with the Reserve Bank gradually raising the OCR to 5.75 percent. The OCR remained at this level until April 2003 when it was gradually lowered to 5.0 percent. In April 2004 the RBNZ increased the OCR from 5.25 percent to 5.5 percent owing to domestic inflationary pressures.

Since 1991, the Federal Government and Bank of *Canada* have maintained an official target range for the inflation rate. This target range was gradually lowered to 1 to 3 percent. The commitment to keep inflation within that target range was renewed in February 1998 and again in May 2001, with the latter in effect until the end of 2006. The commitment to a low and stable inflation environment enables policy to best contribute to a sustained economic expansion in Canada, thereby leading to the likelihood of lower unemployment and improved productivity. In the early part of 2003 upward pressure on prices and concerns about rising inflation expectations prompted the Bank of Canada to raise its key policy rate by 50 basis points. However, reduced pressure on prices as well as increased economic slack in the face of negative microeconomic shocks led the Bank to lower its key policy rate by 50 basis points, reversing the increases over the earlier part of the year. Thus far in 2004, the Bank of Canada has continued to lower its key policy rate (overnight interest rate) by an additional 50 basis points to 2.25 percent citing the negative impact of the rapid appreciation of the Canadian dollar on economic activity.

Chile's monetary and credit conditions on local financial markets remained expansionary during 2003, and became even more so after the latest cuts to the monetary policy rate (MPR), in December 2003 and January 2004, bringing it to 1.75 percent. This situation has been reflected in a strong rise in personal loans, which have posted double digit 12-month growth rates since the middle of 2003, with consumer credits, accounting for a significant share. The outlook for corporate credit in coming quarters looks more promising, thanks to the ongoing expansionary monetary policy stance and the better external and domestic demand conditions expected in 2004 and 2005.

In accordance with its constitutional mandate, the *Mexican* Central Bank's primary objective is to maintain the stability of the purchasing power of the domestic currency and it met this objective during the first six months of 2004. Accordingly, during the first half of the year, the Central Bank increased the "corto" three times, as a response to inflationary pressures. The Central Bank increased the corto from Ps.25 million to Ps.29 million on 20 February from Ps.29 million to Ps. 33 million on 12 March and from Ps.33 million to Ps.37 million on 27 April 2004. The 27 April increase in the corto, by Ps.4 million per day, was a response to a decline in short-term funding rates, among other factors. The Central Bank's decision was taken four days after it announced that, given the increase in inflation expectations and the increase in international interest rates, it would be undesirable to relax domestic monetary policy. The monetary base, which consists of currency in circulation and financial institution deposits with the Central Bank, was Ps.278,847 million on 30 June 2004, 11.3 percent higher in real terms than that registered on 30 June 2003.

Since 2002, *Peru's* Central Bank monetary policy is conducted under an Explicit Inflation Targeting regime. The target is set for an annual rate of inflation of 2.5 percent, with a margin of 1.0 percent. During 2003, monetary policy was loosened and policy interest rates were reduced. The inter-bank interest rate came down from 3.8 percent in December 2002 to 2.5 percent in December 2003. This reduction has influenced short-term interest rates and low-risk loan rates, i.e., the 90-day prime interest rate came down from 5.1 percent at the end of 2002 to 3.3 percent at the end of 2003.

In *Russia*, during 2003 the Central Bank of Russia twice (on 17 February and 21 June) adopted decisions to decrease the refinancing rate. Over this period the refinancing rate decreased from 21 percent to 16 percent. The monetary, credit and foreign exchange policy in 2003 pursued by the Central Bank of Russia was in accordance with the conceptual document proclaimed at the end of 2002 and called "Basic directions of general state monetary and credit policy for 2003". The priority in the RF financial policy was given to slowing down inflation. Huge amounts of foreign exchange received from sales of Russian raw materials at high world prices recently were leading to growing rates of internal inflation.

3.3 Structural Reform

To enhance potential economic growth as well as to maintain resilience against adverse shocks, individual economies have made continuous efforts for structural reforms. They will facilitate the reallocation of resources entailed by technological progress and social changes and economic globalization. There is a wide consensus about the benefits of structural reforms and their orientation towards market-friendly regulatory frameworks and policies. However, the scope and speed of reforms has differed widely across the economies. In the APEC regions, there have been various measures taken in the areas of regulatory reform; corporate restructuring; corporate governance; banking, labor and tax systems; product market and trading systems.

The *Japanese* government has steadily engaged in a wide range of structural reforms in line with the policy that there can be "no growth without reforms". Structural reform represents ceaseless efforts to reform various systems, policies and the government, so that corporations, regions, and individuals can flexibly respond to the new socio-economic environment and can harness their potential to the maximum extent. The progress of structural reform including the steady progress in disposal of NPLs, the broad range of efforts for regulatory reform, the reorganization and revitalization of corporations, and the promotion of reform on expenditure and tax has led to the elimination of several factors that have suppressed the Japanese economy since the burst of the bubble economy. The amount of NPLs in major banks has decreased by over 13 trillion yen in the past two years and the stock prices of banks and real estate industry have enjoyed steady gains. Further, in addition to tax cuts on business capital investment and R&D expenses, there has been active revitalization and restructuring of corporations as can be seen from the drastic increase in new businesses (over 10,000) emerging in the past year under the Special Regulations Governing Minimum Capital Requirements. At the same time, the unemployment rate has marked a decrease for the first time in 13 years. There is definitely a significant difference compared with the previous two economic recoveries following the burst of the bubble economy, during which the unemployment rate rose or hovered at a high rate. It shows that the recovery this time is due to the achievements of structural reform. The task of the government after FY2005 is to put forth further fully-fledged efforts for the implementation of reforms already introduced. The principles of the reform are “from Public Sector to Private Sector” and “from the State to the Regions” and to establish a basis for growth under the new circumstances Japan faces such as the decrease of population and the changes in the international environment. Defining the two-year period between FY2005 and FY2006 as the “Concentrated Consolidation Period”, the government intends to ensure a breakaway from deflation through its policy efforts together with BOJ, and to focus on consolidating the fundamentals for new growth. As a result of these efforts, the nominal growth rate after FY2006 is projected to be around 2 percent or more.

Since 2003, the economy has been over-heated in some sectors in *China*, with problems such as too rapid growth of fixed assets investment in some industries and areas, excess growth of monetary credit, the uncertain supply of coal, power, crude oil and some crucial raw materials and rising grain prices. The Chinese government has taken many measures to regulate the macro-economy, so as to rebuild farmers’ confidence in growing grain crops, to strictly control unreasonable investment and tackle the serious problems of low-level redundant construction in certain trades and areas, tighten up management on the real estate market and land market and seasonally adjust the monetary credit policy. In the first four months of 2004, the above-mentioned measures taken in 2003 began to bring about the following effects: Slowdown of increases in fixed assets investment, newly-started projects beginning to be brought control, monetary credit and supply being put under control initially, national economy beginning to stabilize.

In the financial sector, the *Korean* government has vigorously carried out financial restructuring to restore the workings of the financial market since the financial crisis. In this process, 809 financial institutions were either merged or liquidated while 1661.1 trillion won of public funds was injected to improve the soundness of financial institutions. Consequently, the soundness of financial institutions recovered as evidenced by the amount of non-performing loans in financial institutions. NPLs decreased to 40.2 trillion won (4.2 percent of total loans) as of the end of September 2003 from 88 trillion won (14.9 percent of total loans) in 1999. The corporate restructuring implemented in the aftermath of the financial crisis has remarkably enhanced corporate financial status. The debt- equity ratio in the manufacturing sector dropped to 123 percent as of 2003 from the pre-crisis level of about 400 percent, which is lower than that of advanced economies. Concerning the restructuring of non-viable companies, 83 firms have undergone restructuring through the workout program since the financial crisis. In accordance with the workout procedure, 57 companies took the path to management normalization, 19 firms completed an early liquidation process and 7 firms are currently in the workout program.

In its mid- to long-term industrial development policy, *Chinese Taipei* has been vigorously promoting the expansion of knowledge-intensive industries, the upgrading of traditional industries, and the adjustment of certain IT industries, with a view to achieving the optimum blend of competitive advantages in the industrial sector. The bolstering of domestic innovation and the establishment of sunrise industries has largely offset the exodus of less-competitive industries to offshore locations, enabling industrial production to grow at a sound pace and promising a fall in unemployment in the near future. In 2002, the *Chinese Taipei* government unveiled the Challenge 2008 Six-Year National Development Plan. To speed the implementation of Challenge 2008, in 2003 the government designated key related projects as the New Ten Major Construction Projects. These projects are designed to enhance Chinese Taipei’s competitive strength, maintain its number-one competitiveness ranking in Asia, and make Chinese Taipei one of the world’s three strongest economies. As part of its efforts to reform and strengthen its banking system, Chinese Taipei has introduced asset management companies and the Financial Restructuring Fund to help banks and financial institutions sell assets held as collateral for bad loans and clear non-performing loans from their books. As a result, the average NPL ratio has declined sharply from its peak of 8.04 percent in March 2002 to 4.33 percent in December 2003.

Indonesia needs to continue structural reforms in order to maintain macroeconomic stability and ensure a sustainable economic growth. Hence, a concerted effort to improve macroeconomic performance has been taken by the Indonesian government by continuing structural reform in both on the fiscal and financial sectors. In the fiscal sector, the government's medium-term objective is to achieve a broad balance by 2006–2007, consistent with lowering public debt up to below 50.0 percent of GDP. In order to achieve the objective, the government's main priority is to enhance non-oil tax revenue with the aim of providing adequate resources for physical and social infrastructure, and reducing reliance on oil revenues. In line with the effort to achieve this objective, there is a core set of reforms to improve Indonesia's fiscal performance. In 2002, the government introduced a new system whereby tax offices are organized by taxpayer and called the Large Taxpayer Offices (LTO). The new system replaced the previous one where tax offices were based on the type of tax. In the financial sector, Indonesian Banking Restructuring Agency (IBRA) asset recoveries accelerated, the process of establishing a robust financial infrastructure is advancing and the banking system's fundamentals have been strengthened. An independent central bank is in place, bank supervision is being improved, and a new financial safety net is well on the way to being established. Over its five-year mandate, IBRA has made significant progress towards meeting its primary objectives of securing recoveries from bank assets taken over during the crisis and returning the banks taken over to private ownership.

Financial restructuring in *Malaysia* reached another important milestone, with Danaharta, the national asset management company, redeeming the first two tranches of bonds with a face value of RM2.6 billion as scheduled on 31 December 2003. The bonds had been issued to finance the acquisition of non-performing loans during the Asian financial crisis. As at end-March 2004, Danaharta expects to recover RM30.86 billion from its non-performing loan portfolio of RM52.44 billion (loan rights acquired plus accrued interest), representing a recovery rate of 59 percent.

The Philippines' government's tariff program remained on-track despite a slight increase in the average nominal tariff, from 6.02 percent in 2002 to 6.49 percent in 2003, as a result of the increase in tariffs on certain products to provide temporary relief to local manufacturers and allow them to further enhance their competitiveness. To allow farmers and fishermen access to their imported raw material inputs and equipment at lower cost, the grant of duty exemption privilege, which expired on 8 February 2003, has been reinstated. The Philippines also continued to participate in liberalization initiatives in ASEAN by reducing the common effective preferential tariff (CEPT) rates to zero for around 60 percent of products in the CEPT Inclusion List, granting zero duty on information and communications technology products to accelerate technology transfer, and providing tariff preferences on certain products from less developed ASEAN members to assist in their economic development. In recognition of the vital role of information and communications in achieving growth, the Commission on Information and Communications Technology (ICT) was created. It will be in charge of, among other things, of formulating and recommending policies to promote ICT and wider use of the internet and other cyberspace infrastructure, and establishing and administering comprehensive and integrated programs for ICT at the national, regional and local levels. Efforts were also geared towards improving revenue effort and maintaining prudent expenditure by continuing to push for legislation that will correct the structural defects in the system that have eroded tax collection even as it improves tax administration. To enable the government to implement a more effective tax collection program, a new law was passed expanding the jurisdiction of the Tax Appeals Court to include criminal and civil jurisdiction over tax and customs cases to speed up the prosecution and adjudication of these cases. The Revenue Integrity Protection Services was also created within the Department of Finance (DOF) with the task of investigating allegations of corruption within the DOF and its attached agencies. The enactment of the *Securitization Act of 2004* is expected to lead to a stronger capital market that would provide for a stable source of long-term funds to support broader business undertakings, increase foreign and domestic investments, generate more job opportunities and substantially increase household incomes.

Singapore's structural reform agenda is aimed at developing a globalized, diversified and entrepreneurial economy. Broadly, there are several points that are the focus of the Economic Review Committee's strategic thrusts. First, expanding external ties which means embracing globalization through the multilateral trading framework of the WTO. Second, maintaining competitiveness and flexibility which entails keeping the burden of taxes and the Central Provident Fund on the economy as low as possible, reviewing the labor market and wage system to make them more flexible, and pricing factors of production competitively. Third, promoting entrepreneurship and Singapore companies which encourages people to be innovative and this improves the ability of firms to develop new ideas and businesses, tap new export markets and broaden its economic base. Fourth, growing manufacturing and services which means upgrading these sectors by improving cost competitiveness, equipping the labor force with relevant skills, and developing new capabilities and industries. Lastly, developing human capital which entails investing in education, helping workers train and upgrade, and welcoming global talent to augment the indigenous talent pool.

In *Thailand* the Cabinet approved the Financial Sector Master Plan in January 2004. The Plan aims to improve efficiency, stability and competition within the financial institutions system, and to broaden accessibility of financial services to all potential users. The objectives of the Plan are to formalize and legitimize various types of asset as a step towards creating access to capital markets; to create value from the registered assets; to develop a database that will be instrumental in ensuring a transparent framework for transaction; and to make the necessary preparations for the long-term measures for assets capitalization. The Thai government launched the program for asset capitalization in 2003, and the program is expected to continue in 2004. Public sector reform was commended in October 2002 with the promulgation of the *Ministerial Restructuring Act* and *the Public Administration Act* to improve the working environment and procedures in the public sector. It can be broadly divided into public administration reform and public financial management reform. Public administration reform aims to achieve the most effective policymaking. Moreover, to reduce bureaucratic processes and decentralize functions and resources, the government introduced the CEO Governor Program in 2003. The CEO governor is given greater decision-making power within a province and in turn is accountable for his/her actions. Also, the Ministry of Finance has prepared a plan in accordance with the cabinet resolution on 29 November 2003 regarding state enterprises. The state enterprise policy office (SEPO) will determine the proper management policy for state enterprises. In Thailand, the NPLs resolution has been expedited during the year 2003. Outstanding NPLs of all financial institutions fell from 770.3 billion baht or 15.65 percent of outstanding loans at end-2002 to 617.6 billion baht or 12.1 percent of outstanding loan in the first quarter of 2004. Meanwhile, the Thai Asset Management Corporation (TAMC) has already resolved NPLs of 732 billion baht at book value or almost 94 percent of all NPLs transferred from financial institutions as of December 2003. The Bank of Thailand also sets a goal of reducing NPLs to less than 5 percent of outstanding loans by 2006. To do so, the BOT proposes to amend the Asset Management Corporation law so that it can purchase distressed assets and real property pledged as loan collateral from banks and financial companies. The BOT is also currently revising the guidelines on loan loss provisions to punish financial institutions that have made no progress in resolving NPLs.

Viet Nam's structural reforms have been focused on reforms in state-owned enterprises, strengthening the banking system, international integration commitments, and improving the climate for enterprise. All of these are the basic links representing the new breakthrough in Vietnam's economic renovation process.

In *Australia*, the Intergenerational Report 2002–03 (IGR) released with the 2002 budget continues to inform the structural policy reforms of the 2004 Budget. The *IGR* projected that Australia's changing demographics will be detrimental to long-term growth and the sustainability of public finances over the next 40 years. The 2003–04 Budget suggested that it would be in Australia's long-term interest to address these challenges by pursuing faster economic growth, through increased labor force participation rates and higher productivity. In the 2004–05 budget, the Government announced a package of major initiatives aimed at providing more help for families, cutting taxes further, boosting retirement savings and investing in Australia's future. This package represents a further major step in meeting the challenge of population ageing. Measures such as research and innovation will enhance productivity. Australia has made an unprecedented 10-year commitment aimed at building a world-class innovation system for the twenty-first century. This will enable Australia to develop new products and better work processes to enhance productivity and employment growth. Improved transport infrastructure also has the capacity to enhance productivity. Australia's national land transport plan, *AusLink*, will take a long-term strategic approach to produce an integrated and high-performing Australia-wide land transport network. This is in anticipation of an expected doubling of the non-bulk road freight task by 2020.

In 2004, *Papua New Guinea's* government continued to implement a reform agenda based on four principles: (a) promotion of good governance; (b) improving economic management; (c) improving public sector performance; and (d) removing barriers to investment and economic growth. This is supplemented by a new focus on improving the management of public sector employment and the control of personnel expenditures; restoring the integrity of budget institutions and systems to improve budgetary discipline; and to review the role, functions, and outputs of each spending agency in order to identify ways of improving the allocative and technical efficiencies of public expenditure.

As for inflation targeting, the Bank of *Canada* and the government of Canada jointly agreed to target inflation in 1991 to reduce the inflation to the mid-point of a range of 1.0 to 3.0 percent by the end of 1995. That inflation control target was extended in May 2001, to the end of 2006. Inflation expectations remain firmly anchored at 2.0 percent. As the Tax Reform in 2000, the Canada's federal government was able to introduce the largest tax reduction in its history. The five-year, $100 billion tax reduction plan was most important tax reform in a decade. As for the labor market in Canada the 1990s brought changes for the Employment Insurance (EI) system including an increase in number of weeks required to qualify for the benefits and a reduction in the number of weeks of benefit entitlement. Beginning on 4 January 2004, individuals who meet the eligibility requirements for special benefits will be entitled to a six-week EI compassionate care benefit to care for a gravely ill or dying child, parent or spouse. Also Canada has introduced many other structural reform measures in the fields of social assistance, pensions, trade liberalization and privatization and financial sector reforms since late 1980s.

During 2003, the *Mexican* Congress approved legal reform to promote bank lending. This is consistent with the approval of a reform that incorporated the security trust and the non-possessory pledge as well as their non-judicial execution procedures into the Mexican legal system, in May 2000. As a second step in strengthening the legal framework for secured credit transactions, the Mexican Congress approved on 24 April 2003 amendments to seven laws and improved the execution procedures related to the trust, the security trust, the non-possessory pledge, and several credit transactions including commercial and mortgage loans. The reform also includes new provisions regarding financial leasing, factoring and pledges on securities.

3.4 Future Economic Prospects

World economic growth in 2004 will be the strongest since 2000. For the next few years, growth is expected to be strong but a little lower. Many institutions and economists expect that US and Asian economies will continue to lead world economic growth in this phase of the economic cycle. Therefore we will see the higher growth rates for the APEC region than for the world economy. Reviewing the IMF forecast numbers on real GDP growth, the APEC region as a whole will register 4.6 percent growth in 2004 and 3.9 percent in 2005, compared to 3.8 percent and 3.5 percent for the world in 2004 and in 2005, respectively.

In *the United States,* forward-looking indicators suggest that these trends will continue, although the growth rate will, as always, vary from quarter to quarter. Absent any significant unexpected events, the coming years are likely to be characterized by solid growth, expanding job opportunities, increasing wages, and relatively low inflation and interest rates. The Administration's strong economic forecast is shared by the consensus of private sector forecasters. In light of the growing evidence that the expansion is now on a solid foundation, real GDP growth is expected to grow 4.7 percent in 2004, moderating to 3.7 percent in 2005. Growth is projected to slow gradually to 3.1 percent in 2009, the Administration's estimate of the US long-run potential growth rate. The growth projection beginning with 2006 is the same as in the Budget.

During the six years 2004–2009, growth is expected to average 3.6 percent, nearly the same as the Blue Chip consensus. The 3.1 percent estimate of the potential long-run growth rate is unchanged from that in the Budget. The US unemployment rate is projected to continue to decline through 2007 when it is expected to level off at 5.1 percent. That is the center of the range that is thought to be consistent with stable inflation. As to inflation, the faster-than-expected inflation so far this year has resulted in an upward revision to the near-term inflation forecast. On a year-over-year basis, the CPI is projected to increase 2.5 percent this year and close to that rate during the subsequent years of the forecast period. The CPI projection is close to that of the Blue Chip consensus. An upward revision also has been made to the projection of the GDP chain-weighted price index. US interest rates are projected to rise slowly, with short-term rates increasing more than long-term rates, the usual pattern at this stage of the business cycle. The decision of the Federal Reserve to raise the Federal funds rate 0.75 percent over the past three meetings is consistent with the gradual increase in short-term rates projected in the mid session review. By 2009, the 91-day Treasury bill rate is projected to be 4.4 percent; the yield on the 10-year Treasury note is assumed to be 5.8 percent.

As for short-term prospects, the *Japanese* government projected the real GDP growth rate for FY2004 to be about 1.8 percent (with the nominal GDP growth rate about 0.5 percent) in the *Economic Outlook for FY2004 and Basic Economic and Fiscal Management Measures* (hereinafter referred to as *Outlook*) decided by the Cabinet in January 2004. In July, the Cabinet Office made a forecast of economic situation for FY2004. In *A Forecast of Economic Situation for FY2004 (Calculated by Cabinet Office)* (hereinafter referred to as *Forecast*), the Cabinet Office forecasted the real GDP growth rate to be about 3.5 percent (with the nominal GDP growth rate at about 1.8 percent). Looking forward, the government projected in the *Outlook* the percentage changes over the previous fiscal year of corporate goods price index (CGP)I and CPI to be about -0.4 percent and -0.2 percent, respectively. According to the *Forecast*, they are estimated about 0.6 percent and -0.1 percent, respectively. Also the government projected the unemployment rate for FY2004 to be about 5.1 percent in the *Outlook*. According to the *Forecast*, it is estimated to be about 4.5 percent.

Table 1.12
Forecasts of GDP Growth (percent)

	2003	2004				2005				Medium-term	
		Official	IMF	OECD	ADB	Official	IMF	OECD	ADB	Official	GI*
Western Hemisphere											
Canada	2.0	2.7	2.9	2.8		3.3	3.1	3.3		3.1	3.0
Chile	3.3	4.5-5.5	4.9				4.7			3.4-4.0	5.3
Mexico	1.3	3.1	4.0				3.2			4.4	3.9
Peru	3.8	4.2	4.5				4.5			4.0	4.7
The United States	3.1	4.7	4.3	4.7		3.7	3.5	3.7		3.4	3.0
Northeast Asia											
China	9.1	9.0	9.0	8.3	8.8		7.5	7.8	8.0	8.5	6.9
Hong Kong, China	3.2	7.5	7.5		7.5		4.0		6.0	3.3	5.2
Japan	2.4	1.8	4.4	3.0			2.3	2.8		2.1	1.8
Korea	3.1	5	4.6	5.6	4.4		4.0	5.9	3.6	5.9	5.6
Chinese Taipei	3.3	5.9	5.6		6.0	4.5	4.1		4.8		4.6
Southeast Asia											
Brunei Darussalam	3.6		1.1				2.2				2.0
Indonesia	4.5	4.5-5.0	4.8		4.8	5.0-6.0	5.0		5.2	5.5-6.0	4.7
Malaysia	5.3	7.0	6.5		5.8	6.0	6.3		5.6	4.2	5.0
The Philippines	4.7	4.9-5.8	5.2		5.5	5.3-6.3	4.2		5.5		4.9
Singapore	1.1	8-9	8.8		8.1	3-5	4.4		4.2	3.0-5.0	5.0
Thailand	6.7	7.1	6.2		6.4		6.4		6.6	6.0-7.0	5.4
Viet Nam	7.2	8.0	7.0		7.5		7.0		7.6	7.5	7.0
Oceania											
Australia**	3.3	3.5	3.6	3.8		3.5	3.4	3.5		3.5	2.7
New Zealand	3.5	3.2	4.2	3.3		2.3	2.0	2.5		3.0	2.6
Papua New Guinea	2.0		2.5		2.8		2.9		1.7		4.2
Russia	7.3	6.4	7.3	7.0			6.6	5.8			4.3
APEC	**3.5**		**4.7**				**3.7**				**3.7**
World	2.7		4.1	3.4			3.4	3.3			3.1

Note: *GI stands for Global Insight. 5 year average of GDP growth(2006–2010)
**Official forecasts are based on financial years(beginning July 1)
Sources: Individual Economy Reports.
ADB, *Asian Development Outlook,* September 2004.
Global Insight Inc., *World Outlook*, June 2004.
IMF, *World Economic Outlook*, September 2004.
OECD, *OECD Economic Outlook*, May 2004.

Table 1.13
Forecasts of Consumer Price Inflation (percent)

	2003	2004				2005				Medium-term	
		Official	IMF	OECD	ADB	Official	IMF	OECD	ADB	Official	GI*
Western Hemisphere											
Canada	2.7	1.4	1.9	1.1		1.8	2.2	1.7			1.9
Chile	2.8	0.7	1.1				2.9				3.0
Mexico	4.0	3.9	4.4			.	4.0				4.3
Peru	2.5	3.5	3.5				2.5				3.0
The United States	2.3	2.8	3.0	2.3			3.0	2.0			2.2
Northeast Asia											
China	1.2	3.5	4.0	3.0	3.4		3.0	2.0	4.9		2.9
Hong Kong, China	-2.6	0.0	0.0		0.7		1.0		1.1		1.6
Japan	-0.3	-0.2	-0.2	-0.2			-0.1	0.1		1.3	1.9
Korea	3.6	3.0	3.8	3.2	3.8		3.8	3.2	3.0		3.3
Chinese Taipei	-0.3	1.5	1.1		1.5	1.6	1.5		2.0		2.2
Southeast Asia											
Brunei Darussalam	1.5		1.0				1.3				1.6
Indonesia	5.1	5.5-7.5	6.5		6.5	5.5	6.5		7.0	6.0-7.0	4.3
Malaysia	1.2	1.5	2.2		1.5		2.5		1.7		1.4
The Philippines	3.0	4.0-5.0	5.4		5.2	4.0-5.0	6.8		5.5		4.9
Singapore	0.5	1.5-2.0	1.8		1.8		1.6		1.6		1.4
Thailand	1.8	3.1	2.7		2.8		1.8		2.6	3.0	2.8
Viet Nam	3.0	6.5	6.0		9.0		3.5		6.0		4.4
Oceania											
Australia**	2.4	2.5	2.8	2.0		2.5	2.5	2.5		2.5	2.9
New Zealand	1.6	2.1	2.4	2.1		2.5	2.8 2.5	2.4			2.6
Papua New Guinea	15.7		7.4		7.4		6.0		6.0		6.8
Russia	12.0	10.0	10.3				8.9				7.3

Note: *GI stands for Global Insight. 5 year average of inflation(2006–2010)
**Official forecasts are based on financial years(beginning July 1)

Sources: Individual Economy Reports.
ADB, *Asian Development Outlook*, September 2004.
Global Insight Inc., *World Outlook*, June 2004.
IMF, *World Economic Outlook*, September 2004.
OECD, *OECD Economic Outlook*, May 2004.

Table 1.14
Forecasts of Budget Balances (percent of GDP)

	2003	2004		2005	
		OECD	ADB	OECD	ADB
Western Hemisphere					
Canada	0.6	1.2		1.3	
Chile	-0.8				
Mexico	-0.7				
Peru	-1.8				
The United States	-4.8	-4.7		-3.9	
Northeast Asia					
China	-2.7	-2.5	-0.7	-2.5	1.1
Hong Kong, China	-3.3		-3.0		-2.5
Japan	N.A	-7.1		-6.6	
Korea	1.3	0.9	-0.9	1.0	-1.2
Chinese Taipei	-3.5		-2.9		-2.6
Southeast Asia					
Brunei Darussalam					
Indonesia	-2.1		-1.3		-0.8
Malaysia	-5.3		-4.5		-1.8
The Philippines	-4.6		-4.2		-3.6
Singapore	-1.1		3.6		3.8
Thailand	-0.7		-0.1		-0.3
Viet Nam	5.0		-4.6		-4.2
Oceania					
Australia	0.8	0.5		0.5	
New Zealand	1.5	2.9		2.8	
Papua New Guinea	-1.7		-1.5		-1.0
Russia	1.7	1.0		0.5	

Sources: Individual Economy Reports.
ADB, *Asian Development Outlook*, September 2004.
OECD, *OECD Economic Outlook*, May 2004.

Table 1.15
Forecasts of Export Growth (percent)

	2003	2004			2005		
		Official	OECD	ADB*	Official	OECD	ADB*
Western Hemisphere							
Canada	-2.4	5.6	6.6		5.6	7.1	
Chile	7.8	26.2					
Mexico	1.1	8.9					
Peru	16.4	27.1			4.3		
The United States	1.9		10.4			10.6	
Northeast Asia							
China*	34.6	31.0		22.0			16.0
Hong Kong, China	12.9	14.1		7.0			7.0
Japan	10.1	5.5	12.5			12.1	
Korea	38.2		18.0	33.0		14.0	13.0
Chinese Taipei	10.9	17.1		16.2	5.9		9.2
Southeast Asia							
Brunei Darussalam							
Indonesia	6.6			3.5			3.5
Malaysia	11.5	17.3		14.6			9.4
The Philippines	4.4	3.4-4.4		10.0	8.2-9.2		10.0
Singapore*	15.0			15.0			7.5
Thailand	6.5	15.3		20.0			8.0
Viet Nam	19.0	12.0		16.3			12.0
Oceania							
Australia**	-2.6	9.0	5.7		7.0	8.3	
New Zealand	1.3	5.5	6.7		3.9	8.6	
Papua New Guinea	27.5			0.8			-3.9
Russia	25.7	7.9					

Note: * Based on merchandise exports.
**Official forecasts are based on financial years (beginning July 1)
Sources: Individual Economy Reports.
ADB, *Asian Development Outlook*, September 2004.
OECD, *OECD Economic Outlook*, May 2004.

Table 1.16
Forecasts of Import Growth (percent)

	2003	2004			2005		
		Official	OECD	ADB*	Official	OECD	ADB*
Western Hemisphere							
Canada	3.8	7.5	8.2		8.2	7.9	
Chile	8.8	21.2					
Mexico	-1.0	8.5					
Peru	11.3	13.8			5.4		
The United States	4.4		7.4			8.1	
Northeast Asia							
China*	39.9	35.0		30.0			20.0
Hong Kong, China	11.3	14.2		8.7			6.4
Japan	5.0	5.2	6.9			7.2	
Korea	35.6		14.0	27.0		13.5	16.0
Chinese Taipei*	6.9	20.1		19.6	4.4		10.5
Southeast Asia							
Brunei Darussalam							
Indonesia	2.8			4.0			4.0
Malaysia	4.8	22.1		17.5			10.6
The Philippines	10.3	7.0-8.0		7.0	11.7-12.7		7.0
Singapore*	9.4			17.5			10.0
Thailand	7.3	21.8		27.0			8.0
Viet Nam	26.7	9.0		15.0			11.0
Oceania							
Australia**	11.0	11.0	10.8		7.0	9.0	
New Zealand	10.2	12.1	11.7		3.3	6.6	
Papua New Guinea	-4.6			-2.2			0.3
Russia	21.4	19.1					

Note: * Based on merchandise imports.
**Official forecasts are based on financial years (beginning July 1)
Sources: Individual Economy Reports.
ADB, *Asian Development Outlook*, September 2004.
OECD, *OECD Economic Outlook*, May 2004.

Table 1.17

Forecasts of Current Account Balances (percent of GDP)

	2003	2004			2005		
		OECD	IMF	ADB	OECD	IMF	ADB
Western Hemisphere							
Canada	2.0	2.2	2.9		2.3	2.4	
Chile	-0.8		0.5			-1.9	
Mexico	-1.5		-1.2			-1.5	
Peru	-1.8		-0.4			-0.7	
The United States	-4.8	-4.7	-5.4		-4.8	-5.1	
Northeast Asia							
China	2.1	1.3	2.4	-0.1	1.5	2.8	-1.4
Hong Kong, China	10.7		10.0	6.8		9.6	8.5
Japan	3.2	3.8	3.4		4.4	3.2	
Korea	2.0	2.2	3.1	3.9	2.3	3.3	3.1
Chinese Taipei	10.0		6.9	6.8		6.0	6.0
Southeast Asia							
Brunei Darussalam	80.8		77.9			78.0	
Indonesia	3.8		2.9	3.4		1.9	3.1
Malaysia	12.9		12.4	7.8		10.1	7.0
The Philippines	4.2		2.8	3.0		1.8	2.8
Singapore	30.9		25.7	27.0		23.9	25.0
Thailand	5.6		3.8	4.0		2.0	4.0
Viet Nam	-5.8		-4.5	-4.1		-3.6	-4.1
Oceania							
Australia	-6.0	-5.2	-5.3		-4.5	-4.9	
New Zealand	-4.5	-4.6	-4.4		-3.9	-4.4	
Papua New Guinea	9.1		16.2	5.0		10.0	3.2
Russia	8.3	8.5	9.9		6.5	7.8	

Sources: Individual Economy Reports.
ADB, *Asian Development Outlook*, September 2004.
IMF, *World Economic Outlook*, September 2004.
OECD, *OECD Economic Outlook*, May 2004.

In 2004, *China's* economic development is at its critical juncture. The Chinese government is going to make full use of economic leverage, coordinating other regulating measures to strengthen the macro-economic regulation and ensure the stable, harmonious and rapid development of the Chinese economy. The emphasis on macro-economic regulation in 2004 is to solve the following four crucial problems: controlling the too rapid growth of investment in fixed assets; alleviating the disparity between supply and demand in coal, electricity, oil and transport capacity; strengthening grain production capability and improving the economy's food security; and keeping the general level of prices essentially stable.

The *Korean* government has been taking various measures to boost investment and generate jobs, which will, in turn, resolve unemployment and credit delinquency issues. In particular, to prevent fiscal conditions from acting as factors that contract the economy, the government plans to vigorously support the recovery in domestic demand by increasing fiscal expenditures. If this measure proves to be effective, the Korean economy will regain a balanced growth between internal and external sides. In this case, growth rate for 2004 is expected to exceed 5 percent, the level of potential growth rate. In the second half of 2004, difficulties are expected to persist due to unfavorable external conditions such as skyrocketing oil prices and rises in international raw material prices. However, the government intends to focus its efforts on achieving price stability by responding flexibly to each oil price hike employing countermeasures drawn up on a case- by-case basis. If pertinent measures are implemented without any setbacks, the CPI rate is projected to reach the mid-3 percent range despite adverse external factors such as soaring oil prices.

The short-term prospects for the economy of *Hong Kong, China* are favorable. Externally, merchandise exports are expected to stay buoyant throughout 2004, on the back of upbeat global and regional economic environment. Exports of services are expected to be even more vibrant in 2004, as inbound tourism thrives under the support of Individual Visit Scheme for Chinese Visitors and experiences a rebound in visitors from other major sources, and as offshore trade stays robust. On the domestic front, consumer spending is poised for a notable growth in 2004, while machinery and equipment investment should be well underpinned by the need for companies to reinstate their capacity to meet the anticipated growth in business. Also, the closer business links between Hong Kong, China, and other economies in East Asia render added scope. Overall, GDP is forecast to pick up to a 7.5 percent growth in real terms in 2004, higher than the 3.2 percent growth in 2003. According to forecasts published in March 2004, for the medium-term period 2005-08 as a whole, GDP is expected to grow at a trend rate of 3.3 percent in real terms.

Global economic recovery and trade expansion are expected to remain strong enough to sustain the gathering momentum of *Chinese Taipei's* export growth in 2004. On the home front, the launch of the *New Ten Major Construction Projects* to complement and speed up the implementation of the *Challenge 2008* six-year national development plan, should deliver a powerful stimulus effect. As the upswing in domestic and foreign demand gains strength, Chinese Taipei's GDP growth rate is projected to rise to 5.87 percent in 2004, accompanied by continued price stability. Driven by the expansion of global trade, Chinese Taipei's foreign trade is expected to increase substantially in 2004. Merchandise exports and imports are forecast to grow 21.31 percent and 29.37 percent respectively, generating a trade surplus of US$10.3 billion. Trade in goods and services is projected to register real growth of 17.05 percent in exports and 20.13 percent in imports.

Looking forward, the prospect for *Indonesian* economic growth in 2004 is encouraging. This projection is based on factors including the continued improved economic conditions in most developed economies as well as the healthier state of the domestic economy as reflected in the stable exchange rate, lower interest rate and relatively low and stable inflation. The improved economic prospect is also benefiting from the favorable development of the global economy and the existence of a clear package of economic policies after the IMF program known as the White Paper. In light of these developments, it is estimated that economic growth in 2004 would be around 4.5 to 5.0 percent. In the medium term, Indonesia's economy is forecasted to improve further in line with favorable improvement of the global economy. Economic growth is projected to pick up to around 5.5 to 6.0 percent averagely in 2005-2007, driven primarily by a strong domestic demand accompanied by a rebound in private investment and a recovery in export, which is associated with strengthening external demand. CPI inflation in 2004 is expected to be slightly higher than previously expected, forecasted to grow at 5.5-7.5 percent in 2004. The higher prices have been largely attributed to the weakening rupiah, rising expectations of inflation, administered prices and the hike in fuel prices. External factors such as high commodity prices and the upward trend of global inflation have to some extent brought about higher domestic prices. However, in line with the implementation of a tight bias monetary policy stance since mid 2004, such external influence is expected to be minimal. Over the longer term, however, inflation is expected to be within its disinflation target range of around 5.5 percent in 2006.

The *Malaysian* economy has generated sufficient momentum to sustain strong growth in the remaining quarters of 2004 as shown by the Leading Index, which gained 11.4 percent in the first half of 2004. Consequently, real GDP is expected to post a strong growth of 7.0 percent for the whole year. Robust private sector activities will continue to drive the economy over the coming months, whilst firm commodity prices and improving stock market activities will further enhance consumer and business sentiments.

The *Philippines* economy is still expected to continue growing in 2004. GDP is projected to increase by 4.9 to 5.8 percent while real GNP is expected to expand by 5.2 to 6.0 percent. Specifically, the net factor income from abroad is anticipated to grow by 8.5 to 8.7 percent this year due to the continued increase in foreign remittances. The average annual inflation rate will remain low and stable in 2004. It is expected to increase by 4.0 to 5.0 percent, lower than its 2003 target. The budget deficit is also estimated to comprise 4.2 percent of GDP. Meanwhile, the current account will likely remain in surplus due to increasing exports.

In *Singapore,* economic recovery is gathering momentum. For 2004, Singaporeans and businesses alike have expressed greater optimism. Accordingly, the growth forecast for 2004 has been revised upwards to 8.0 to 9.0 percent. However, beyond the cyclical pickup in the growth rate, the foundation for achieving sustained long-term growth lies with Singapore's ability to restructure its economy. This should sustain medium-term growth at 3.0 to 5.0 percent per annum.

In 2004 the *Thai* economy is expected to continue its strong growth momentum. Following the Finance Ministry's projection in May 2004, the Thai economy is projected to grow by 7.1 percent from the well-balanced sources of growth of private consumption, private investment, and net exports. In the medium term (2005 to 2008), the government has set the macroeconomic framework, including the economic growth rate of 6.0 to 7.0 percent, with the inflation rate of around 3 percent. Economic growth in 2004 to 2006 is expected to be supported by strong domestic demand and external demand. Private investment should pick up more firmly once problems in the financial sectors are resolved. In 2004, UNCTAD ranked Thailand as the fourth most attractive place for investment in the world, which should also enhance investors' confidence. One crucial factor supporting growth will be an improving productivity, which will enhance the economy's competitiveness and increase investment efficiency.

Viet Nam's stabilization of a number of main macro-economic indicators, the Government's efforts to reform its own structure and its most important institutions, and the strong support from international organizations such as the World Bank, IMF, and ADB were the favorable factors that allowed Viet Nam to keep being one of the Asian economies with the highest growth rates in short- and medium-term. Viet Nam's medium-term economic prospects are relatively bright: the growth rates for 2004 and 2005 are estimated to be 8.0 percent and 8.3 percent respectively, higher than that for 2003. These high rates are largely based that the rise in private consumption (more than 6 percent) and the fact that the ratio of investment to GDP was higher than 31 percent. Export revenue will maintain its high growth rate owing to the high oil prices and the recovery trend in the world economy.

Australia's forecasts are prepared on a financial year basis. In 2004–05, economic growth is forecast to be 3.5 percent. Growth in gross national expenditure (GNE) is forecast to ease to a more sustainable 3.75 percent. Net exports are forecast to subtract 0.5 percent from economic growth in 2004–05, as imports continue to grow a little more quickly than exports in response to the still solid levels of domestic spending. The inflation outlook remains benign, underpinned by moderate growth in labor costs and the substantial appreciation of the Australian dollar over the past two years. Inflation is forecast to gradually decline to around 1.75 percent through the year to

June 2005. Wage pressures are expected to remain contained through 2004-05, but recent falls in the unemployment rate are forecast to lead to a slight firming in wage growth in the near term. Over the short term, the momentum in growth is expected to continue, owing to continued strong household and business spending. Factors supporting this include high house prices, solid labor income growth and favorable terms of trade. This near-term strength is forecast to give way to a period of slower GDP growth over the second half of 2004 and much of 2005. Slowing net migration, slower employment growth, and the lagged effect of the high exchange rate are the main drivers of the forecast easing in growth. Exporters are expected to spend less, with flow-on effects to those who provide goods and services to exporters. Economic growth begins to rebound in late 2005 and early 2006. Annual real GDP growth steadily picks up, increasing to around 3.4 percent at the end of 2006 and beginning of 2007.

Looking ahead, *Canada's* solid domestic fundamentals, low interest rates and a more favorable global economic environment, particularly a stronger US economy, are expected to support robust Canadian growth. According to the March 2004 survey of private-sector economists, growth in Canada is expected to accelerate to 2.7 percent in 2004 and 3.3 percent in 2005. According to the March 2004 survey of private sector economists, Canadian real GDP growth is expected to average 2.7 and 3.3 percent in 2004 and 2005 respectively. Growth is forecast to average 3.1 percent for the period of 2006–09. Canada's inflationary pressures are expected to remain subdued for the remainder of 2004 reflecting the slack in labor and product markets. The core rate of inflation is expected to stay around 1.5 percent through 2004, before gradually moving to the 2.0 percent mark by the end of 2005. Total CPI inflation is projected to be slightly higher than core inflation over 2004 and into 2005 as a result of strong energy prices.

In *Chile*, the expected growth in activity is between 4.5 percent and 5.5 percent in 2004. This follows the recovery of terms of trade, combined with the real exchange rate remaining at current levels, better prospects for capital flows into emerging economies in general, and the expectations that domestic spending will rise by one or two percentage points more than GDP growth. Although the negative figures for 12-month inflation are believed to be essentially temporary phenomenon, they should contribute to the deceleration of nominal wage growth. Similarly, lower growth in labor productivity, which at some point caused concern due to its potential impact on costs and inflation, has turned around, especially in the manufacturing sector. Thus, the medium-term scenario shows no signs of major pressures on unit labor costs from private sector.

Mexico's economic policy strategy is geared towards strengthening internal sources of growth, the reactivation of investment spending, and to the continued expansion of consumption. Estimated GDP growth for 2004 is 4.0 percent, December-December inflation is expected to be 3.9 percent, and the current account deficit is anticipated at US$8.9 billion. Fiscal discipline will continue to be the backbone of the macroeconomic strategy in 2004. The fiscal deficit's target for the year will be 0.3 percent of GDP, and the estimated public sector borrowing requirements (PSBR) are 2.6 percent of GDP. Congress authorized a reduction of the external indebtedness of US$500 million. This external indebtedness reduction implies that the fiscal deficit will be entirely financed in domestic financial markets for the fourth consecutive year.

During 2004, *Peru's* real GDP is expected to grow 4.2 percent and domestic demand to expand 3.7 percent. The fiscal deficit should continue decreasing, reaching 1.4 percent of GDP in 2004 and 1.0 percent in 2005 as stated in the new Fiscal Responsibility and Transparency Law. Monetary policy will continue to be conducted under the Explicit Inflation Targeting regime with a target of 2.5 percent with a 1.0 percent margin up or down.

The main priorities of *Russian* economic policy for 2004 are to increase the income level of the population, work out and realize measures to support economic growth, and shape the potential of Russia's stable development. According to the last government assessment (in April 2004), the growth rate of GDP in 2004 will be 6.4 percent, of industrial production 5.9 percent, of agriculture 3.0 percent, of investments in fixed capital 11.5 percent, and of inflation (in terms of CPI) 10.0 percent.

3.5 Summary and Risks

After reviewing the recent macroeconomic developments of the APEC region, in this chapter, we evaluated the future prospects of the APEC economy as well as the global economy. We confirmed strong forces for broad-based economic recovery in the APEC region and its sustainability. In addition to robust consumption growth, increasing capital spending has been a major engine of the recent recovery in most member economies. Rapid growth of trade among economies has accelerated world economic growth. These factors constitute the background of recent self-sustaining world economic growth. Although some economies suffered from declining growth momentum during the second quarter of 2004, the world economy is advancing basically along the path of an unyielding recovery. As the US and Asian economies will lead world economic growth, GDP growth rates in the APEC region are expected to register about 4.5 to 5.0 percent and 3.5 to 4.0 percent in 2004 and 2005, respectively. Reflecting the strong growth in domestic demand of major economies, world trade will grow strongly this year and next. According to OECD forecasts, world trade volume will grow 8.6 percent and 10.2 percent in 2004 and 2005, respectively. Against such positive economic prospects, we have some headwinds that may hinder vigorous economic growth in the APEC region.

The most worrying headwind is the uncertainty surrounding the world oil market and the possibility of rising oil prices. Since early last year, rapidly rising in oil prices have reflected the “terror premium” in oil prices by geo-political factors in the Middle East. Early in 2004, the world petroleum markets hinted at the possibility of a supply shortage of crude oil, bringing about a hike of oil prices up to around US$50 per barrel for West Texas Intermediate (WTI). This possibly foreshadows a bad scenario for the development of the oil market and the possibility of another oil crisis and economic recession. According to the experience of recessions in the post-war period, most recessions were preceded by large increases in crude oil prices. Although many analysts pointed out why the recent levels of oil prices are unlikely to do serious damage to the world economy, higher oil prices could bring about world economic difficulties. First of all, higher oil prices may causes inflationary pressure. A rise in the price of petroleum, the most important raw material for industrial production, would raise the production costs of most goods and services and generate inflationary pressures of the economy, especially in oil importing economies. Then a resurgence of price and wage inflation could, in turn, trigger a tightening of monetary policy in most economies. Therefore the production level would be subdued, more or less, via tight credit conditions and a reduction in real incomes would be caused by the rising inflation. Also oil-importing economies would suffer a deterioration in their balance of payments due to the higher bill for oil imports. As the focus is placed on the effects of higher oil prices in the APEC region, oil-importing member economies would be hit hard from the higher oil price. A high oil price would be beneficial to oil-exporting member economies such as Indonesia, Brunei Darussalam, and Russia in terms of higher export earnings of oil. Due to the possible world economic downturn, however, even oil-exporting economies would be hurt by diminishing external demand for their own products including oil.

Another headwind is the stubbornly widening global imbalances, and trans-Pacific imbalances amongst APEC members. Considering the differences in the strength of domestic demand, the imbalances are not expected to narrow in the near future. In the APEC region, domestic demand is strong in the economies that already have large external deficits on their current accounts. Large external deficits in leading economies could restrict their ability to maneuver to support the sustainability of the global economic recovery. One way to reduce the current account imbalances is to narrow domestic imbalances. In the case of the US, presidential candidates say that they would cut the fiscal deficit by half over the next four years. Realization of these proposals would imply the possibilities of cooling down the growth momentum in globally as well as in US Greater exchange rate flexibility would help address current global imbalances. For this reason it is noteworthy that while in Washington for the recent G-7 meeting the senior Chinese leadership reaffirmed their commitment to push ahead "firmly and steadily toward a market-based flexible exchange rate.”

There is also an increasing possibility of rising interest rates, initiated by monetary authorities in the context of a cyclical peak of economic growth and soaring energy costs. Although there is little possibility of raising interest rates in the near future, the room for monetary easing by major central banks is much diminished. Also the fiscal stimuli for economic growth have, in most economies, run its course during the past two years. However not many more stimulating measures can be expected from fiscally over-stretched major economies such as the US, Japan, and China. Their budget deficits cannot be expected to increase. In general, there is little room for policy maneuver to supporting economic growth.

CHAPTER TWO:

FREE TRADE AGREEMENTS/REGIONAL TRADE AGREEMENTS (FTAS/RTAS) IN THE ASIA-PACIFIC REGION

CHAPTER TWO:
FREE TRADE AGREEMENTS/REGIONAL TRADE AGREEMENTS (FTAS/RTAS) IN THE ASIA PACIFIC REGION

EXECUTIVE SUMMARY

Chapter 2 of the *2004 APEC Economic Outlook* deals with the issue of the continuous growth of Regional Trade Agreements (RTAs) in the APEC region. Developed under the framework of Article XXIV of the General Agreement on Tariffs and Trade (GATT), all existing and proposed RTAs declare themselves to be WTO-consistent. Essentially this means they comply with Article XXIV of the GATT and Article 5 of the General Agreement on Trade in Services (GATS).

The continuous growth of RTAs led to a discussion regarding the benefits and disadvantages they might impose on both the welfare of the region and the achievement of the goals set out by all APEC economies. Such a discussion is important because APEC is perceived as the only regional grouping that is completely WTO-consistent in both letter and spirit and, although APEC has an informal structure and serves as a consultative, non-negotiating body whose decisions are not legally binding, APEC members have agreed to pursue the Bogor goals of free trade and investment by 2010/2020. Acceptance of these goals implies that APEC economies engaging in RTAs are committed to remove barriers to trade on a most-favored-nation basis by 2010/2020. In addition, APEC's *Osaka Action Agenda* proposes a form of open accession by extending, on a voluntary basis to all APEC economies, the benefits derived from reductions and elimination of trade barriers in any sub-regional arrangements.

In this context, Chapter 2 examines a number of different trade issues that might hinder or help the achievement of the aforementioned goals. It discusses the ideas and policies associated with RTAs, such as: open regionalism; building blocks; hub and spoke; and public goods, and their relation to APEC-specific issues such as Pathfinder Initiatives. It then deals specifically with other RTA-related issues such as the current status of, and future prospects for, RTAs, trade coverage, actual liberalization, net trade diversion effect, and the 'spaghetti bowl' effect.

Following such a wide, theoretical and practical background, Chapter 2 then investigates some practices in RTAs and assesses their convergence with APEC trade issues such as rules of origin, trade in services, investment, competition policy and trade remedies. These issues are then analyzed specifically to find out how they are dealt with: from a general perspective; in RTAs in general; in RTAs in the APEC region; and by APEC itself.

Finally, Chapter 2 proposes some tentative conclusions, such as:

- APEC stimulates the interaction of economies to move towards RTAs, even if that is not its intention;
- APEC should stress the need for achievements to become available on an MFN basis;
- efforts should be made to minimize the effects of possible trade-distorting practices, such as in the rules of origin;
- a mechanism should be developed for cooperation;
- liberalizing trade in services requires the removal, modification, or nondiscriminatory application of national regulatory mechanisms;
- larger markets resulting from RTAs attract greater FDI; and
- RTAs may expand provisions on competition policy beyond WTO disciplines.

However, besides the aforementioned and other direct measures and effects that result from RTAs, a number of other trade disciplines and practices are enhanced through the existence of RTAs. These include customs procedures, application and knowledge of technical standards, sanitary and phytosanitary measures, intellectual property protection and incentives.

1. INTRODUCTION

The continuous growth around the world of Regional Trade Agreements[1] under the framework of GATT's article XXIV, has fueled the discussion about their benefits and disadvantages.

The APEC forum is perceived as the only regional grouping that is completely WTO-consistent in both letter and spirit. Despite its informal structure APEC serves as a consultative, non-negotiating body whose decisions are not legally binding. It has been argued that, from its inception, one of the underlying principles behind APEC has been to exert a strong, positive influence on the future evolution of the global trading system.

In this context the Bogor goals of free trade and investment by 2010/2020 imply that APEC economies engaging in RTAs are committed to remove barriers on an MFN basis by those dates[2], and the *Osaka Action Agenda* proposes a form of open accession by extending, on a voluntary basis to all APEC economies, the benefits derived from reductions and elimination of trade barriers in sub-regional arrangements.

All existing and proposed RTAs/FTAs declare themselves to be WTO-consistent. Essentially this means complying with Article XXIV of GATT and Article 5 of GATS. Although there has been no concrete consensus among WTO members as to how to define the precise meaning of the requirements of Article XXIV, most RTAs/FTAs will be WTO-consistent so long as they adhere to the spirit of trade liberalization under WTO guidelines. In fact, in most instances, the scope of RTAs/FTAs is WTO-plus, meaning that the terms and guidelines within the agreements are more favorable than those of the WTO.

As a result, RTAs/FTAs that follow the framework of Article XXIV of GATT's are not necessarily homogeneous in many of their provisions. This non-homogeneity is even more likely for those issues for which the WTO has still not reached agreements at a multilateral level, such as rules of origin, investment and services, competition policy and trade remedies. These are the issues which will be addressed in this article.

Another perspective was presented by researchers at the International Economic Outlook Symposium, held in August 2004, in Santiago, Chile. According to their perspective, there are other characteristics of RTAs/FTAs that could lead to a favorable negotiating environment for all APEC economies and, afterwards, in WTO negotiations. These different perspectives both refer to the relationship between trade and cooperation that has been implemented in some RTAs/FTAs, thereby contributing to the supply of public goods as defined in economic theory. The relevance of this issue is even greater given its affinity with the APEC processes, where cooperation is a fundamental instrument in facilitating and liberalizing trade in the region, especially considering the economic and cultural differences of member economies.

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[1] A number of names have been given to integration agreements by the bibliography referring to them. WTO refers to them as regional trade agreements (RTAs), due to the fact that, initially, it was estimated that economies that had geographical proximity would undertake these agreements. However, these have also been called free trade agreements (FTAs) due to the trade liberalizing nature that is included in these agreements by economies that have no geographical proximity. Finally, given the preferential nature of these sorts of agreements, they have also been referred to as preferential trade agreements (PTAs). Onwards, this paper will refer to trade agreements as RTAs/FTAs between members of APEC or with non-APEC economies that include tariff and non-tariff provisions in order to reach free trade.

[2] Even though they may give preferential liberalization in the interim to fellow RTA members.

1.1 Open Regionalism

In general economic terms open regionalism is a general strategy to enhance the benefits of regional liberalization without jeopardizing the continued vitality of the multilateral system.[3]

The open regionalism has at least five possible definitions: a) open membership; b) unconditional MFN c) conditional MFN; d) global liberalization; and e) trade facilitation.[4] Alternatives a) to d) refer to tariffs and other traditional trade barriers. The last one, facilitating trade through no-tariff and non-border reforms, is a new focus of the open regionalism and constitutes one of the most important contributions from APEC.

Nevertheless, it should be pointed out that, regarding trade facilitations issues, there is empirical evidence suggesting that the existence of FTAs/RTAs in the region has been successful in achieving progress in regards to open regionalism.

As aforementioned, there are a number of trade disciplines and practices that are enhanced through the existence of FTAs/RTAs, such as customs procedures, application and knowledge of technical standards, sanitary and phytosanitary measures, intellectual property protection and incentives, among others. The application and formulation of these measures could be viewed as non-discriminatory in nature — or at least, they become more practical if applied and formulated on a MFN basis — thus, their updating and the benefits that this implies can also be viewed and perceived on an MFN basis.

1.2 Building Blocks

The question of whether the growth of RTAs/FTAs is a stumbling block or a building block to a more open multilateral system has been raised often.

There is by now a well-developed literature on whether RTAs/FTAs may act as “building blocks” or “stumbling blocks” to the objective of free trade on a global basis and, by implication if not explicitly, on an APEC-wide basis. One conclusion that can be drawn from the literature is that RTAs/FTAs may in fact be either “building blocks” or “stumbling blocks”, depending on their individual characteristics. An important task is to identify the conditions under which each outcome is most likely, thereby enabling measures to be developed for increasing the likelihood that RTAs/FTAs will act as “building blocks” and for reducing the risk that they will act as “stumbling blocks”.

One of the conditions that will allow this to occur is a web of RTAs/FTAs that provide for a free trade area which specifies the terms of accession, symmetry in arrangements, coverage, and the commitment to multilateralize preferential tariff cuts.[5]

It must be pointed out that there is no clear evidence of FTAs/RTAs in the APEC region being “stumbling blocks” to reaching global free trade. In fact, even if there are various elements, such as chapters, that vary among FTAs/RTAs, it has been observed that many agreements, such as those signed by Mexico or Chile, follow common guidelines, have the objective of having no exclusions in trade, and go beyond WTO-accepted trade disciplines. Thus, if these basic elements are followed, the achievement of a web of building blocks enabling global free trade might be possible.

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[3] Kuwayama, (1999). p.9.
[4] Bergsten, (1997) .
[5] Findlay and Pangestu, (2001). p. 19.

1.3 Hub and Spoke

Wonnacott [6] introduced the terminology of hubs and spokes. He described a hub as arising from the decision of an outside economy to form a bilateral agreement with only one member of a multi-member pre-existing RTA. The inside economy is called the hub. This definition of a hub is too narrow. The general phenomenon is one of *intersections* between RTAs. A hub exists where one economy (customs territory) is a member of two distinct RTAs. This is a generalization of the Wonnacott definition.[7]

Intersections or hubs arise in several ways. Hubs may arise when one economy is a member of one (bilateral or plurilateral) RTA and then forms a new bilateral RTA with another single economy outside the original RTA. In such cases, the spokes may be called *bilateral spokes*. Or they may arise when one economy is a member of one (bilateral or plurilateral) RTA and then forms a new bilateral RTA with another RTA. These spokes may be called *plurilateral spokes*. Or hubs may arise when one economy almost simultaneously negotiates bilaterals with a number of economies: for example, Chile. Or they may arise when one economy is a member of more than one plurilateral; for example, Mexico is a member of the NAFTA and of the Group of Three.

Most hubs arise when an economy is a member of one (bilateral or plurilateral) RTA and then forms/joins a new RTA with one or more other trading partners. There are hubs now in all regions of the world economy. Many hubs have multiple spokes. One can measure this effect by counting the number of spokes for each hub, that is, the number of parties with which one hub economy has separate free trade agreements. One can separate bilateral spokes from plurilateral spokes (and from membership in plurilateral RTAs). Many hub economies have a policy of developing numerous spokes.

In the Asia-Pacific region, Singapore, the US, Canada, Mexico, Chile, Peru, Australia, New Zealand and Russia are now hubs on the basis of RTAs/FTAs already in force. [8]

Hub and spoke agreements do not provide equal access to all participants. Even if tariffs were removed along each spoke, the spoke economies would still not have free access to each other's markets. They only have access to the hub. In fact, the extent of access is also likely to vary along each spoke. Nevertheless, the differential treatment could induce spoke economies to pursue RTAs/FTAs with other participants so as to secure free access to each other's markets.

The hub economy gains benefit from the preference it gets in access to each spoke economy, compared to all the other spokes. Also only firms based at the hub can get duty free inputs from each spoke. Other ways in which the hub economy could gain is that it could divert investment from each of the spokes. This is because of the favored position of that economy, which makes it sensible to build a plant there and get access to not just the hub but also all the spoke economies. Furthermore, a firm based in the hub is likely to be able to get more inputs at low or zero tariffs than if it was based in one of the spokes – it can source from the hub and any of the spokes.

1.4 The Pathfinder Initiatives

The common understanding of "Pathfinders" is that RTAs/FTAs are initiatives to which all APEC economies have agreed, but which will initially be implemented by only a subset of APEC members, with other members joining the initiatives at a later date.

If the array of RTAs/FTAs entered into by APEC economies constitutes a form of collective "Pathfinder" initiative, it would be fully consistent with APEC objectives and principles. It also

[6] Wonnacott, (1996). pp. 237-252.
[7] The terminology can be confusing. An economy may be both a hub and a spoke, depending on the economy point of view.
[8] Lloyd, (2002). p.8.

implies that participation in the network of RTAs/FTAs being developed within the APEC region should, over time, become open to all APEC economies.[9]

Alternatively, the web of RTAs/FTAs could also constitute a specific sectoral "Pathfinder" initiative as the commonality of commitments across sectors demonstrates participation of two or more economies in that sector.

1.5 Public Goods

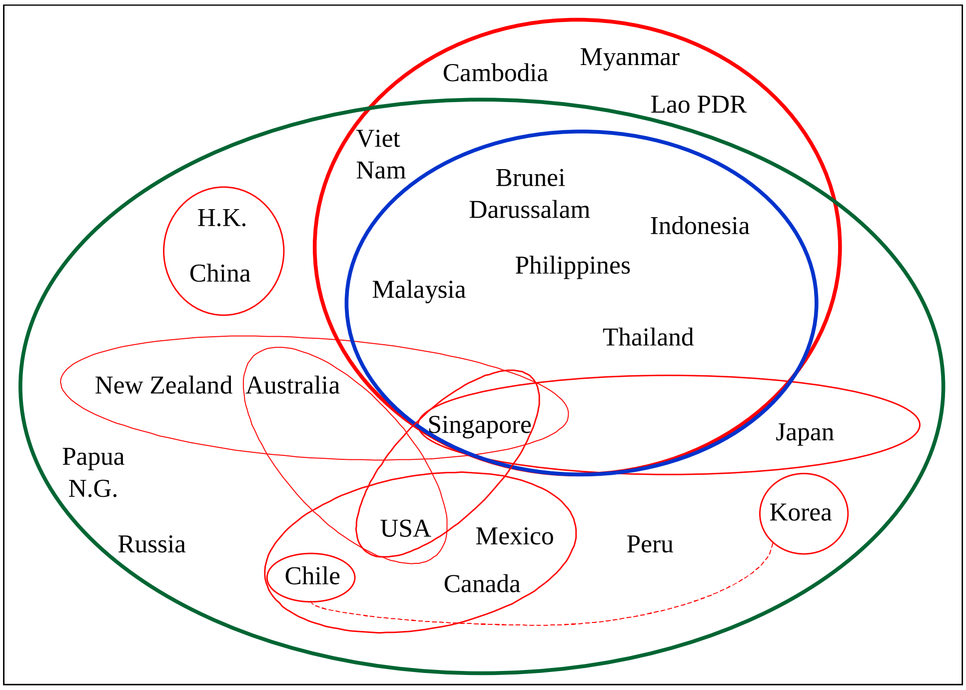
Estevadeordal and Devlin define regional public goods (RPGs) as transnational public goods whose non-rivalry and non-exclusive properties extend beyond national borders, but are contained in a well defined set of states or a geographical region. For example: cleaning up a lake; a transnational park; preserving a rain forest; prevention or mitigation of natural disasters; reducing acid rain; power grids and other energy projects; airport hub-spoke networks; transportation infrastructure; transnational diseases; agricultural and other research; and policy standards (financial; labor; etc.). A formal regional integration agreement (RIA) such as a free trade area or a customs union should also be considered as another type of RPG.[10]

2. CURRENT STATUS AND FUTURE PROSPECTS FOR FTAS IN THE APEC REGION

According to WTO data, as of 1 May 2004 there are 53 partial scope agreements and 155 GATT Article XXIV FTAs. However, the requirements met by these agreements are not always the same. For example, many agreements are not notified to the WTO, not all the negotiations are made public, and national requirements for approval and implementation can vary between economies. In addition, there is not enough information about dynamic effects on trade liberalization and available information focuses mainly on trade data, paying less attention to other aspects of an agreement, like investment and transparency.[11] Current FTAs are as indicated by Figure 2.1.[12]

[9] Scollay and Gonzales Vigil, (2003). p.13
[10] Devlin and Eztevadeordal, (2002). p. 7.
[11] Van Grasstek, (2004).
[12] Due to the date of issue of some of the bibliography used in this paper, some FTAs/RTAs currently in force might have been excluded from Figure 2.1, such as the Japan – Singapore FTA (concluded) and the Japan – Mexico FTA (signed).

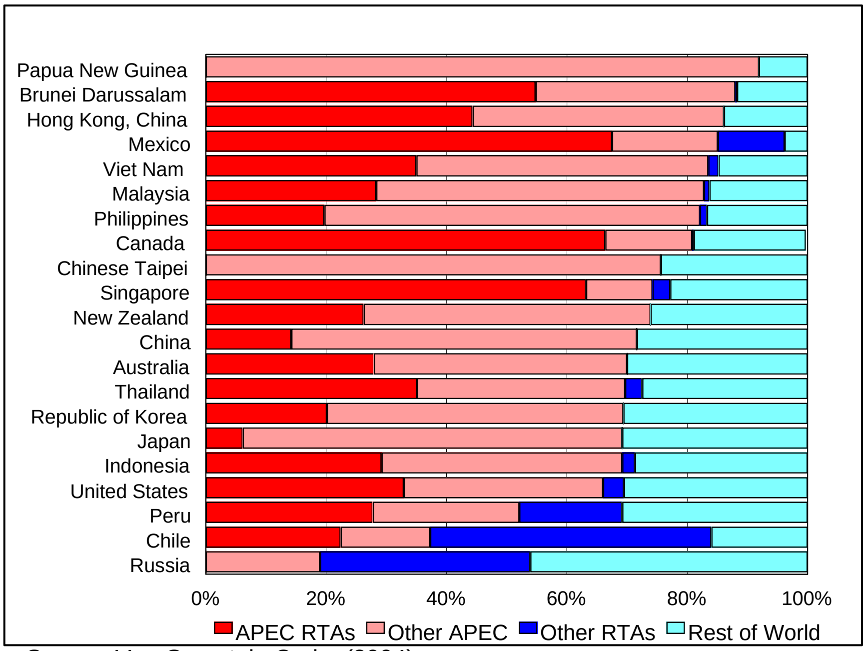
Figure 2.1: Current RTAs/FTAs in the APEC Region



Source: Van Grasstek, (2004)

The numerical evidence of import flows observed in APEC economies, whether these are derived from FTAs or not, between APEC economies or outside APEC, is summarized in Figure 2.2.[13]

Figure 2.2: Overall Breakdown of Imports: APEC Economies



Source: Van Grasstek, Craig. (2004).

[13] Van Grasstek, (2004).

This information, on the one hand, suggests/indicates that the most integrated economies (through FTAs) are Canada, Singapore, and Mexico; and, to a lesser extent, Brunei Darussalam.. However, in the case of Canada and Mexico, a large portion of their trade is within North America. Chile is an interesting case: although this economy is very actively integrating through FTAs in the region, (Mexico, the US, Canada and Korea), or PTAs (Peru), the diversification of its trade translates into a relatively small portion of APEC's trade covered by FTAs.

On the other hand, other APEC economies such as Russia, Papua New Guinea and Chinese Taipei have not generated any trade through FTAs. China and Japan deserve special attention due to their regional and global importance.

It is noteworthy to observe the import structure of Chile, which has been an active economy with regard to regional agreements, efficiently utilizing the comparative advantages of a number of economies, both within and outside APEC.

2.1 Integration Trends in East Asia and the Americas

In terms of FTAs, East Asia has fewer FTAs than other major regions like the Americas or the EU. Amongst all the existent RTAs/FTAs, East Asian economies are involved in 8 FTAs, 3 preferential agreements and 8 services agreements. Among the FTAs, apart from the China/Hong-Kong, China and China/Macao Closer Economic Partnership Arrangements, the only FTA concluded between East Asian economies is the Japan/Singapore FTA..

Table 2.1.1 FTAs/RTAs in APEC involving East Asia Economies
(Negotiations concluded)

FTAs	Preferential Arrangements	Services Agreements
Singapore-New Zealand	Bangkok Agreement	Singapore-New Zealand
Japan-Singapore	Laos-Thailand	Japan-Singapore
Japan-Mexico	AFTA	Japan-Mexico
EFTA-Singapore		EFTA-Singapore
US-Singapore		US-Singapore
Korea-Chile		Korea-Chile
China-Hong Kong, China (1)		China- Hong Kong, China (1)

Notes:
1. Closer Economic Partnership Arrangement;
2. Not notified to the GATT/WTO
Source: *Lee (2004)*.

Nevertheless, in recent years, East Asian economies have begun to establish regional trade through RTAs/FTAs, due to factors such as: larger markets, economies of scale, more competitive environment for local firms, and political motives. Additionally, these economies have the objective of raising their bargaining power in the international arena, including multinational trade talks and negotiations with international financial institutions. Finally, strategic reasons in regional economic integration should not be underestimated.[14]

The provisions contained in some FTAs negotiated by APEC member economies are given in Table 2.1.2.

One of the noteworthy aspects of the provisions included in Table 2.1.3 refers to the accession clause for non-parties of an FTA. None of the FTAs referred to in the table contain such a provision, considering it is argued that this provision is necessary in order to achieve the *Osaka Action Agenda*. Furthermore, this may mean that a FTAs/RTAs network could to become a "stumbling block".[15]

[14] Lee, (2004).
[15] Some comments about this issue are addressed in pages 1, 6 and 7 of this paper.

Table 2.1.2: Provisions in some RTAs/FTAs

Chapters/Agreements	**CHL-ROK**	**JPN-SIN**	**CDA-CHL**	**CHL-USA**
Initial Provisions	✓	✓	✓	✓
General Definitions	✓	✓	✓	✓
National Treatment and Market Access for Goods	✓	✓	✓	✓
Rules of Origin Procedures	✓	✓	✓	✓
Customs Administration	✓	✓	✓	✓
Sanitary and Phytosanitary Measures	✓			✓
Technical Barriers to Trade	✓			✓
Trade Remedies	✓		✓	✓
Government Procurement	✓	✓		✓
Investment	✓	✓	✓	✓
Cross-border Trade in Services	✓	✓	✓	✓
Financial Services		✓	✓	✓
Telecommunications	✓	✓	✓	✓
Temporary Entry for Business People	✓	✓	✓	✓
Electronic Commerce	✓	✓		✓
Competition Policy, Designated Monopolies and State				
Enterprises	✓	✓	✓	✓
Intellectual Property Rights	✓	✓		✓
Labour				✓
Environment				✓
Transparency	✓		✓	✓
Administration of the Agreement	✓			✓
Dispute Settlement	✓	✓	✓	✓
Exceptions	✓		✓	✓
Final Provisions	✓	✓	✓	✓
Accession Clause				

Source*: Lee, (2004).*

Lee (2004)[16] suggested that current Asia-Pacific integration has some policy implications:

a) ASEAN and Korea should play a facilitator's role by pursuing an active FTA policy. Korea should form an FTA with Japan, China, and ASEAN as well as the US and other APEC economies;
b) The Japan-Korea FTA is high quality. It contains comprehensive elements, great market access for goods and services, simple rules of origin and an accession clause;
c) The Japan/Korea FTA must be assessed by taking into consideration that it will be open to other East Asian Economies and/or that it could serve as a template for other East Asian FTAs;
d) Keep the Bogor goals in mind;
e) Strong interest groups in Japan and Korea could utilize, both internal and external competition to overcome domestic politics; and
f) APEC should assume a more active role in linking FTA movements with the Bogor goals.

[16] Lee, (2004).

In the same way as integration in East Asia is progressing, there is evidence of this trend occurring in Latin America and the Caribbean (LAC), which has shown a drastic shift from an intra-regional standpoint (South-South),[17] to an ever-growing interest for inter-regional agreements (specially, North-South).

The hub-and-spoke process of regionalism implemented in the Americas has been leaded by two APEC economies: Chile and Mexico. These economies are at the forefront transforming themselves in true FTAs "semi-hubs".

Table 2.1.3. shows additional information that allows for a comparative analysis of the magnitude of the trade in South-South integration. This table indicates that the block of developing economies in Asia (DA) accounts for the largest volumes of trade in the region (US$465 billions), and the largest share of this trade are between developing economies in Asia themselves (US$374 billions).

Table 2.1.3: Size of South-South Trade: Average of 2000-2002
(US dollars billion; percentage)

2000-2002	**LAC**	**CEE**	**Africa**	**ME**	**DA**	**S-S-T**	**Growth 1990-2002**
Latin America and the Caribbean (LAC)	58.5	3.0	3.6	3.8	14.8	**83.8**	**7.5**
Central and Eastern Europe[a] (CEE)	4.8	53.3	2.3	4.4	14.4	**79.2**	**-1.2**
Africa	4.7	0.8	11.2	3.3	18.3	**38.3**	**9.4**
Middle East (ME)	3.2	1.9	9.8	15.8	72.0	**102.7**	**7.7**
Developing Asia (DA)	27.5	14.7	18.4	30.9	374.0	**465.5**	**11.9**
South-South Trade (S-S-T)	**98.8**	**73.7**	**45.3**	**58.2**	**493.5**	**769.5**	**8.0**
Share of Region in Total World Exports							
In 1990	**1.3**	**2.9**	**0.6**	**0.7**	**3.9**	**9.4**	
In 2002	**1.5**	**1.2**	**0.7**	**1.0**	**8.0**	**12.5**	

Source: ECLAC, International Trade and Integration Division, based on data of WTO.
[a] Includes Russia

Table 2.1.3 also shows the growth rate in the share of intra-regional trade for each South-South block in terms of total global trade between 1990 and 2002. From this perspective, a growth of 4 percent in the share of intra-DA trade from a world total should be pointed out.

The reasons that might justify the process observed in DA, could be explained through cultural, social and structural patterns that aid trade and that have generated economies based entirely on businesses.

Kuwayama argued, at the 2004 APEC International Economic Outlook Symposium, that regional integration initiatives in DA had been led, mostly, by a common interest of augmenting trade flows with the United States, which has been achieved successfully.[18]

2.2 Costs and Benefits of RTAs/FTAs

The evidence demonstrates that current RTAs/FTAs may be North-North, North-South, and South-South, and different motivations may apply in each case. An important motivation for North-North agreements may be to capture the dynamic gains potentially available from economies of scale and increased competition through intra-industry trade in technologically dynamic markets. Similar motivations may apply in North-South agreements, but North-South agreements are also much more likely to offer potential for the conventional gains from inter-industry trade based on

[17] Some authors used 'South-South integration' not only for those arrangements between southern hemisphere economies but also between developing economies.
[18] Kuwayama, (2004).

differences in comparative advantage. Developing economies are also likely to pursue agreements with developed partners to safeguard vital export markets that they perceive to be vulnerable. South-South agreements may be pursued by developing economies as a way of developing potential export markets for value-added products in situations where they face difficulty in penetrating developed economy markets for these products due to the well-known phenomena of peak tariffs and tariff escalation.[19]

Sometimes, there may not be enough quantitative evidence to support commercial reasons for negotiating a free trade agreement. A good example of this is the decreasing MFN tariff in the US, which is now approximately 2 percent. In this case there are few commercial benefits from negotiating an FTA like the one between the US and Singapore. However, a report by the US ITC on the US/Singapore FTA (USSFTA) noted that, although the gains to US in terms of tariff reduction are negligible, the US will benefit in terms of services trade liberalization, trade and investment facilitation, etc, which is, unfortunately, difficult to quantify. Hence, assessing the benefits of an FTA by just looking at the level of tariff reduction could seriously underestimate the true economic potential of such agreements.

Another example of an FTA incentive is the Chilean experience which indicates that joining/forming an FTA is useful in trying to reach the higher levels of certainty and safeguarding of commercial interests that are a must for a small economy that has little bargaining power.[20]

Even though, each economy that has subscribed to an FTA argues about the benefits and reasons for having undertaken the process, specialized bibliography on this issue is extensive in showing the benefits and costs that FTAs/RTAs might have for parties (and non-parties) to an agreement.

As a first step, it is argued that APEC economies have understood that FTAs are easier to sell at home than MFN liberalization. On the one hand, the benefits of MFN are more diffuse, on the other hand, an FTA's bilateral benefits are more specific, and their political costs are easier to manage.[21]

Developing economies have also used the argument of capacity building for choosing the preferential route compared with the multilateral process. For example, ASEAN economic cooperation was often seen as a "training ground" for competition in the wider global market and to enhance the capacity and experience of policy makers.

From the perspective of economic analysis, RTAs/FTAs represent a "second best" approach to liberalization. From the perspective of policymakers they represent a "pragmatic" approach that tends to proceed on the assumption that some liberalization is better that none at all.

In addition, many economies, including those in East Asia, believe that GATT/WTO rules cannot adequately deal with rising phenomena such as FDI, trade in services, and the increasing mobility of labor. Border measures such as tariffs, which are the main focus of GATT/WTO, cannot provide foreign as well as domestic companies with a level playing field. The inherent limits of border measures call for development of rules—such as competition policy—covering domestic systems. Thus, some economies have started using RTAs/FTAs to deal with the problem.[22]

[19] Scollay and Gonzalez Vigil, (2003). p.7.
[20] Matus, (2004).
[21] Findlay, Piei and Pangestu, (2003) .p.11.
[22] Urata, (2003) .p.2.

Text Box. 2.2.1: Chile's Approach to FTAs/RTAs

Chilean foreign trade policy has some basic elements on which it bases its commercial strategy. These elements are:

a) Open economy;
b) Dependent on international trade;
c) Small country;
d) Transparency/Reliable/Legalistic
e) Basic consensus on trade policy

To balance the aforementioned elements and to reach legal certainty alongside trade growth, Chile followed several paths: Multilateralism (WTO); Regionalism, either geographical (APEC, FTAA, LAIA, MERCOSUR etc) or by subjects (CAIRNS, G-20, FAN, FOF etc); and bilateralism.

In order to reduce the inherent economic vulnerability and uncertainty of small economies, Chile has built a web of RTAs/FTAs that safeguard its commercial interests. The main reason to adopt this strategy is the absence of a strong binding structure at the multilateral level.

To this date, Chile has signed 13 FTAs with 47 economies and others are under study or negotiation.

FTAs in force	FTAs under negotiation or study
Mercosur	New Zealand (1)
Venezuela	Singapore (1)
Colombia	India (1)
Ecuador	Brunei Darusalam (1)(2)
Peru	Bolivia (3)
Bolivia	Panama (3)
Canada	Mercosur (UG) (2)
Mexico	Turkey (2)
Central América	Japan (2)
European Union	China (2)
Korea	
EFTA	

Notes
(1) Under negotiation
(2) Ideas
(3) Suspended

One of the advantages of signing several FTAs is that the higher standard prevails in most of the issues negotiated, so that the FTA's members have the chance to explore last generation disciplines that are being negotiated in other FTAs. According to the Chilean point of view, FTAs enhance individual interests in market access issues; reduce external economic vulnerability and help differentiation in a context of international economic turbulence.

Other individual interests that have implications for public goods are: rules and disciplines, dispute settlement and rules to attract FDI.

From a regional public good perspective, the MFN provisions included in some FTAs signed by Chile brought benefits for the entire region. This is the case for commercial disciplines regarding TBT measures, customs procedures and intellectual property rights. RTAs/FTAs bring incentives to improve domestic legislation and also to extend these improvements to other economies on a MFN basis.

Careful study and analysis are warranted to better understand the implications of RTAs, including:

- ***Net trade diversion effect.*** It is important to understand and analyze the balance between the positive effect of trade creation and favorable dynamic effects from the creation of the RTA on the one hand, and on the other hand the negative effects of the diversion of trade from more efficient non-members to less efficient members of the RTA. Empirically the results are not conclusive. Much depends on the assumptions made and the methods used to measure trade creation and diversion. Dynamic effects are difficult to quantify. Some findings are for a positive net trade creation effect while others argue that there has been a serious net trade diversion effect in some cases, such as in North America. **A key finding which is consistent with theory is that trade diversion can be minimized if external tariffs are low and the members become more open by further reducing their external tariffs as they enter into an RTA**. The balance between positive and negative effects could also differ between members and non-members of an RTA. For example, dynamic benefits might outweigh positive effects for members, but non-members might still be adversely affected by trade diversion as a result of their exclusion.

- ***Spaghetti bowl effect.*** A proliferation of overlapping preferential agreements can create a “spaghetti bowl” effect, due to inconsistencies between various elements of the agreements, such as different schedules for phasing out tariffs, different rules of origin, exclusions, conflicting standards, and differences in rules dealing with anti-dumping and other regulations and policies. The more dimensions there are to the new agreements and the more agreements there are, the wider the scope for inconsistencies to emerge. The outcome is essentially that the costs of doing business could increase and further trade diversion effects may potentially arise. [23,24] However, while it is possible that administrative costs may increase with the proliferation of overlapping preferential agreements, there are also substantial gains for businesses from the preferential treatment at the same time. Hence, it will be difficult to measure the overall "spaghetti bowl effect" unless a detailed cost-benefit analysis is conducted.

Apart from low inter-bloc tariffs another parameter which suggests that the risks of a preferential route might be low are high levels of existing bilateral trade. Growth and development in East Asia have led to stronger trade growth and the partners are becoming more important in each other’s trade. The consequence is that they look to further options to extend the relationship. The growth in intraregional trade has not been driven by preferential agreements, but, on the contrary, occurs as a consequence of trade and growth associated with MFN liberalization.[25] On the other hand, RTAs/FTAs are also negotiated based on the balance of interests of the partners. They could result in further cementing of relationships, with a two-way increase in trade and investments flows and other co-operation.

[23] Pangestu and Scollay, (2001) .p.6.
[24] Pangestu and Scollay also believe that there are other implications of RTAs such as its use as a backdoor for sensitive issues, the unbalanced hub-spoke pattern of regional agreements, the diversion of attention and resources, and the potential regional tensions.
[25] Pangestu and Scollay, (2001).p.8.

Text Box 2.2.2: Framework for a Comprehensive Economic Partnership between ASEAN and Japan[26]

Measures for a Comprehensive Economic Cooperation/Partnership	**Outlines 3 measures by which the ASEAN-Japan CEP will be realized: measures for immediate implementation; facilitation and cooperation; liberalization.**
Measures for Immediate Implementation	Identifies 7 activities that could provide immediate benefits on an accelerated basis. These include, among others: technical assistance and capacity building to ASEAN; trade and investment promotion and facilitation measures; trade and investment policy dialogue; and measures to facilitate the mobility of business people.
Facilitation and Cooperation	Provides that ASEAN and Japan shall conduct consultations from the beginning of 2004 on areas of facilitation and co-operation, and develop work programs for the expeditious implementation of measures or activities in: trade-related procedures; business environment; intellectual property rights; and other areas of co-operation, including energy, information and communications technology; human resource development; small- and medium-size enterprises; standards and conformance and mutual recognition arrangement, among others.
Liberalization	Features the following key provisions: (a) ASEAN and Japan will start consultations on the ASEAN-Japan CEP on the liberalization of trade in goods, trade in services, and investment, from the beginning of 2004; (b) they will initiate a negotiation on the CEP Agreement as a whole, taking into account the achievements in bilateral negotiations between ASEAN member economies and Japan; and (c) ASEAN member economies which have not concluded bilateral Economic Partnership Agreements (EPA) with Japan will negotiate concessions bilaterally.
Most Favored Nation Treatment	Provides that Japan will continue to extend MFN treatment, on a reciprocal basis, to ASEAN member economies, which have not acceded to the WTO.
General Exceptions	Provides that nothing in the Framework shall prevent any of the parties from adopting or enforcing measures for: (a) the protection of the national security; (b) the protection of articles of artistic, historic and archaeological value; or (c) other measures deemed necessary to protect public morals or to maintain public order, or to protect human, animal or plant life and health.
Consultation	Consultation Provides that differences in the interpretation or implementation of the Framework shall be settled amicably by consultations and/or mediation.
Timeframes	Parties will: (a) start consultations on the ASEAN-Japan CEP on the liberalization of trade in goods, trade in services and investment, from the beginning of 2004; (b) will make maximum efforts to commence the negotiation on the CEP Agreement between ASEAN and Japan as a whole from the beginning of 2005 and conclude negotiations as soon as possible; and (c) complete the implementation of the measures for the realization of the ASEAN-Japan CEP, including elements of a possible free trade area, as soon as possible by 2012, including following additional 5 years for newer ASEAN members.
Institutional Arrangements for the Framework	The ASEAN-Japan Committee on Comprehensive Economic Partnership (AJCCEP) will carry out work set out in the Framework.

[26] SOM Policy Dialogue on FTAs/RTAs. Submission by ASEAN members, Pucón, Chile, May 2004.

2.3 A Regional Public Goods Perspective on FTAs/RTAs

From the perspective of open regionalism, or even from a multilateral perspective, the growth of FTAs/RTAs can bring important additional costs such as the ones already described. However, other characteristics of certain FTAs/RTAs should be analyzed, since if they are to be incorporated or considered in wide ranging fora where members have a wide range of cultural and economic backgrounds, such as APEC and WTO, as a way for them to become a regional public good (RPG).

An important point about this issue is that since RPGs cannot be supplied by various governments acting unilaterally, economies need to cooperate in their provision. In this context, cooperation will usually require an agreement of some kind, supported by a variety of institutional arrangements.

With this in mind, it has been seen that the implementation of FTAs could help in the creation of RPGs through the establishing of formal structures of supervision and by generating the need for cooperation in order to take full advantage of bilateral and regional trade potential.

In other words, it is argued that an FTA network, setup in accordance with the economic interests of its members, could serve as the basis for forming cooperation links that could aid in developing the capacities of an economy. Thus, the costs associated to the "spaghetti bowl effect" could be compensated for.

Therefore, new aspects of trade negotiations in FTAs could develop provisions that include RPGs as additional elements in the negotiations and procedures for technical assistance or compensation mechanisms.

It is estimated that the creation of RPGs is better than the creation of global public goods (GPG) due to evident reasons: economies in a regional group have greater homogeneity, scale economies and lower constraints due to asymmetric information.[27]

Regional integration should tackle several dimensions of "deep integration" in a context of "open regionalism" by way of enhancing the provision of regional public goods. This involves reducing tariff dispersions and non-tariff barriers, and addressing "behind-the-border" measures, while harmonizing regulatory regimes, improving infrastructure (e.g., transport, communications, cooperation in energy via regional interconnection, and ports), and strengthening dispute settlement mechanisms. As this paper noted, the harmonization of rules among the member economies on certain areas such as services, investment, rules of origin, anti-dumping, safeguards, and competition policy, among others,[28] should enhance the systemic competitiveness of each economy and the region as a whole. In addition, this approach to integration requires the adoption of agreements that will contribute to macroeconomic stability and productive development in each economy. Therefore, Government provision of many of these public goods is a key factor in enhancing regional competitiveness.[29]

In this way, RTAs/FTAs may reduce competition among regional members that may otherwise inhibit an efficient provision of RPGs. Also, FTAs/RTAs can act as intermediaries in global networks contributing to a more optimal provision of GPGs, understanding these would be generated within a WTO context.

[27] In this regard, Kuwayama suggests that it is vital for LAC to revisit the issue of the nexus between trade and cooperation in trade agreements from the perspective of RPGs as a vehicle for further regional integration.
[28] Like intellectual property rights, sanitary and phyto-sanitary measures, customs procedures, and factor mobility.
[29] Kuwayama, (2004). p.22

One of the proposed ways of creating RPGs through the formation of FTAs/RTAs is through the use of two new "technologies" [30] in regional integration agreements. The first refers to trade and the second to cooperation.[31]

Trade technology (T), has two basic characteristics:

- Its depth regarding contents; and
- Selection of partners.

a) The depth in regards to contents has been seen through automatic schedules for regional trade liberalization with limited negative lists instead of laborious positive lists. Free trade objectives also incorporate new issues as services, investment, intellectual property, dispute settlement mechanisms and consistency with GATT/ WTO rules.

b) In terms of selecting a trade partner, refers to the growing interest of forming North-South integration agreements, instead of the traditional South–South or North–North scheme.

c) Cooperation technology (C) can be seen through coordinated efforts of economies that have the objective of a general good, thus resulting in benefits for all, including non-parties to an agreement.

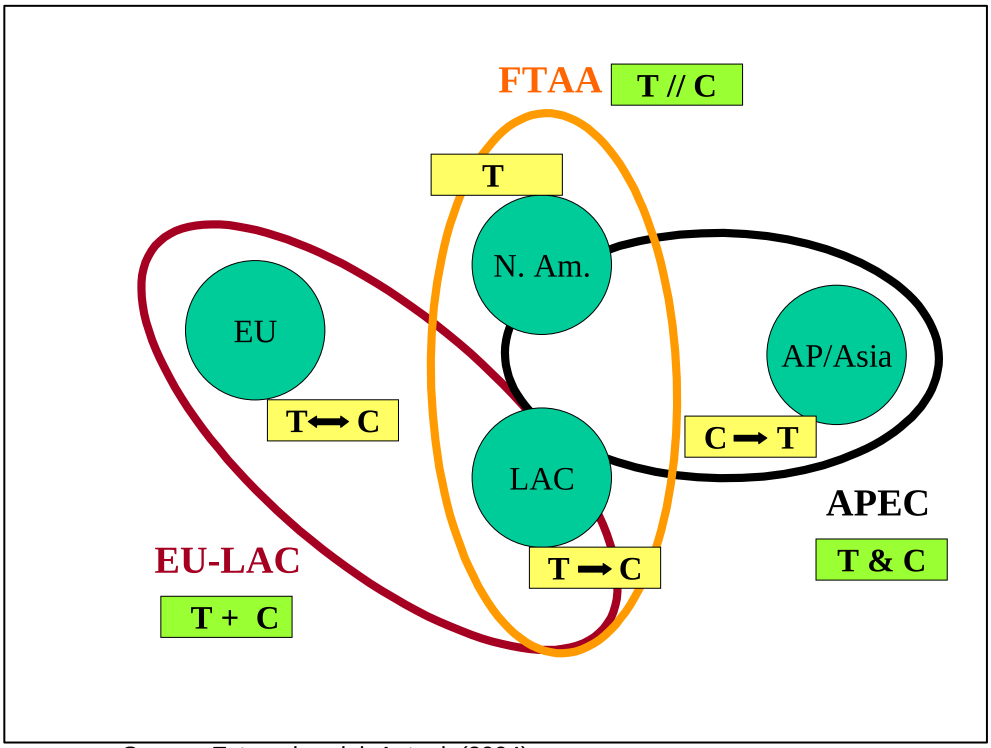
The importance of these two integration technologies is based in the way links are generated between them. Among the links are: (i) trade alone [T]; (ii) cooperation alone [C]; (iii) trade and cooperation jointly but as separate processes [T + C]; (iv) trade and cooperation together in a single and integrated process [T & C]; (v) trade precedes cooperation [T -> C (or T + C)]; (vi) cooperation precedes trade [C -> T (or C + T)]

One would expect that when economic integration is launched with the far-reaching objectives of a common market (common external tariffs and free movement of the factors of production) or more, the agreement will not only anticipate regional free trade, but also systematic cooperation in trade related and non-trade areas, thus creating a trade and cooperation nexus (T+C). This approach may save costs associated with negotiations, as well as development and administration of the cooperation programs. However, it also runs the risk of getting bogged down with a large number of complex issues.

[30] Estevadeordal calls the different forms that FTAs/RTAs negotiations that contain trade and cooperation provisions take, "technologies".
[31] Devlin and Estevadeordal, (2002).

As it is argued, current FTAs/RTAs present links between trade and cooperation as shown in Figure 2.3.1.

Figure 2.3.1: Trade and Cooperation Models

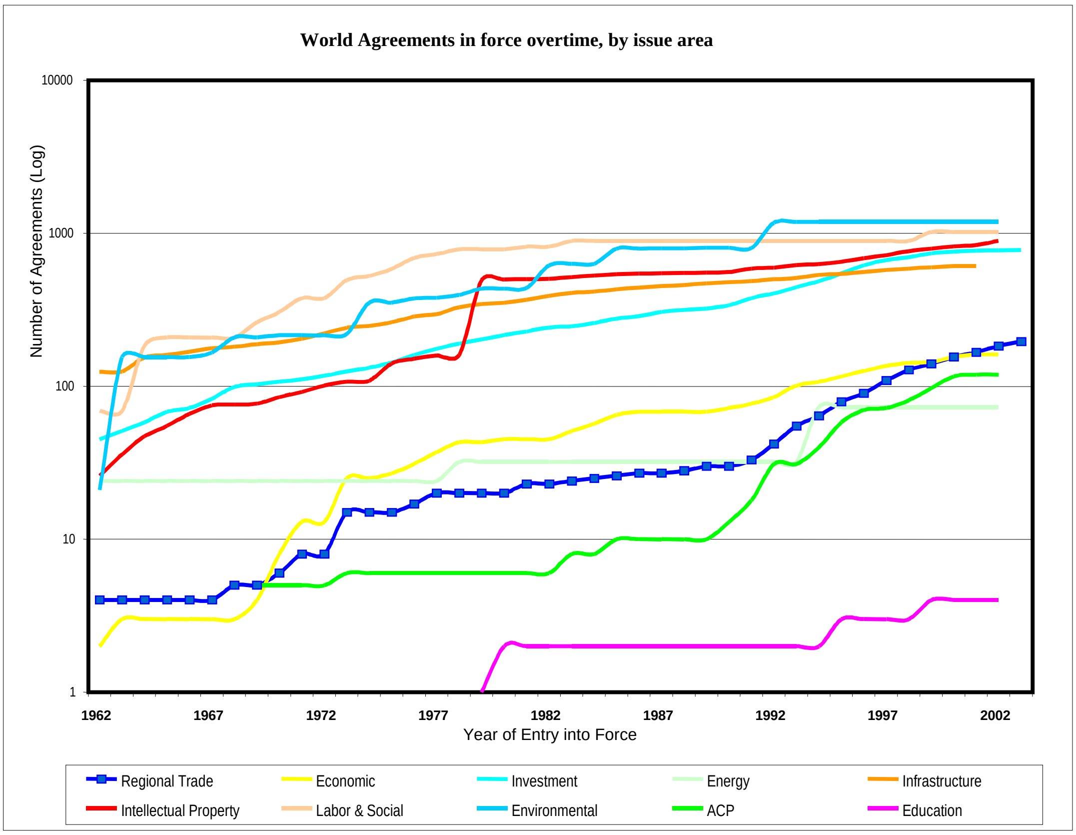


Source: Estevadeordal, Antoni. (2004).

Figure 2.3.2 indicates the growing trend in cooperation areas vis-à-vis FTAs growth.

Estevadeordal argues that an FTA without cooperation elements limits its depth and scope, so he suggested the incorporation of these kinds of provisions in FTAs/RTAs, so that they go beyond commercial issues (T).

Figure 2.3.2: RTAs and Regional Cooperation Facts



Source: Estevadeordal, (2004)

In the APEC context, where Asian and American cultures widely differ, (Asia business-oriented vis-à-vis America rules-oriented) special attention is required to trade and cooperation processes. From this perspective, it is not clear, within the "Pathfinder initiatives", that the implementation of only trade provisions would move the APEC process to FTAs.[32]

Text Box 2.2.2 shows how APEC's member economies have understood regional integration. They incorporate cooperation issues oriented to business facilitation and grant MFN benefits to ASEAN members although some individual members might not be WTO members.

[32] Estevadeodal (204).

3. SOME PRACTICES IN FTAs AND ITS CONVERGENCE WITH APEC

The discussion undertaken at APEC referring to the treatment of certain issues at a bilateral level, specially how existing FTAs/RTAs, could eventually facilitate the achievement of the Bogor goals, could be aided by evidence that will be presented, referring to some particular issues.

The bibliographical compilation performed at the 2004 APEC International Economic Outlook Symposium envisaged the treatment in FTAs of four specific issues: rules of origin, investment and services, trade remedies and competition policy. The observations made on how the discussion on these issues at a bilateral level and their consequences in terms of incrementing and facilitating trade could hand over, in accordance to what has been under discussion in APEC, certain indications on how these ‘practices’ could help the objectives of APEC and, consequently, substantial improvements at WTO.

3.1 Rules of Origin

Rules of origin (ROO) provisions are a feature of virtually all RTAs around the world. The APEC forum is a prominent exception, with its members employing their respective domestic ROO.[33] APEC is based on a principle of open regionalism—extending tariff preferences on an MFN basis—which renders the need for preferential ROO obsolete.[34]

Regarding the type of ROO negotiated in FTAs/RTAs within the APEC region, it has been observed that in most cases agreements follow specific rules of origin, even if they might have general rules as a general discipline.[35]

The complexity and stringency of ROO employed in RTAs has given rise to concerns over the diversionary effects that ROO may have on trade and investment flows. More generally, the often dauntingly complex ROO have led analysts to question the extent to which RTAs can create trade, boost welfare, and serve as stepping-stones in the march toward global free trade. From a legal standpoint, preferential ROO are feared to breach Article XXIV of the General Agreements on Tariffs and Trade (GATT), which in paragraph 8(b) defines a free trade area as “a group of two or more customs territories in which the duties and *other restrictive regulations of commerce*...are eliminated on *substantially all* the trade between the constituent territories in products originating in such territories.”[36]

ROO can affect trade by inflicting two types of costs—production and administrative costs. Both of these costs can introduce a protectionist bias. Production costs arise from the various technical criteria imposed by the ROO regime. In theoretical terms, a ROO-less RTA could be expected to result in dramatic changes in trade patterns due to increased transshipments through the economy with the lowest tariff: without ROO, an RTA would be highly liberalizing given that the lowest tariff would apply to each import category.[37] However, in the presence of stringent ROO, the potential for an RTA to boost trade between the members will likely be moderated by the rise in the cost of inputs for the intra-RTA final goods producers—which decreases the production of final goods and lowers the final goods’ producers derived demand for intra-RTA inputs, undercutting intra-RTA trade in both inputs and final goods. The costs of production may be compensated by the fact that ROO are formulated on the basis of the Harmonized System, which was not designed with a consideration for the determination of origin.

The administrative costs stem from the procedures required for ascertaining compliance with the ROO. These involve bookkeeping costs—the costs for the exporter of certifying the origin of a good prior to its export to the territory of another RTA member—and the costs to the partner

[33] OECD, (2002). p.9.
[34] Estevadeordal and Suominen, (2003).p.1.
[35] “Main Characteristics Of FTA/RTAs Subscribed By APEC Economies: An Overview”. SOM Policy Dialogue on FTAs/RTAs Submission by Chile. Pucón, Chile. May 2004.
[36] Estevadeordal and Suominen, (2003).p.6.
[37] Krishna, (2004).p.3

economy customs of verifying the origin of goods. The different certification mechanisms impose divergent costs on firms and governments alike, particularly when economies belong to several RTAs with different types of ROO. These costs are hardly trivial However, the flexibility of customizing the FTAs/RTAs to the needs of interest parties could also generate benefits that could outweigh the costs of administrating the differences in ROO.

Producers in sectors governed by ROO that are based on the value content (VC) criterion face the added administrative complexity of fluctuations in exchange rates and changes in production costs. Besides increasing unpredictability, changes in relative prices complicate the verification of origin by customs, and may give rise to subjective administrative discretion on the part of the importing economy's customs.[38]

Besides the short-run trade effects, ROO may in the longer-run encourage ROO-jumping investment, whereby extra-RTA producers locate plants within an RTA region in order to satisfy the ROO. If this occurs even when the RTA region was not economically the most optimal investment location, ROO can engender investment diversion.[39]

Rules of origin may also impose efficiency costs on the members of an RTA, though these effects are as yet poorly understood. One clear conclusion is that provision of full accumulation of origin in RTAs with multiple memberships is important in order to facilitate the efficient development of regional production networks.

The potential effects of restrictive ROO have three immediate implications to the theoretical debate over the potential trade effects of RTAs. First, ROO can reduce the utilization rates of the RTA-provided preferences. Second, ROO can hinder RTA-induced trade liberalization; undercutting the trade effect that tariff lowering between the RTA partners would have in an RTA with loose ROO. Third, the relevance of ROO *per se*—and their importance as a constraint on commerce thereby—decreases with the lowering of MFN tariff barriers across RTA members.[40]

Examining NAFTA in a three-economy, multisector Computable General Equilibrium (CGE) model, it is found that ROO distort trade flows, diverting resources from their most efficient uses and undercutting global welfare. It is attributed that the mere 64 percent utilization rate of NAFTA preferences is due in part to ROO, and also demonstrated that Mexican exports to the United States have been undermined by stringent ROO. Canadian producers are reported to have opted to pay the tariff rather than going through the administrative hurdles of meeting the ROO already in the context of the NAFTA predecessor, the US-Canada FTA.[41]

3.2 Rules of Origin in RTAs/FTAs in the APEC Region

Rules of origin in RTAs among APEC economies range from the highly complex to the apparently very simple. Very complex rules of origin are likely to add to the compliance costs of business and increase the likelihood of costly disputes. Ideally rules of origin should be as straightforward as possible consistent with the objective of preventing unwanted trade deflection. However, even apparently straightforward rules of origin, such as those based on a percentage of area content, can create significant difficulties for exporters and can have perverse effects on economic efficiency. Perhaps the most unequivocal criteria that can be stated for rules of origin is that they should be transparent,
clear and consistent.

Some of the main integration schemes in APEC: the ASEAN Free Trade Area (AFTA), Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA), Singapore-Australia Free Trade Agreement (SAFTA), and South Pacific Regional Trade and Economic Cooperation (SPARTECA) in Asia-Pacific, are based on an across-the-board VC rule.

[38] Estevadeordal and Suominen, (2003).p.7.
[39] Estevadeordal and Suominen, (2003).p.8.
[40] Estevadeordal and Suonimen, (2003), supra, note 37.
[41] Estevadeordal and Suonimen, (2003). p. 9.

The inter-continental ROO regimes of the US-Singapore and Chile-Korea FTAs, as well as the recently concluded EFTA-Singapore FTA where ROO follow the PANEURO model, have delivered additional complex ROO regimes to the Asia-Pacific region.

Surely, the key to undercutting ROO's negative trade effects lies, however, in the success of multilateral liberalization. Preferential ROO are restrictive only as long as there are MFN tariffs; should the multilateral trade rounds result in further MFN tariff lowering and the proliferation of RTAs engender a dynamic of competitive liberalization worldwide, the importance of preferential ROO as gatekeepers of commerce would begin to fade.[42]

3.3 Rules of Origin in APEC

The Committee on Trade and Investment Plenary Session/Meeting works to harmonize these rules among APEC member economies.

In February 2004, Chile developed and presented a Comparative Matrix on Rules of Origin. This Matrix contains a description of the rules of origin and customs procedures related to origin applied by different APEC member economies in their bilateral and multilateral free trade agreements. The matrix emphasizes the role of Customs Administrations in the verification and control process of preferential origin.

Main activities carried out by APEC members have been workshops on rules of origin, which provide technical assistance for customs officials to implement the WTO Agreement on Rules of Origin.

3.4 Trade In Services

Services are a significant part of every economy in output and employment terms. The share of GDP is high, even in developing economies, and rises further with the level of economic development. Based on the World Bank Work Development Indicators, the share of services in total value-added of the least developed economies was 42 percent in 2000, compared with 55 percent in middle-income economies and 69 percent in high-income economies.

While services are typically not protected by tariffs, services trade barriers may or may not be tariff-like. For example, some regulatory trade restrictions, particularly quantitative restrictions, create artificial scarcity. In this sense, liberalization of these barriers would yield the gains associated with improvements in allocative efficiency, but also have the redistributive effects associated with the elimination of rents to incumbents.[43]

[42] Estevadeordal and Suominen, (2003). p. 30.
[43] Dee and Sidorenko, (2003).p.8.

Table 3.4.1: Disposition of Employment in Selected APEC Economies

	Share of Labour Force in Industry (percent)	Share of Labour Force in Services (percent)
Australia	21	74
Canada	23	74
Chile	26	60
China	22	13
Indonesia	16	39
Japan	31	63
Malaysia	32	50
Mexico	25	53
New Zealand	23	68
Peru	19	76
Philippines	16	45
Russia	29	59
Singapore	29	71
Thailand	18	33
United States	23	75

Source: UNCTAD Handbook of Statistics Online, www.unctad.org/statistics/handbook, accessed Nov 2003.

Alternatively, services trade restrictions could increase the real resource cost of doing business. Liberalization would be equivalent to a productivity improvement (saving in real resources), and yield gains in terms of freeing resources for use elsewhere. This could increase returns for the incumbent service providers, as well as lowering costs for users elsewhere in the economy.

Issues in the area of services revolve around how the key principles of most-favored-nation treatment, national treatment, and transparency are to be handled in the context of a contractual agreement.

Other rules to be determined include those relating to the type of access for foreign service providers, the treatment of investment, the disciplines over monopoly behavior, the recognition of the equivalence of qualifications (such as diplomas or certificates) between service providers from different economies, rules of origin, the treatment of quantitative restrictions, the possibilities of providing subsidies and of taking safeguard action, denial of benefits, and withdrawal of concessions, as well as dispute settlement provisions.

Text Box 3.4.1: Modes of Supply of Services (GATS Article1)

Mode 1: Services supplied from one economy to another (e.g. international telephone calls), officially known as "cross-border supply"
Mode 2: Consumers from one economy making use of a service in another economy (e.g. tourism), officially known as "consumption abroad".
Mode 3: A company from one economy setting up subsidiaries or branches to provide services in another economy (e.g. a bank from one economy), officially known as "commercial presence"
Mode 4: individuals traveling from their own economy to supply services in another (e.g. an actress or construction worker), officially known as "movement of natural person".

Liberalizing trade in services requires the removal, modification, or nondiscriminatory application of member economies' regulatory mechanisms.

3.5 Trade in Services in RTAs/FTAs in the APEC Region

There are two approaches to the liberalization of trade in services: a) “positive lists” such as that under the GATS; and b) “negative lists” such as under the NAFTA or other RTAs in the Western Hemisphere.

Under the positive list or ‘bottom-up’ approach two types of principles apply to trade in services. One type is of a general nature, in the form of MFN treatment as described in Article II of the GATS. The other principles in the bottom-up type of agreement are of a specific nature and are the result of the negotiation process. They apply only to those sectors and modes of supply that participants specifically incorporate into their schedules, and they include obligations with respect to market access and national treatment.

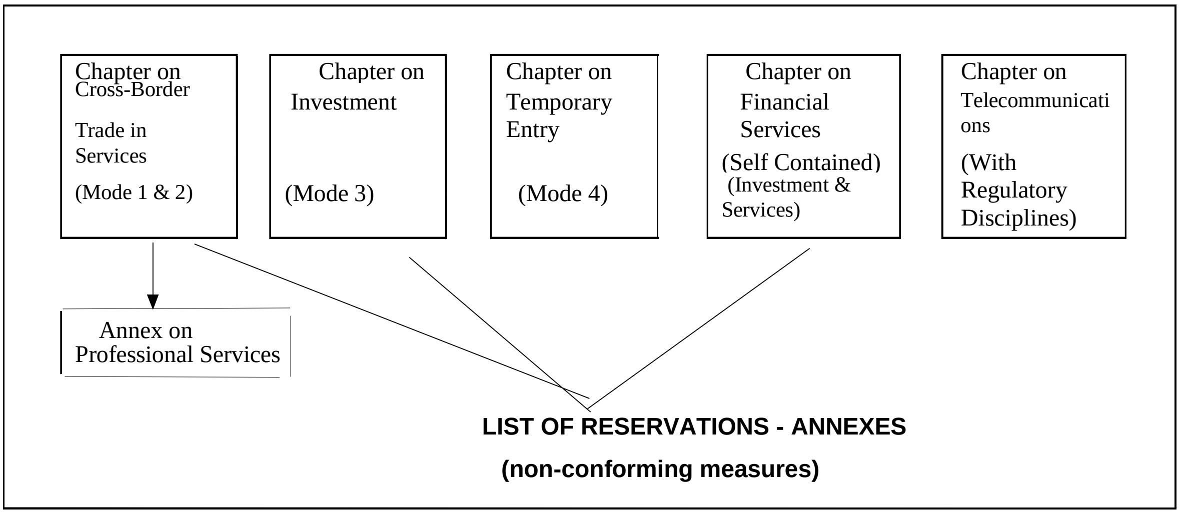
On the other hand, in the negative list or ‘top-down’ type of integration arrangement the basic principles governing liberalization of trade in services are the following: unconditional most-favored-nation treatment, national treatment, and the absence of local presence requirements.

In reality neither of the two negotiating modalities guarantees full liberalization of trade in services. The top-down type of agreement provides a great deal of information in a transparent form on the existing barriers to trade. In the bottom-up type of agreement the sectoral coverage commitments may vary significantly between the parties, and the relative importance of the types of conditions and limitation to market access and national treatment does not necessarily reflect existing access conditions.[44]

In consideration of FTAs/RTAs of the “second wave” negotiated by the APEC member economies, it can be seen that those negotiated after 2000 include extensions and/or further elaborations of the NAFTA model. Such is the case for: Chile-US; Singapore-US; CAFTA-US; Australia-US FTA and Singapore-Australia agreements.[45]

The structure of negative lists for these RTAs is shown in Figure 3.5.1.

Figure 3.5.1: Structure of Negative Lists RTAs for Services



Source: *Stephenson, (2004)*

[44] Prieto and Stephenson, (1999). pp. 244-247.
[45] And others under negotiation.

The “second wave” RTAs in services include and extend provisions on market access, domestic regulation, investment in services, and sectoral disciplines such as telecom and financial services.

Regarding market access all measures affecting services are brought within scope of the agreement, i.e., non-discriminatory quantitative restrictions and all discriminatory measures. In addition, all service sectors are brought within scope of the agreements. In this sense, the comprehensive nature of RTAs/FTAs compared with GATS is noted.

Stephenson has noted that there is a significant liberalization realized in “second wave” RTAs, as is shown for APEC economies in Table 3.5.2. In addition, RTAs also bring about enhanced regulatory cooperation.[46]

Table 3.5.2: Examples of Specific Market Liberalization

Chile: Business Services; Tourism; Financial Services
Singapore: Financial Services; Professional Services
USA: Professional Services; Construction/Engineering; Financial Services

Source: Stephenson, (2004).

This information supports Fink and Matoo’s argument that the RTA route is more likely to lead to economic gains for trade in services than for trade in goods. If a problem still remains, it has three elements:

- *Preferential liberalization* Not all services trade barriers are amenable to liberalization on a preferential basis, For example, undertakings to more strongly enforce intellectual property rights, or to establish competition policy law, cannot be made on a preferential basis;

- *A trading partner who is not world’s best producer of the particular service;*

- *Liberalization of measures that are tariff-like.* Liberalization of cost-escalating trade barriers is always welfare enhancing, even if the trade partner is not the least-cost supplier.[47]

Preferential liberalization of tariff-like measures with trade partner who is not the most efficient producer is problematic because an economy can lose all the rents from the trade barriers, without receiving adequate compensation in the form of lower prices to consumers. This is the essence of the trade diversion problem in services. This loss could be offset: if there was a sufficiently higher volume of trade with the new trade partner than with the old, so that the triangle gains in producer and consumer surplus from the higher trade volume offset the uncompensated loss of rents trade creation could outweigh trade diversion. But the outcome is ambiguous.

Regarding services within the WTO context, especially the Doha round, where there was no progress in negotiations on rules on: safeguards; subsidies; government procurement; and domestic regulation, as well as no agreement on classification improvements, economies who wish to liberalize services will continue to go the regional route. If this is the case, it has been argued that it is not hazardous if trade diversion is minimal or nonexistent and if results are applied on an MFN basis, as they tend to be.

3.6 Trade in Services in APEC

APEC members are to liberalize on a most-favored-nation basis so that non-APEC members will also receive equal access to APEC markets. This is in sharp contrast to traditional RTAs, which are preferential in nature.

In principle, APEC goes beyond WTO commitments, but its agreements are non-binding to members. Its major principle is unilateral reforms. Members have endorsed the common

[46] Stephenson, (2004).
[47] Matoo and Fink, (2002). p.2

liberalization targets, and have full autonomy over the reform path they pursue to meet these common goals (the “concerted unilateralism” effort).

Several APEC initiatives illustrate how voluntary cooperation in the area of professional standards and recognition of qualifications and experience may contribute to the liberalization of movement of professionals within the region. These programs include the APEC Business Travel Card and APEC Engineer.

There is a scope for non-preferential regional trade to provide a useful testing ground for exploring liberalizing steps that can be further extended on a most-favored-nation basis and bound in the WTO. The proposal for the “GATS visa” matches the existing APEC Business Travel Card program and the development of common APEC standards for professional training and core competencies creates opportunities for internationalization of standards and hence, for removing a significant barrier to the mobility of professional services providers.

Text Box 3.6.1: APEC Business Travel Card and APEC Engineer Program[48]

The APEC Business Travel Card program has been developed to facilitate movement of businesspersons traveling frequently to conduct trade and investment activities in APEC economies by providing pre-cleared entry to participating economies as well as streamlined immigration control on arrival. Currently there are 14 APEC economies participating in the scheme. These economies are: Australia; Brunei; Chile; China; Hong Kong, China; Indonesia; Japan; Korea; Malaysia; New Zealand; Peru; the Philippines; Chinese Taipei; and Thailand.

The APEC Engineer program has been established in 11 APEC member economies (Australia; Canada; Hong Kong, China; Indonesia; Japan; Korea; Malaysia; New Zealand; Peru; Thailand; and the United States) to facilitate cross-border mobility of professional engineers. Effectively there is an international standard established for the accreditation of engineering teaching programs and recognition of degrees and experience. An agreement on mutual recognition of engineering qualifications was signed in 1989 (the Washington Accord). The Washington Accord and the Engineering Mobility Forum (EMF) are distinct from the APEC Engineer initiative but closely involved in coordination and mutual harmonization of professional standards. Each participating economy maintains its own APEC Engineer Register. In August 2003, there were 467 members on the Australian Engineer Register, representing less than 5 percent of those registered with the National Professional Engineers Register (NPER) but, according to NPER, there is a keen interest among the export-oriented engineering professionals to join the APEC Engineer Register.

3.7 Investment in RTAs/FTAs

The evolution of an international policy framework for international investment reflects the growing recognition of the role investment has come to play in international economic development and integration. According to this, and as it is with all the ‘Singapore’ Issues, there is evidence of investment provisions in RTAs/FTAs going beyond provisions in the WTO. However the nature of that “going beyond” differs from issue to issue.

The extent to which signatories to an RTA attempt to establish ambitious investment rules would seem to be largely a function of the economies’ previous experience with a liberal investment regime. Most economies that have entered into agreements containing high-standard rules on investment had either already been liberalizing their investment regimes unilaterally or had experimented with investment rules in prior agreements.

Where economies have only recently begun to liberalize their investment regimes and where these have traditionally been highly restrictive, the preference has been for less encompassing agreements covering limited rights of establishment and the movement of capital. In other words,

[48] Dee and Sidorenko, (2003).p.23.

the negotiation of investment rules in RTAs/FTAs could be characterized as taking place at the investment policy margin. Economies at similar levels on the investment liberalization 'trajectory' can scale their investment rule-making ambitions in line with historical local norms on international investment.

The objectives of investment rules, in most cases, are aimed at improving economic efficiency. However, some provisions in RTAs/FTAs are more oriented towards development issues, especially as concerns the promotion of local firms.[49]

The content of investment provisions in RTAs/FTAs include: non-discrimination, expropriation, minimum standard of treatment, transfers, performance requirements, establishment, and investor economy dispute settlement.[50] Specifically, RTAs/FTAs go beyond provisions found in the WTO in that they contain provisions on the right to establish a presence in other economies covered by the RTA, an obligation that does not exist in any WTO agreement. And many RTAs/FTAs reach beyond the question of establishment and the free movement of capital by building on the treatment and protection principles of bilateral investment treaties.[51]

Regarding whether RTAs/FTAs affect investment flows, there are few empirical studies.

When the RTA/FTA is between a developing and a developed economy, a firm located in the developing economy can take advantage of cheap inputs while obtaining free access to the large developed economy. This can be a powerful stimulus to investment. Although Mexico has long been used as an export platform to the USA, NAFTA had a profound impact on foreign direct investment (FDI) into Mexico after 1994 from economies outside NAFTA, as it became a way to guarantee market access into its northern neighbors.

It has also been widely documented that European integration has made EU member economies more attractive to US, Japanese and other third economy firms. The creation of the single market in the EU in 1992 had a significant impact on Japanese, Korean and Taiwanese company decisions to establish operations in the Union.

For other RTAs/FTAs similar evidence exists. In the case of MERCOSUR: following the signature of the Asuncion Treaty, FDI into MERCOSUR member economies increased, from US$3.5 billion in 1991 to US$18 billion in 1996 and US$38 billion in 1998. With nearly US$11 billion within this context, Brazil surpassed Mexico as the largest FDI recipient in Latin America in 1996 (compared with US$1.1 billion in 1991).

To further investigate whether the formation of RTAs/FTAs can affect FDI flows in a consistent fashion, the World Bank examined the effects of RTA/FTA membership and other variables on FDI inflows for a panel of 152 economies over the 1980–2002 period. The dependent variable was FDI inflow by economy measured in current US dollars, and the independent variables include host economy GDP and per capita income, trade-to-GDP ratio (openness), GDP growth, annual rate of inflation, world FDI, world growth, the combined GDP of the economy's RTAs/FTAs partners, and year and economy fixed effects. The sample takes into account 238 RTAs/FTAs (both regional and bilateral), many of which overlap and which encompass the vast majority of sample economies.

In general, economies that are more open (measured as the sum of exports and imports over GDP), growing more rapidly, and are more stable (captured in less volatile inflation rates) attract greater quantities of FDI, controlling for growth rates of FDI to all economies and the world growth rate.

RTAs/FTAs that result in larger markets do attract greater FDI. The interaction of RTAs/FTAs signing and additional market size associated with the integrated markets is significant and

[49] OECD, (2002) .p.4.
[50] Dymond., (2004). page ref?
[51] OECD, (2003). p.3.

positively related to FDI. On average, a 1.0 percent increase in market size associated with RTAs/FTAs produces an increase of 0.5 percent in FDI.

This has important policy implementations: If an economy seeks to use an RTA/FTA to attract investment, it should seek to amalgamate with the largest possible markets; RTAs/FTAs among small market economies have little effect.

Two important caveats to this conclusion are worth underscoring:

a) A preferential trading arrangement cannot substitute for an inadequate investment climate. It was shown that institutional variables that make up the whole of an economy's investment climate—including political stability, government effectiveness, rule of law and lower risks of expropriation—are all significantly associated with increases in investment flows, controlling for other determinants of FDI. These wash out the otherwise positive effects of RTAs/FTAs. If the economy suffers from poor macroeconomic management, high levels of corruption, and poor infrastructure, an RTA/FTA will not, by itself, offset these disadvantages**.**

b) Creation of an RTA/FTA will not have much effect on investment inflows from outside the region if restrictions on market access are severe and remain unchanged.[52]

3.8 Investment in APEC

APEC members have liberalized their trade and FDI policies unilaterally in recent years, but many areas remain to be liberalized in a number of APEC economies. Recognition of these issues led to the agreement on Non Binding Investment Principles (NBIP) in November 1994.

The NBIP supports the need to liberalize FDI policies in order to promote economic growth in the region. It consists of four sections:

A. Principles that govern international relations;
B. Codes of conduct for government which stipulate the use of specific policies related to FDI;
C. Codes of conduct for investors; and
D. A system of dispute settlement.

The APEC (non-binding Investment) Principles are an excellent example of the changed patterns of law making. They are best described as 'soft' or 'fuzzy' law- a set of commonly agreed skeletal principles, stated in broad terms, establishing a minimum, standard of treatment for foreign investors.

The NBIP go beyond the limited rules contained in the "binding" framework of the WTO – TRIMs/GATS/TRIPs- and deal with a number of issues relevant to the regulation of investment, and incorporating the viewpoints of a wide range of sources.

The APEC NBIP affect the development of the legal framework for regulating investment in RTAs/FTAs in the Asia Pacific region at least in two ways: a) the NBIP influence domestic law; and b) although NBIP are non-binding in nature, thy are evidence of "soft law" policy and may be a useful "tool" in the role of creating an agreement on investment rules to be included in an RTA.[53]

The current patchwork of investment provisions can give rise to certain difficulties. RTAs/FTAs can affect investment patterns, whether through perceived growth opportunities in an expanded market, investment protection provisions within the RTA or specific rules of origin.[54]

However, since most member economies are implementing liberalization measures under more than one initiative (e.g. WTO, APEC, AFTA, NAFTA etc), it is difficult to tell whether the actual

[52] Hoekman, (2004).
[53] Davidson, 2003.).p.7
[54] OECD, (2002).p. 5.

liberalization measures adopted by member economies are actually in fact APEC commitments or they were undertaken for other initiatives and only deployed as APEC deliverable. But since there is a general recognition among member economies of the importance of an open investment regime, it is safe to say that the combined Individual/Collective Action Plan approach may have helped speed up the liberalization process.[55]

3.9 Competition Policy in RTAs/FTAs

Commercial openness and the expansion of integration between economies that have trade agreements, define greater competition conditions in their economies and the markets in which they take part. At the same time, the benefits of trade liberalization can be countered by anticompetitive practices that affect the national economy. The displacement of FDI, together with the liberating process, and with them a concentration tendency and the cross border type of economic growth, demand greater efforts in defense of competition.

For this reason, it is observed a widespread use of competition-related provisions in RTAs/FTAs. They appear in trade agreements covering all parts of the globe and with memberships varying between, and across, both developed and developing economies.

It is important to highlight, however, that RTAs/FTAs represent only one of several institutional settings addressing competition law and policy at the international level. For example, beyond regional and bilateral trade agreements, a plethora of co-operative competition arrangements to facilitate competition law enforcement exist at the multilateral, regional and bilateral levels. These include the United Nations Set of Multilaterally Agreed Principles and Rules for the Control of Restrictive Business Practices, a number of OECD Recommendations and various bilateral arrangements. [56]

Given the embryonic and somewhat indirect nature of competition-related disciplines in the WTO, most RTAs/FTAs almost by definition expand upon the WTO disciplines. Moreover, in "going beyond", RTAs/FTAs often do so in a way that allows considerable flexibility of application – allowing participating economies to scale their regional ambitions according to their particular circumstances.

Amongst the RTAs/FTAs dealing with competition policy a broad distinction can be drawn on the basis of the extent of co-ordination of competition standards and rules that they envisage. In this regard, it is possible to distinguish between those trade agreements that contain general obligations to take action against anti-competitive business conduct (for example a requirement to adopt a domestic competition law without setting out the specific provisions the law should contain) and others that call for more extensive co-ordination of specific competition standards and rules (such as setting out common competition laws and procedures).

An example of the application of the *General Obligations against Anti-competitive Conduct* approach is NAFTA, which under Chapter 15, entitled "Competition Policy, Monopolies and State Enterprises", requires member economies to "adopt or maintain measures to proscribe anticompetitive business conduct and to take appropriate action with respect thereto", without, however, prescribing specific competition rules. In connection with this obligation, Mexico enacted a comprehensive modern competition law in 1993. A similar provision exists in both the Canada-Chile FTA and the Mexico-Chile FTA. The Japan-Singapore Economic Partnership Agreement provides that each party shall in accordance with its applicable laws and regulations, take measures, which it considers appropriate against anti-competitive activities. Similarly, the EU-Mexico FTA, focuses on ensuring the implementation and enforcement of the parties' *respective* competition laws in a manner recalling the side agreements on environment and labor standards embedded in NAFTA.

[55] Austria, (2002).p.6.
[56] OECD, (2003). p.5

There is a significant difference between RTAs/FTAs, which are limited to consultation, and co-operation between national competition authorities and those that provide for elements of supranationality. The latter often assign a key role to supranational institutions in the enforcement of competition rules while the former rely primarily on non-institutionalised procedures

An example of an RTA with considerable jurisdictional reach yet which is not reliant upon independent supranational institutions is the Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA). On the other side NAFTA and the Canada-Chile FTA adopt a different approach, which does not rely on supranational institutions for enforcement. Rather, general consultation and co-operation requirements call on the parties to consult on the effectiveness of their national competition laws and to co-operate on the enforcement of those laws via mutual legal assistance, notification, consultation and the exchange of information.

Under the JSEPA, Japan and Singapore may consider extending co-operation, including coordinating of enforcement activities. As Singapore does not have a comprehensive competition law or authority, this RTA provides and example of the potential for such co-operation with economies which do not have comprehensive competition regimes or institutions.

With respect to the effect on third parties in the area of competition, as with that of investment, there is a provision for RTAs/FTAs to adopt the principle of non-discrimination. For example, the Canada-Costa Rica FTA contains a commitment that measures taken to proscribe anti-competitive activities should be applied on a non-discriminatory basis. This is not to deny, however, that a risk of discrimination is inherent in agreements at the regional level. To cite another example, the Free Trade Agreement between Mexico, Colombia and Venezuela (the "G3 Agreement") requires state-owned monopolies to act on the basis of commercial considerations in operations in their own territories and not to use their monopoly positions to engage in anti-competitive practices in a non-monopolised market in such a way as to affect enterprises in other member States.

The use of competition measures in lieu of anti-dumping measures in intra-regional trade, where anti-dumping measures would still apply to third parties, has been raised by certain WTO Members as risking potential distortions in the international trading system where both regimes are based on different criteria and conditions[57]. Certainly it is an area where it has been suggested that the relationship between competition policy and RTAs/FTAs should be explored.

3.10 Competition Policy and Deregulation in APEC

Unilateral deregulation by APEC economies makes an important contribution to trade and investment liberalization and facilitation. Transparency in regulatory regimes and the elimination of trade-impeding or unnecessarily restrictive regulations are the key objectives of APEC work in the deregulation area. This work is undertaken by the Committee on Trade and Investment (CTI). Under direction from the CTI, the Competition Policy and Deregulation Group (CPDG) works on activities relating to information gathering and analysis as well as experience sharing. [58]

The analysis of international experiences allows pointing out that bilateral cooperation agreements on competition present limitations as well as benefits. On the limitations it can be said that they present an inability to attend the challenges of globalization with greater interdependencies than those that are established bilaterally. In terms of costs, the ones that can be pointed out are those of negotiation, administration and of inconsistency given the proliferation of RTAs/FTAs.

In terms of the benefits that can bee seen in RTAs/FTAs, these are related to the incidence of the construction of the capacity and probably in competition culture, especially when developing economies establish cooperation with economies that are more developed. Also, there is the establishment of a legal framework for cooperation, encouraging closer relations. There is also

[57] WTO Committee on Regional Trade Agreements, (2000).p. 7.
[58] Asia Pacific Economic Cooperation, Update of Activities May 2004.p.21

the potential learning in dispute prevention and solution that arise from transnational activities and that can facilitate analytic convergence[59].

3.11 Trade Remedies in RTAs/FTAs

As it has been said, RTAs/FTAs have recently been actively utilized. The main purpose of them is, without doubt, the elimination of tariff barriers. However, it is a recent trend, that many of the RTAs/FTAs furnish provisions concerning trade remedy measures (i.e. anti-dumping, countervailing and safeguard measures), such as abolishing or strengthening the imposition criteria for trade among their constituent economies.

Although imposition of trade remedy measures are legally allowed under the relevant WTO Agreements if certain criteria are met, it also has been widely acknowledged that, on one hand, they can protect the domestic industries damaged by foreign imports, and, on the other hand, they harm domestic consumers, domestic downstream industries, and foreign exporting industries, by increasing the commodity price and by creating an unstable trade environment and trade distorting effects.

One of the most significant tendencies in RTAs/FTAs is the diversity for the treatment of each of the trade remedy measures in their provisions. For example, the diversity of treatments includes abolition of measures, strengthening the disciplines for imposition, mere reference to the WTO Agreements, additional conditions for imposition, use of the transitional measures, and so on.

The language of Article XXIV of GATT and the Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994, which govern the principles for the relations between the WTO as the multinational trade regime and the RTAs/FTAs, are not clear enough on the issue of how to treat trade remedy measures. Therefore, one of the reasons for diversity in the provisions is deemed to have been derived from the lack of a prescribed model with a consensus for the treatment of trade remedy measures in the RTAs/FTAs.[60]

In addition, even economies that engage in more than one RTA do not necessarily adopt the same treatments for trade remedy measures all the time. In fact, they have chosen different types of treatments on a case-by-case basis, depending on trade relations with the other party.

Since the 1990s more and more parties to the RTAs/FTAs found that the mutual elimination of the tariff barriers only was not fully satisfactory, and the abolition of trade remedy measures for intra-trade evolved, greatly strengthening the disciplines of imposition, harmonization and cooperation in competition and subsidy policies in RTA negotiations. This is because discussions in academia became active concerning the trade distorting effects of trade remedy measures, and the possibility of substituting trade remedy measures with a competition policy.

In this sense, some RTAs/FTAs prohibit the use of antidumping measures between the signatories. A key example is ANZCERTA, which has phased out, since 1 July 1990, the application of antidumping remedies in bilateral trade relations between Australia and New Zealand in parallel with the amendment of domestic competition laws to make their prohibition of misuse of substantial market power fully applicable to anti-competitive transactions occurring within the region. (See Text Box 3.9.1) Similarly, and matching their non-application within the EU, the EEA precludes the application of anti-dumping measures, countervailing measures and measures against illicit commercial practices in the relations between the contracting parties. Under MERCOSUR, although the use of anti-dumping duties remains possible in internal trade, it is envisaged that it will be gradually eliminated in parallel with ongoing progress to harmonise competition policy.

[59] Silva, (2004). pp.17-18.
[60] Sagara, (2002). p.32.

The Canada-Chile FTA also prohibits anti-dumping actions between the two parties. The agreement is significant in this regard as it is the first to prohibit anti-dumping measures between the parties while only addressing competition policy in general terms elsewhere in the RTA. (See Text Box 3.10.2)

Text Box 3.11.1: Provisions for Trade Remedies in ANZCERTA (Australia-New Zealand Closer Economic Relations Trade Agreement)[61]

The ANZCERTA came into effect in 1983. It conducted a major review of the Agreement in 1988 and signed a new Protocol ("Protocol to ANZCERTA on Acceleration of Free Trade in Goods").

Article 4 of the Protocol stipulates the abolition of anti-dumping measures after July 1990, when free trade is achieved. The Protocol, in parallel, extended the application of both economies' respective competition law prohibitions on the misuse of market power to trans-Tasman markets.

As to subsidies and countervailing duties, Article 16 of the Agreement of 1983 stipulates that neither member economy shall levy countervailing duties on goods imported from the territory of the other member economy, except when no mutually acceptable alternative course of action has been determined and in accordance with its international obligations under the WTO Agreement on Subsidies and Countervailing Measures.

In the Agreed Minute on Industry Assistance of 1988, it is confirmed that from July 1990 neither Australia nor New Zealand would pay export incentives, production bounties and like measures on goods, which are exported to the other economy.

From January 1989 Australia and New Zealand tried to avoid the adoption of industry-specific measures (bounties, subsidies and other financial support), which had adverse effects on competition between industries in the ANZCERTA. This agreement was taken into consideration as a part of the formal review in 1992.

Article 17 of the Agreement provides for safeguard measures during the transition period. Safeguard measures may be introduced in respect to goods traded in the area which originate in the territory of a member economy as a last resort when no other solution can be found and only during the transition period, if increased imports were occurring as a result of trade liberalization by the FTA, and causing or posing an imminent and demonstrable threat to cause severe material injury to a domestic industry producing like goods.

The transition period was referred to as the period in which tariffs exists, quantitative import restrictions or tariff quotas, performance-based export incentives, or measures for stabilization or support, hinder the development of trading opportunities between the member economies on an equitable basis. The transition period ended when free trade in goods based on the Protocol of 1988 was achieved. Accordingly, the safeguard measures were abolished for intra-trade.

Regarding the application of a global safeguard action for intra-trade, there are tri-polar trends in RTAs/FTAs: a) abolition, b) irrespective application of intra-trade or trade with non-members, and c) abolition in principle with exceptions under certain conditions. Bilateral or intra-regional safeguard actions, which should be distinguished from global safeguard actions, are often set out as extra provisions in preparation for the vast increase of imports as a result of trade liberalization by the agreed-upon RTAs/FTAs. A bilateral safeguard action may be applied under certain conditions only during the transition period. Recently, inclusion of provisions for bilateral safeguard actions became more common in RTAs/FTAs.

The new approaches to trade remedy measures applied in the various RTAs/FTAs, i.e., as a means to enhance trade liberalization beyond mutual tariff elimination, are deemed to be useful for extending the discussions in the multilateral trade regime in which the WTO is playing a central part. For instance, the establishment of the Working Group on Trade and Competition at the WTO can be seen as the first step.

[61] Sagara, (2002). p.24

Based on what has been learned from the treatments of trade remedy measures in RTAs/FTAs, it is expected to reconsider the functions of trade remedy measures under the WTO, and to explore new ways to further facilitate global free trade.

3.12 Trade Remedies in APEC

In APEC trade remedy measures are merely mentioned as operating consistently with the relevant WTO Agreements. Competition policy is on the table as one of the important issues to consider, and a database of the competition policies and legislation of member economies is being developed. Strengthening the disciplines of subsidies does not seem to have attracted much attention so far.

In the past, APEC's Eminent Persons Group pointed out that APEC should commit itself to address the problems associated with the abuse of anti-dumping policies, taking into full account the interests of consumers and industrial users of imports, as well as import competing firms and workers, in implementing anti-dumping policies. It was also argued that member economies should authorize their competition policy officials to challenge anti-dumping actions that run counter to the goals of competition policy. As for safeguard measures, stricter application was proposed. However, further consideration of disciplining trade remedy measures subsided after that.

Text Box 3.12.2: Provisions for Trade Remedies in the Canada-Chile Free Trade Agreement[62]

The Canada-Chile Free Trade Agreement, which came into effect in 1997, has a distinctive chapter on anti-dumping and countervailing duties (Chapter M: Anti-dumping and Countervailing Duty Matters).

The abolition of anti-dumping for intra-trade takes effect when the tariffs on each product have reached zero in both economies, or by 1 January 2003, whichever comes first. (Articles M-01 and M-03). If exceptional circumstances arise with respect to the operation of Chapter M, both parties will have consultations. (Article M-04). Such circumstances may include changes in normal trading patterns due, for example, to a trade action in a third economy.[1]34

A party will still have recourse to countervailing duties as permitted under the WTO if its domestic industry is injured, or threatened with injury, by subsidized imports from the other party. Article M-05 also provides for consultations through the Committee on Anti-dumping and Countervailing Measures, with a view to defining subsidy disciplines further and eliminating the need for domestic countervailing duty measures on trade between the parties. The same article, moreover, stipulates that the aforementioned Committee was established to work together in multilateral fora, including the WTO, and the establishment of the Free Trade Area of the Americas, with a view to improving trade remedy regimes to minimize their potential to impede trade; and to consult on opportunities for working together with other like-minded economies with a view to expanding agreement on the elimination of the application of anti-dumping measures within free trade areas.

The Agreement also requires both parties to re-evaluate the above mention provisions, including the exemption provision for anti-dumping measures, after five years, that is, in 2002. (Article M-06)

The provision for safeguard measures in the Canada-Chile FTA is similar to that of NAFTA. There are separate provisions for bilateral and global safeguard measures. Article F-01 provides bilateral emergency action (bilateral safeguard measures), during the six-year transition period, in circumstances where duty reductions made pursuant to the Agreement result in increased imports from the other party under such conditions that these imports alone are causing serious injury, or threat thereof, to the domestic industry of the importing party. These measures may include the suspension of the further reduction of rate of duty provided under the Agreement, and an increase in the rate of duty to a level not higher than the MFN rate. Such action may be taken against a particular good only once. No action may be maintained for a period exceeding three years or beyond the expiration of the transition period without the consent of the other party.

As to global safeguard measures, Article F-02 establishes that when a party takes a safeguard action, the other party shall be excluded from the action, except where its exports of the good in question to the party concerned (a) account for “a substantial share” of total imports of the good by the economy applying the measure (the Agreement stipulates that for exports of a party to constitute a “substantial share” of the imports it must be among the top five suppliers of the good in question): and (b) contribute importantly to the serious injury or threat thereof (for exports from the other party to be considered not to contribute importantly to the injury or threat thereof, the growth rate of imports of the good originating in such a party must be appreciably lower than the growth rate of total imports of the good).

In case of either bilateral or global safeguards, compensation must be provided to the other party by the party taking the action. The language of the provisions implies that Canada and Chile were keen on the abolition of the anti-dumping measures for intra-trade, and on the extension of the idea to NAFTA at Chile’s entry and to the FTAA. Although Canada had been eager to abolish anti-dumping measures for intra-trade in the US-Canada FTA and succeeding NAFTA establishment processes, they were maintained and the replacement option of a judicial review for final anti-dumping or countervailing duty determinations with a binational panel review was achieved.

[62] Sagara, (2002).pp 17-18

4. TENTATIVE CONCLUSIONS

APEC has a diverse membership reflecting different levels of economic development and different legal systems. Because of this diversity, APEC has not sought to create binding rules, but has advanced cooperation through non-binding commitments. The paradigm of APEC is essentially a mechanism based on voluntary consensus and "peer pressure".

Although APEC has the goal of "free and open trade and investment",[63] APEC is not a GATT Article XXIV Free Trade Area or Customs Union. Rather it seeks to achieve its goals through "open regionalism" and "concerted unilateral liberalization" – "a process of voluntary reduction through enlightened dialogue among APEC members, and the extension of these markets – opening measures to non-members without call for reciprocal actions".[64]

So, the nature of the processes undertaken within APEC are per se in the long run or at least need more time to achieve the incorporation and preparation of all the economies to an equal level of welfare. The latter, is not necessarily in contradiction with the motives that stimulate the negotiation of preferential agreements but these are the natural result of the interaction of two or more economies that are prepared to recognize, give and request concessions in a series of issues that are necessary for the consolidation of its inter-block trade in a shorter time period.

In this sense, APEC provides a necessary framework for preparing the way for other economies in the future to consolidate their trade through tariff and non-tariff agreements.

It has been said that the growth of trade agreements leads to the discrimination towards those economies that are non-members and the rise of costs for business in each economy that must comply different norms depending on which economy it has signed an RTA. However, the majority of the problems tend to disappear if the MFN rate of the hub economy tends to zero. If this is the case, then a great part of the cost of an uncoordinated net of RTAs/FTAs disappears, especially in relation to rules of origin.

The elimination of tariff issues, leaves the discussion on non-tariff problems as wells as trade in services and investment, which are being addressed within APEC and greatly depend on cooperation and agreements from greater developed economies towards the developing ones.

The revision of the provisions contained in RTAs/FTAs referred to rules of origin, trade in services, investment, trade remedies and competition policy, indicates that in many occasions these practices could converge with Bogor objectives, especially in those cases where there is evidence of cooperation between members.

Specifically, amongst the current practices in RTAs/FTAs regarding different issues, the following is noted:

- Liberalizing trade in services requires the removal, modification, or nondiscriminatory application of national regulatory mechanisms, so there is a significant liberalization realized in the "second wave" of RTAs/FTAs. In addition RTAs/FTAs also bring about enhanced regulatory cooperation.[65] Most of the times, the commitments assumed by APEC economies regarding trade in services replicate what is done at the bilateral level. The main benefit of this practice is that concessions are on MFN basis, which implies the proliferation of access market benefits for all WTO members. Additionally, although APEC commitments are non-binding, they go beyond those assumed in WTO. Their main feature is that they follow, most of the time, unilateral reforms that allow further advance to deeper integration. The APEC Business Travel Card and APEC Engineer are clear examples where business facilitation and cooperation absolutely converge with the proposal for the "GATS visa".

[63] Leaders' Declaration – Bogor.(1994). Number 6, second paragraph.
[64]Duff and Woo, (2002). p.2.
[65] Stephenson, (2004).

- RTAs/FTAs that result in larger markets do attract greater FDI, such as NAFTA, EU or MERCOSUR. The interaction of negotiated RTAs/FTAs and additional market size associated with the integrated markets is significant and positively related to FDI. The evidence shows that growing investment flows comes not only from the FTA members but also from non-member economies. However, economies which attract FDI are, in general, economies that are more open (measured as the sum of exports and imports over GDP), growing more rapidly, and are more stable (captured in less volatile inflation rates) attract greater quantities of FDI, controlling for growth rates of FDI to all economies and the world growth rate. Economies with these characteristics should attract FDI with or without an FTA.

  Investment treatment in the APEC fora takes shape through non-binding procedures, supported by unilateral reforms of the members who are committed to fulfill certain standards in the Non-Binding Investment Principles (NBIP) context. The NBIP go beyond the limited rules contained in the "binding" framework of the WTO —/GATS/ TRIMs/ TRIPs (trade-related investment measures/ trade-related aspects of intellectual property rights) — and deal with a number of issues relevant to the regulation of investment, incorporating viewpoints from a wide range of sources. It is estimated that the APEC NBIP influence domestic investment law and, although NBIP are non-binding in nature, they are evidence of "soft law" policy and may be a useful tool in creating an agreement on investment rules to be included in an RTA.

- Most FTAs expand their provisions on competition policy beyond WTO disciplines. It is possible to find RTAs/FTAs, which contain general obligations to take action against anti-competitive business conduct and others that call for more extensive co-ordination of specific competition standards and rules. There are also different approaches regarding enforcement: in some cases it is supranational and in other times it is restricted to cooperation activities between member economy authorities. In general, bilateral cooperation agreements enhance a competition culture and stimulate capacity building. APEC's work regarding this issue has been restricted to activities relating to information gathering and analysis as well as experience sharing.

- Regarding Trade remedies, RTAs/FTAs reach different levels of agreement, including the abolition of bilateral measures between members. Without doubt these "practices" go beyond those defined in the WTO. In terms of the work accomplished, in APEC trade remedy measures are merely mentioned as operating consistently with the relevant WTO Agreements.

- Besides the aforementioned and direct measures and effects that result from FTAs/RTAs, there are a number of trade disciplines and practices that are enhanced through the existence of FTAs/RTAs, such as customs procedures, application and knowledge of technical standards, sanitary and phytosanitary measures, intellectual property protection and incentives, among others. The application and formulation of these measures could be viewed as non-discriminatory in nature — or at least, that they become more practical if applied and formulated on a MFN basis. Therefore,, their updating, and the benefits updating implies, can also be viewed on an MFN basis. This fact, is truly trade enhancing and benefits the APEC region as a whole.

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ANNEX I:

INDICATORS OF A KNOWLEDGE-BASED ECONOMY

ANNEX 1
INDICATORS OF A KNOWLEDGE-BASED ECONOMY

This statistical annex presents a comparison of selected APEC economies along 22 indicators relevant to knowledge-based economies (KBEs). This section builds on work first presented in the 2000 APEC Economic Committee's report, *Towards Knowledge-Based Economies in APEC*, and refined in subsequent updates.

While recognizing the unique role that information and communication technologies play, APEC recognizes that KBE is a wider concept than computers, telephones, and the Internet. It embodies total transformation of economic activity, offering the possibility of a person-centered model of knowledge sharing leading to increased productivity and improved economic well-being.

FRAMEWORK

The basic framework of this annex derives from analysis undertaken by the Organization for Economic Cooperation and Development (OECD) and published in *The New Economy—Beyond the Hype* (OECD, 2001). In this report, four policy dimensions were identified as critical for sustainable economic growth in a "new economy" environment. These are:

1. *Innovation:* Innovation and technological change are pervasive and supported by an effective national innovation system (i.e., a network of public and business private sector institutions whose activities and interactions initiate, import, modify, and diffuse new technologies and practices).

2. *Human Resource Development (HRD):* Human resource development is pervasive: education and training are of a high standard, widespread and continue throughout a person's working life and even beyond ('lifelong learning').

3. *Information and Communication Technology (ICT):* An efficient infrastructure operates, particularly in ICT, which allows individuals and businesses to readily and affordably access pertinent information from around the world.

4. *Business Environment*: The business environment is supportive of enterprise and innovation. (The term "business environment" includes the economic and legal policies of government, and also the mix of enterprise operating in the economy.)

INDICATORS

Within the four dimensions outlined above, there are many possibilities for specific indicators. Most indicators included in this annex are the same as in previous years, providing continuity in analysis. However, some changes have been made and these are noted in the individual dimension sections that follow. Within each dimension there continues to be the attempt to represent the four phases of knowledge creation, acquisition, dissemination and use, so that the indicators complement rather than duplicate each other.

The source for much of the data remains the *World Competitiveness Year Book* (WCY). In addition to collating data available from sources such as United Nation (UN) agencies, the OECD, International Monetary Fund, and private data publishers (such at the Computer Industry Almanac), the WCY conducts opinion surveys of business leaders in each of the countries covered to gauge country perceptions of on a wide variety of issues. In addition, this annex includes data from the International Telecommunication Union, the World Bank, the OECD, *The Global Competitiveness Report,* UNESCO, the International Labor Organization, the World Economic Forum, and various country sources. In order to present the most recent data available, original sources are used wherever possible.

As in previous reports, discussion is limited to the 17 economies for which most of the indicators are available.[1] The economy charts are presented in section A-1. They provide a snapshot of each economy's position with respect to being a KBE.

Details for the indicators used are given in Table 1. These include a description of each indicator, reason for inclusion, source, reference year, and reference value. Reference year varies by indicator, and for some indicators, the reference year also varies by economy. The reference value is the value of the indicator averaged [2] over the 30 OECD countries. In order to provide a consistent basis for comparison, each country indicator is divided by this reference value. Therefore in each chart, the value 1.0 represents the OECD average. This provides a basis for comparison that is relevant, but independent of the sample set.

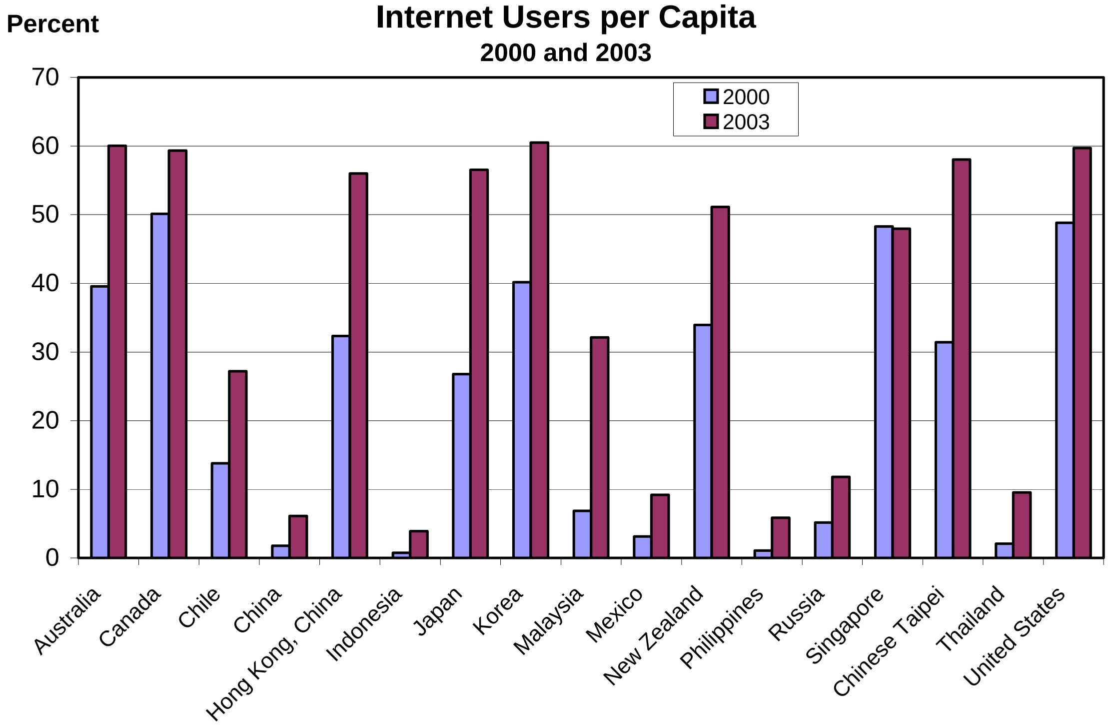
The reference value also provides the means by which values in the charts in Section A-1 can be converted to their original values. For some purposes, the original values of the indicators may be useful. For example, Chart 1 shows Internet use per capita for each of the 17 economies in 2000 and 2003. These data show strong growth (particularly if one is looking at percentage growth) in all economies, with the exception of Singapore (which was already at a very high level of Internet penetration in 2000). In Chart 2, the Internet per capita figures are shown relative to the OECD average (28.1 percent in 2000 and 45.2 percent in 2003). This chart allows economies to be viewed against the rising bar of growing Internet use and illustrates a trend toward convergence; i.e. the economies that were above the OECD average in 2000 were somewhat less so in 2003 and all economies below the OECD average in 2000 have made gains toward the average, even with the 17 percent point rise in the OECD average between 2000 and 2003.

[1] By expanding the data sources, next year's Annex should be able to include a few additional APEC economies.
[2] This is a simple average, not weighted by population, GDP, or any other variable.

CHART1

Internet Users per Capita

2000 and 2003

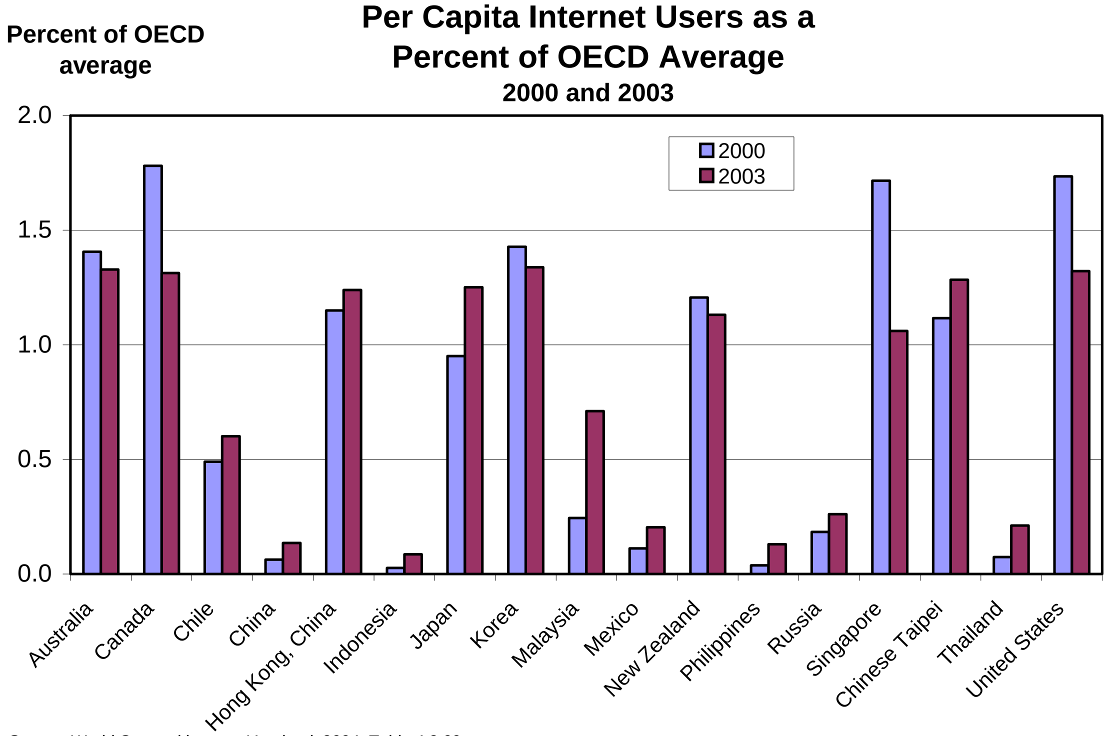


Source: World Competitiveness Yearbook 2004, Table 4.2.09

CHART 2

Per Capita Internet Users as a Percent of OECD Average

2000 and 2003



Source: World Competitiveness Yearbook 2004, Table 4.2.09

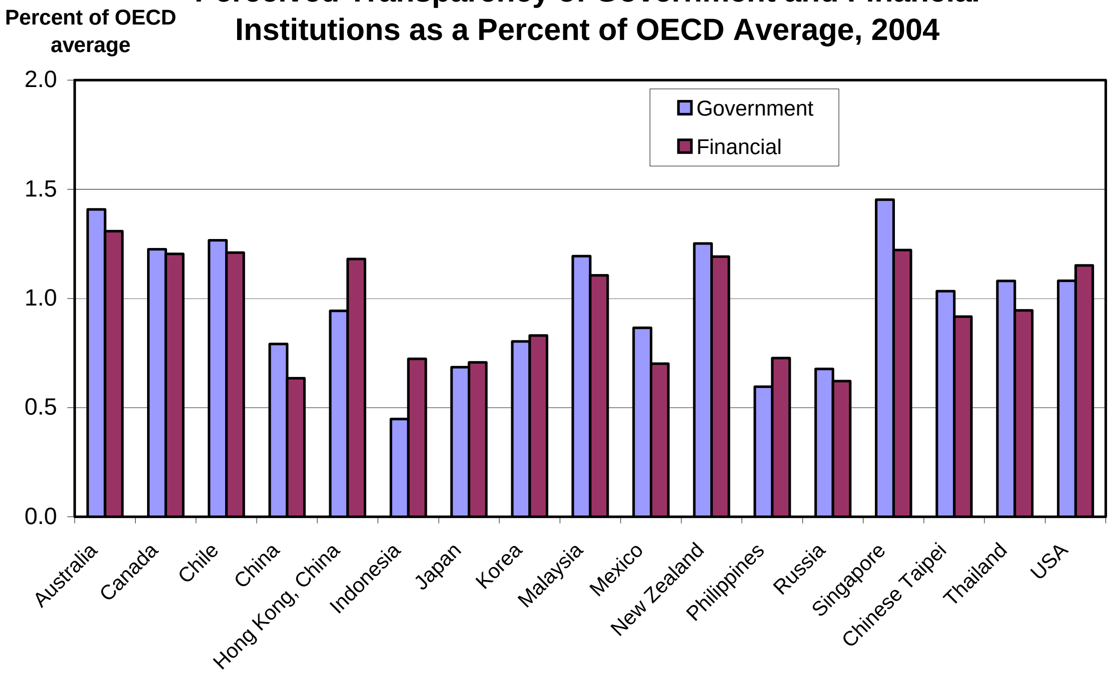
BUSINESS ENVIRONMENT

In prior years, Business Environment included a "Knowledge-Based Industries" indicator that was developed by the OECD. However, because of limited availability (total value-added for KBI was available only for four APEC economies in the 2003 OECD Science Technology and Industry Scoreboard) this measure was dropped. The remaining indicators in this dimension include service exports, high-tech manufacturing exports, foreign direct investment, government transparency, financial institutions' transparency, competition policy, and protectionism (or openness).

While the annex includes three "hard" or objective measures of Business Environment (service exports, high-tech exports, and foreign direct investment), some of the more interesting comparison arise in the "soft" or opinion measures derived from 2004 WCY executive survey questions. Chart 3 shows that perceived transparency of government (Transparency of government policy is satisfactory) and transparency of financial institutions (Financial institutions' transparency is widely developed in your economy) are highly correlated. These two measures have also been fairly stable over time. Notable exceptions are Russia, where both government (.46 to .68) and financial institutional (.35 to .62) transparency increased substantially between 2000 and 2004 relative to the OECD average.

Chart 3

Perceived Transparency of Government and Financial Institutions as a Percent of OECD Average, 2004



Source: World Competitiveness Yearbook 2004, Table s 2.3.14 and 3.3.17

INFORMATION AND COMMUNICATIONS TECHNOLOGY

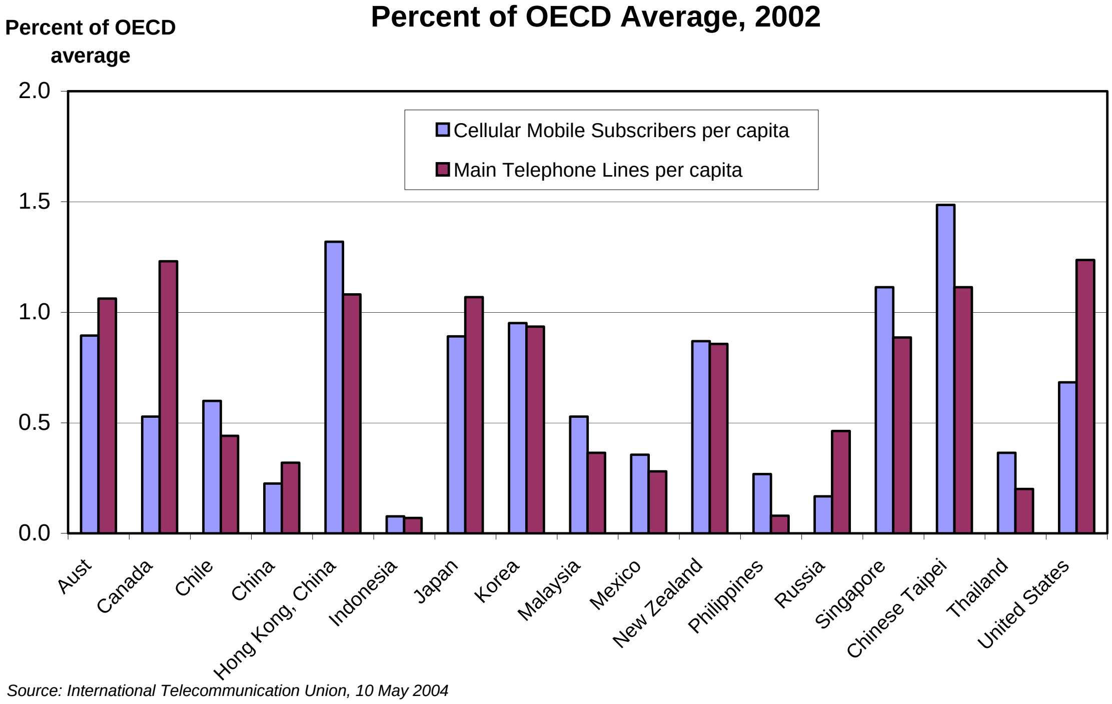
As shown in Chart 2 above, the APEC economies are moving toward the OECD average in Internet usage, one of the ICT indicators. With respect to two other ICT indicators, main telephone lines per capita and cellular mobile phone subscriptions, there appears to be substitution away from landlines toward mobile communication. As shown in Chart 4, most of the economies where the number of main telephone lines per capita is below the OECD average have rates of cellular subscription closer to the OECD average.

This substitution becomes more apparent in Chart 5, which shows the growth in the number cellular mobile subscribers and main telephone lines between 1999 and 2003. It is clear from this chart that relatively more of the increases in telephony connections are deriving from cellular, not landline.

The ICT dimension also includes a new indicator this year, replacing e-commerce: the business usage of ICT index from the World Economic Forum.[3] This index was derived from estimates of each economy's installed business computers, firm-level technology absorption, and the prevalence of foreign technology licensing.

Chart 4

Mobile Telephones and Main Telephone Lines per capita as a Percent of OECD Average, 2002



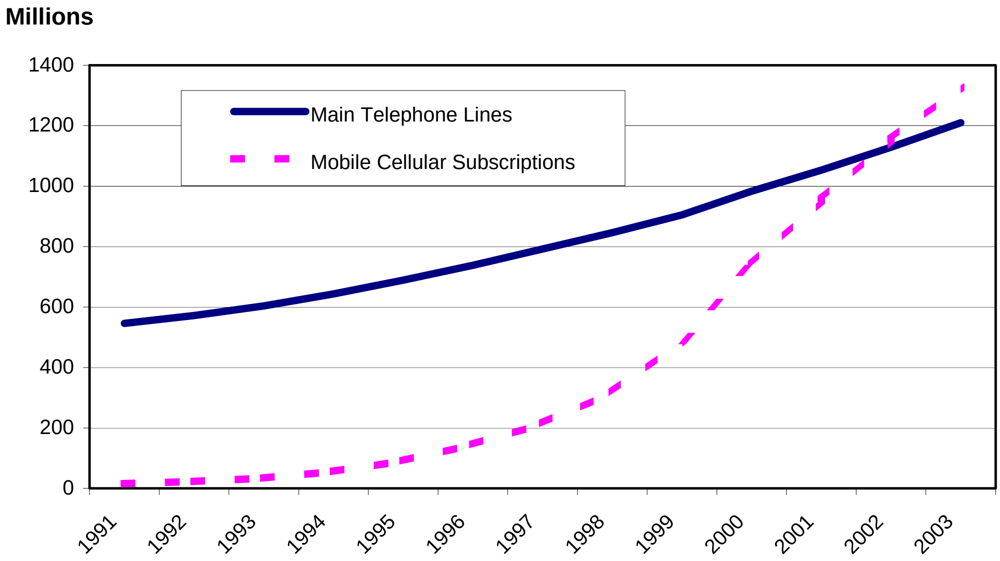
Source: International Telecommunication Union, 10 May 2004

[3] E-commerce was dropped because of a lack of comparable data.

CHART 5

Main Telephone Lines and Mobile Cellular Subscriptions

Worldwide, 1991 -2003



Source: International Telecommunication Union, 10 May

INNOVATION SYSTEM

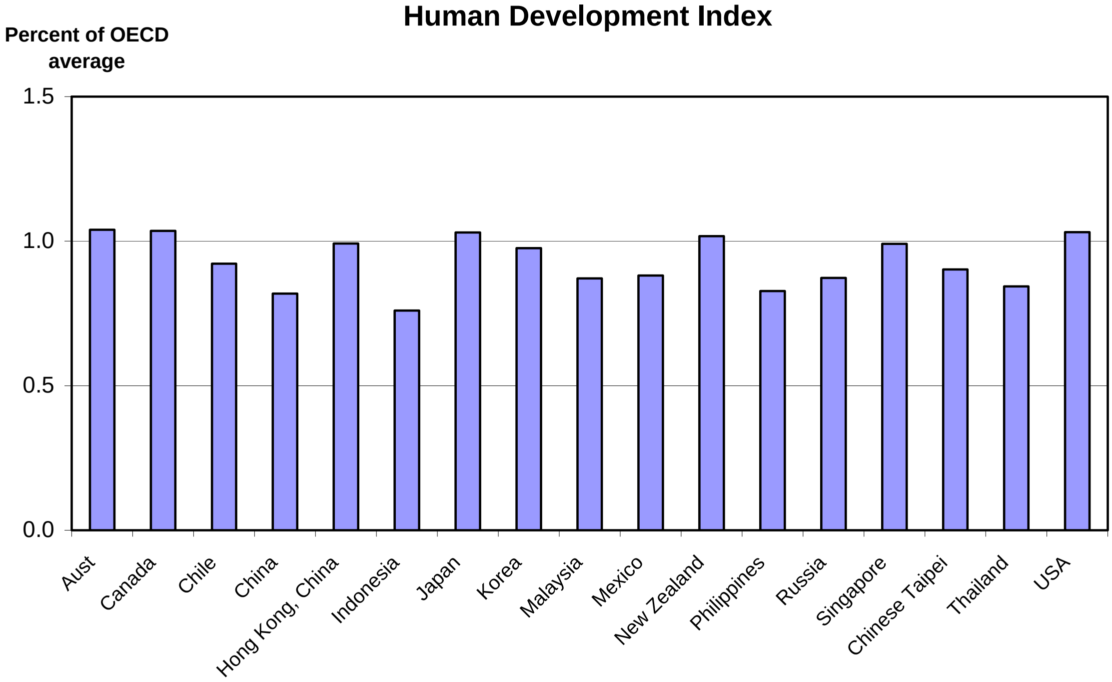
The biggest disparities among APEC economies occur in this dimension. Although the relative levels of the soft measures of company cooperation (Technological cooperation is developed between companies) and company-university cooperation (Knowledge transfer is highly developed between companies and universities), the hard measures of US patents, researchers, and total and business expenditures on research and development show a more distinct lag where several of the economies are substantially below one-half of the OECD reference value (particularly Chile, Malaysia, Mexico, and Thailand).

HUMAN RESOURCE DEVELOPMENT

In contrast to Innovation Systems, Human Resource Development is a dimension where the indicators are most tightly clustered across APEC economies. This is demonstrated by the comparison of relative values of the Human Development Index (HDI) in Chart 6. The United Nations Development Programme developed the HDI as a composite of three indicators of human development: life expectancy at birth, educational attainment, and GDP per capita.

Chart 6

Human Development Index



Source: United Nations Development Programme, Human Development Report 2004

Table 1: Indicators, Explanations, and Sources

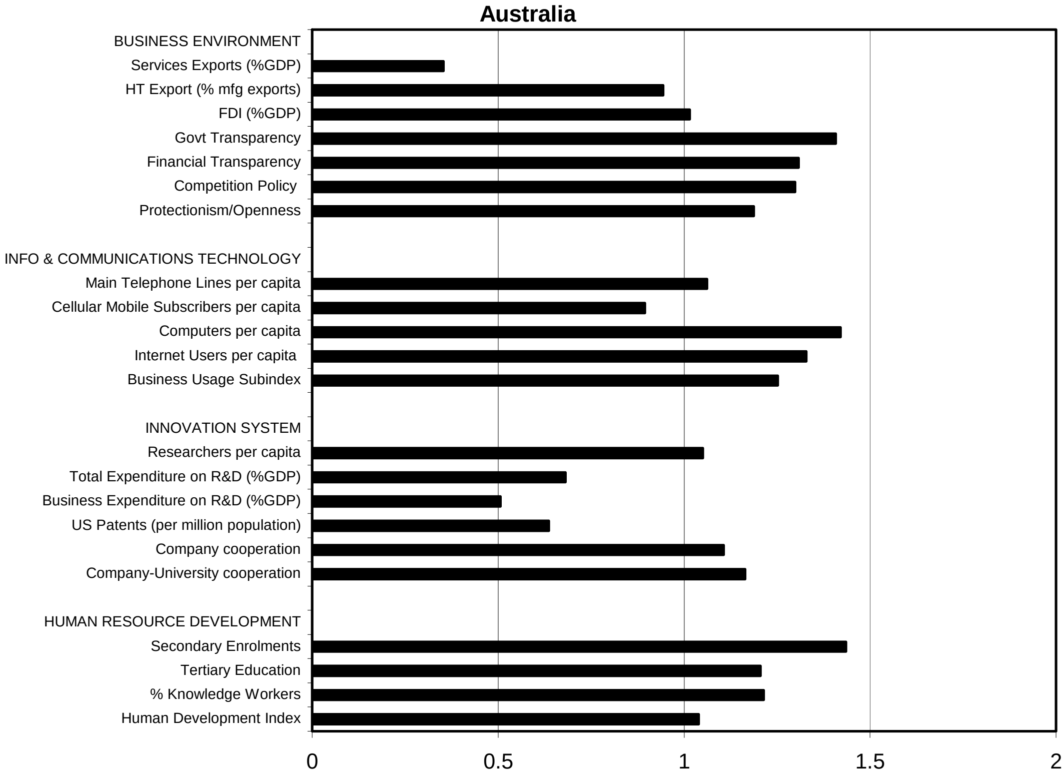
Indicator	Significance for KBE	Details	Source	Data Year	OECD Reference Value
Business Environment					
Service Exports as a percent of GDP	Indicator of knowledge-intensity and size of service sector. Exportable services tend to be knowledge-intensive; Most developed economies tend to have higher proportion of service exports.	Exports of commercial services as percent of GDP (includes transportation, travel, communication, construction, insurance, financial, computer, information, other business, and cultural and recreational services, and royalties and license fees; excludes government)	IMD World Competitiveness Yearbook (WCY) 2004, Table 1.2.11 based on World Trade Organization data (www.wto.org)	2002	11.89
High-Tech Exports as a percent of Manufactured Exports	Indicator of knowledge intensity of manufacturing	Need to check with World bank on how High-Tech is defined	WCY 2004, Table 4.2.17 based on World Development Indicators 2003, World Bank (www.worldbank.org/data)	Chile, Chinese Taipei, and Thailand are 2001; All others are 2002	17.43
Foreign Direct Investment as a percent of GDP	Indicates investor confidence in the economy. Also indicates openness to outside influence (and knowledge).	Direct investment flows inward as a percent of GDP	WCY 2004, Table 1.3.06 based on Balance of Payments Statistics Yearbook (IMF) 2003, UN World Investment Reportt 2003, and National Sources	2002	3.87
Government Transparency (survey rating)	Indicates clarity of policy and (to lesser extent) absence of cronyism—both elements of a KBE	WCY survey (scale 0-10): “Transparency of government policy is satisfactory.”	WCY 2004, Table 2.3.14	2004	5.24
Financial Institutions’ Transparency (survey rating)	Without reasonably high rating of financial institution transparency outside investment is deterred.	WCY survey (scale 0-10): “Financial institutions' transparency is widely developed in your economy.”	WCY 2004, Table 3.3.17	2004	6.28
Competition Policy (survey rating)	Competition encourages innovation.	WCY survey (scale 0-10): “Competition legislation in your economy is efficient in preventing unfair competition.”	WCY 2004, Table 2.4.09	2004	5.94

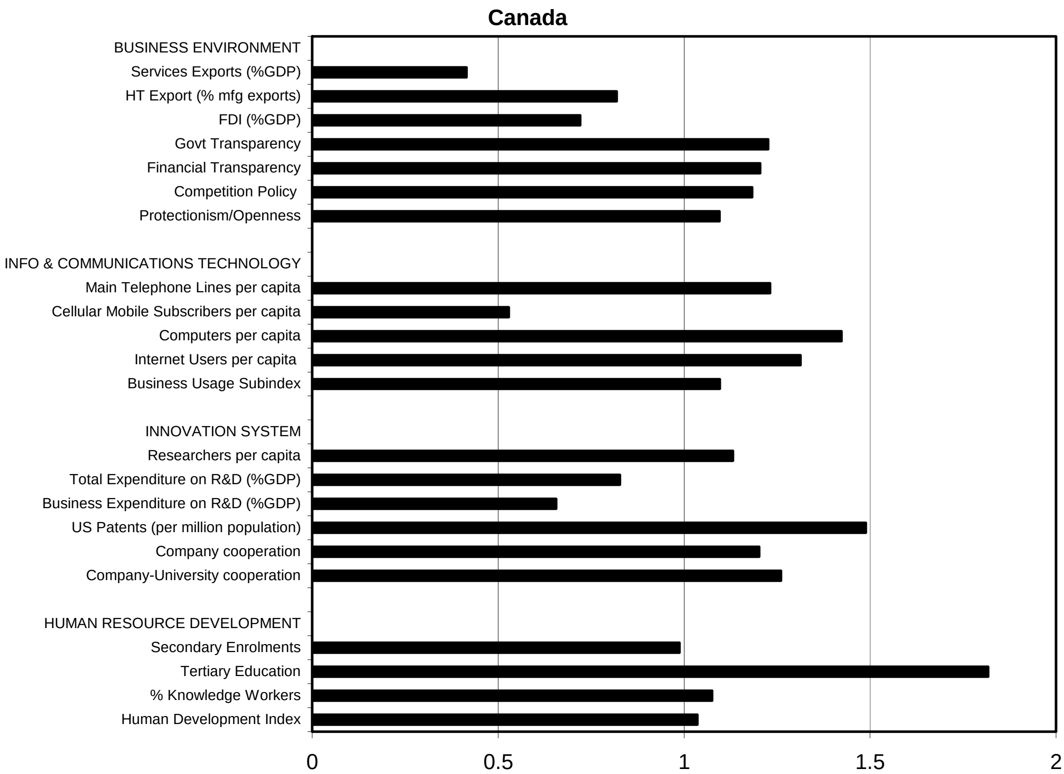
Indicator	Significance for KBE	Details	Source	Data Year	OECD Reference Value
Protectionism/Openness (survey rating)	Openness and access to outside goods and services is an indicator of openness to outside ideas.	WCY survey (scale 0-10): “Protectionism in your economy does not affect the conduct of your business.”	WCY 2004, Table 2.4.02	2004	6.70
Information and Communication Technology (ICT) Infrastructure					
Main Telephone Lines per capita	Primary indicator of domestic telecommunications capacity	Per 100 inhabitants	International Telecommunication Union www.itu.int/ITU-D/ict/statistics, 10 May 04	2002	52.24
Cellular Mobile Subscribers per	Indicator of newer communications technology—may substitute for telephone lines	Per 100 inhabitants	International Telecommunication Union www.itu.int/ITU-D/ict/statistics, 10 May 04	2002	71.47
Computers per capita	Spread of technology infrastructure	Per 100 inhabitants	WCY 2004, Table 4.2.09, Source: Computer Industry Almanac Inc (www.c-I-a.com)	2003	45.78
Internet Users per capita	Indicates ability to engage in a variety of electronic activities, including commerce, information dissemination and retrieval,	Per 100 inhabitants	WCY 2004, Table 4.2.09, Source: Computer Industry Almanac Inc (www.c-I-a.com)	2003	45.21
Business Usage of ICT (index)	Measures the level of deployment and use of ICT across businesses in a nation. Business usage is determined by factors such as the level of B2B and B2C e-commerce, the use of ICT for activities like marketing, and levels of online transactions.	Index comprised of computers installed in businesses (2002), firm-level technology absorption (2003), and prevalence of foreign technology licensing (2003). Index scale: 1-7	Global Competitiveness Reports, World Economic Forum, Chapter 1: The Networked Readiness Index 2003-2004: Overview and Analysis Framework. Http://www.weforum.org/pdf /Gcr/GITR_2003-2004/ Framework_Chapter.pdf	2003-2004	4.67

Indicator	Significance for KBE	Details	Source	Data Year	OECD Reference Value
Innovation System					
Researchers per 1,000 Population	Indicates potential to create new (technical) knowledge	Researchers (full-time work equivalent) per 1,000 population	OECD, Main Science and Technology Indicators, May 2004, Table 09/TableE and WCY 2004 Table 4.3.03	2000: Australia, Canada, Chile; 2001: Hong Kong, China; Mexico; New Zealand; Thailand; 2002: remainder	2002: 4.73
Total Expenditure on R&D as a percent of GDP	Indicates current effort to create new (technical) knowledge.	Gross annual expenditure on R&D (GERD= Business Exp + Public Exp) as a percent of GDP	OECD, Main Science and Technology Indicators, May 2004, Table 02 and WCY 2004, Table 4.3.03.	2000: Australia; 2001: Hong Kong, China; Indonesia: 2003: Canada, US; 2002: remainder	2002: 2.26
Business Expenditure on R&D as a percent of GDP	Commitment by enterprises to knowledge creation	Business annual expenditure on R&D (BERD) as a percent of GDP	OECD, Main Science and Technology Indicators, May 2004, Table 24and WCY 2004, Table 4.3.04.	2001: Australia; Chile; Hong Kong, China; Mexico; New Zealand: 2003: Canada, US; 2002: remainder	2002: 1.54
US Patents per million population	Industries which patent extensively mostly do so in the USA (a major technology market) as well as at "home."	Number of US Patents awarded in specific year to residents of specified economy per million population.	Patents: March 2004 US Patent and Trademark Office, http://www.uspto.gov/web/offices/ac/ido/oeip/taf/cst_all.htm, and Population WCY 2004, Table 4.1.4	2003	82.69
Company Cooperation (survey rating)	Partial indicator for the extent of knowledge networks	WCY survey (scale 0-10): "Technological cooperation is developed between companies."	WCY 2004, Table 4.5.15	2004	6.35
Company-University Cooperation (survey rating)	Partial indicator for extent of knowledge networks	WCY survey (scale 0-10): "Knowledge transfer is highly developed between companies and universities	WCY 2004, Table 4.5.13	2004	5.22
Human Resource Development					
Secondary Enrollments as a Percent of Relevant Age Group	Potential for skilled workforce in the future	Total enrollment, regardless of age, divided by the population of the official age group which corresponds to this level of education	http://www.uis.unesco.org/ TEMPLATE/ html/ HTMLTables/education/ gerner_secondary.htm Chinese Taipei supplied data directly	2000/01: Canada, Chile, China, Thailand; remainder 2001/2002	107.30

Indicator	Significance for KBE	Details	Source	Data Year	OECD Reference Value
Percent of Population between 25-34 that have attained at least a Tertiary Education	Potential availability of workers that either have needed skills or can be trained for technology jobs		WCY 2004, Table 4.5.05, based on Education at a Glance, OECD 2003 and World Indicators 2003 (check for OECD update)		
"Knowledge Workers" as a percent of the Labour Force	Indicates current status as a KBE	Knowledge workers are all those whose occupation is reported to the ILO as Group 1 (legislators, senior officials and managers), Group 2 (professionals) and Group 3 (technicians and associate professionals) for ISCO-88 and as Group 0/1 (professional, technical and related workers) and Group 2 (administrative and managerial workers) for ISCO-68	http://laborsta.ilo.org Chinese Taipei supplied data directly	1999: Russia; 2000: Korea; 2001: Mexico, Philippines, Thailand; 2002: Australia, Canada, US; 2003: remainder	2002: 35.42
Human Development Index (rating)	Broad indicator of social development: KBE cannot develop unless all components of HDI as reasonably high	UNDP index based on three indicators of human development: life expectancy at birth, educational attainment (measured by a combination of adult literacy and school enrollments) and GDP per capita at purchasing power parity (maximum value=1.0000)	http://hdr.undp.org/reports/global/2004/pdf/hdr04_HDI.pdf Chinese Taipei supplied data directly	2002	0.9103

Notes:
Knowledge-based Industries was dropped as an indicator in the Business Environment section because it is only available for four OECD countries for 2000. E-Commerce was replaced as an indicator by the Business Usage Subindex, a subcomponent of the Networked Readiness Index as calculated by INSEAD.


Australia
BUSINESS ENVIRONMENT
Services Exports (%GDP)
HT Export (% mfg exports)
FDI (%GDP)
Govt Transparency
Financial Transparency
Competition Policy
Protectionism/Openness
INFO & COMMUNICATIONS TECHNOLOGY
Main Telephone Lines per capita
Cellular Mobile Subscribers per capita
Computers per capita
Internet Users per capita
Business Usage Subindex
INNOVATION SYSTEM
Researchers per capita
Total Expenditure on R&D (%GDP)
Business Expenditure on R&D (%GDP)
US Patents (per million population)
Company cooperation
Company-University cooperation
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
Tertiary Education
% Knowledge Workers
Human Development Index
0
0.5
1
1.5
2


Canada
BUSINESS ENVIRONMENT
Services Exports (%GDP)
HT Export (% mfg exports)
FDI (%GDP)
Govt Transparency
Financial Transparency
Competition Policy
Protectionism/Openness
INFO & COMMUNICATIONS TECHNOLOGY
Main Telephone Lines per capita
Cellular Mobile Subscribers per capita
Computers per capita
Internet Users per capita
Business Usage Subindex
INNOVATION SYSTEM
Researchers per capita
Total Expenditure on R&D (%GDP)
Business Expenditure on R&D (%GDP)
US Patents (per million population)
Company cooperation
Company-University cooperation
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
Tertiary Education
% Knowledge Workers
Human Development Index
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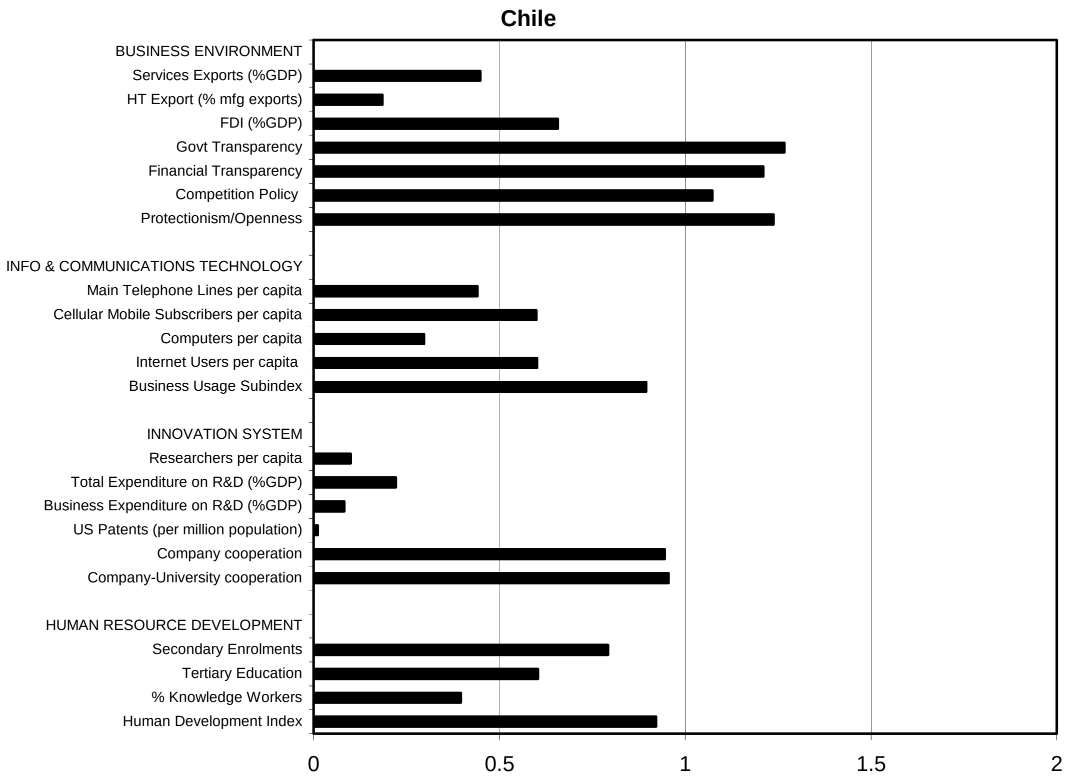
Chile
BUSINESS ENVIRONMENT
Services Exports (%GDP)
HT Export (% mfg exports)
FDI (%GDP)
Govt Transparency
Financial Transparency
Competition Policy
Protectionism/Openness
INFO & COMMUNICATIONS TECHNOLOGY
Main Telephone Lines per capita
Cellular Mobile Subscribers per capita
Computers per capita
Internet Users per capita
Business Usage Subindex
INNOVATION SYSTEM
Researchers per capita
Total Expenditure on R&D (%GDP)
Business Expenditure on R&D (%GDP)
US Patents (per million population)
Company cooperation
Company-University cooperation
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
Tertiary Education
% Knowledge Workers
Human Development Index
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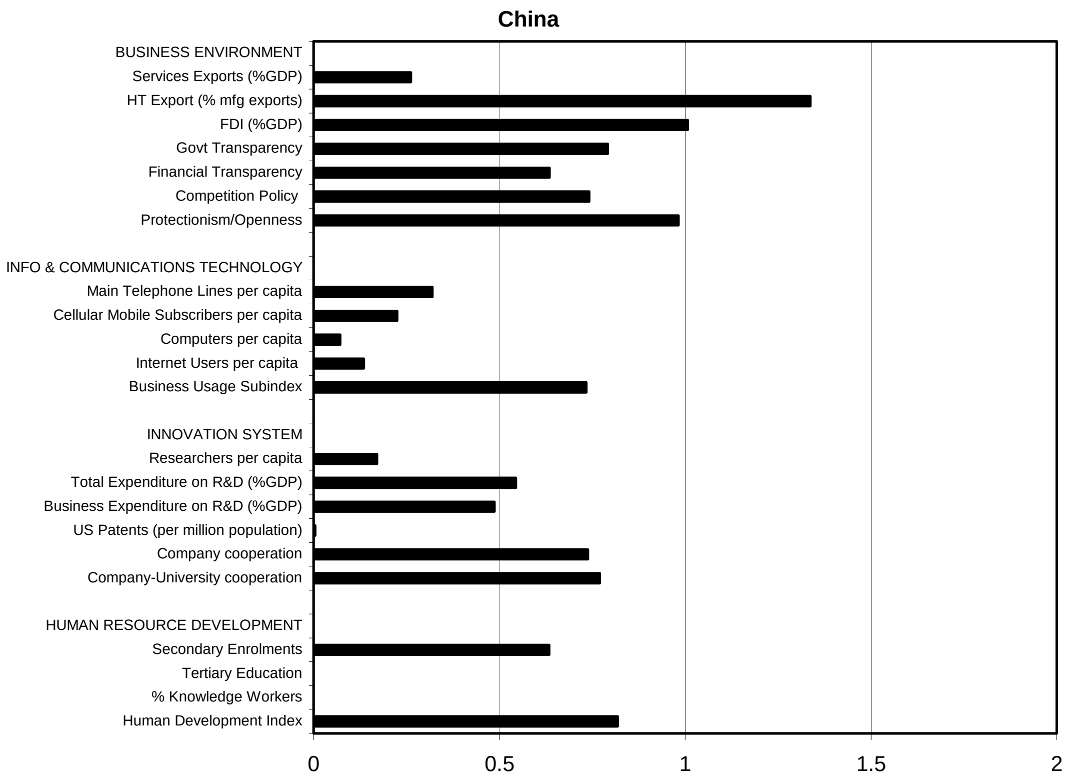
China
BUSINESS ENVIRONMENT
Services Exports (%GDP)
HT Export (% mfg exports)
FDI (%GDP)
Govt Transparency
Financial Transparency
Competition Policy
Protectionism/Openness
INFO & COMMUNICATIONS TECHNOLOGY
Main Telephone Lines per capita
Cellular Mobile Subscribers per capita
Computers per capita
Internet Users per capita
Business Usage Subindex
INNOVATION SYSTEM
Researchers per capita
Total Expenditure on R&D (%GDP)
Business Expenditure on R&D (%GDP)
US Patents (per million population)
Company cooperation
Company-University cooperation
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
Tertiary Education
% Knowledge Workers
Human Development Index
0
0.5
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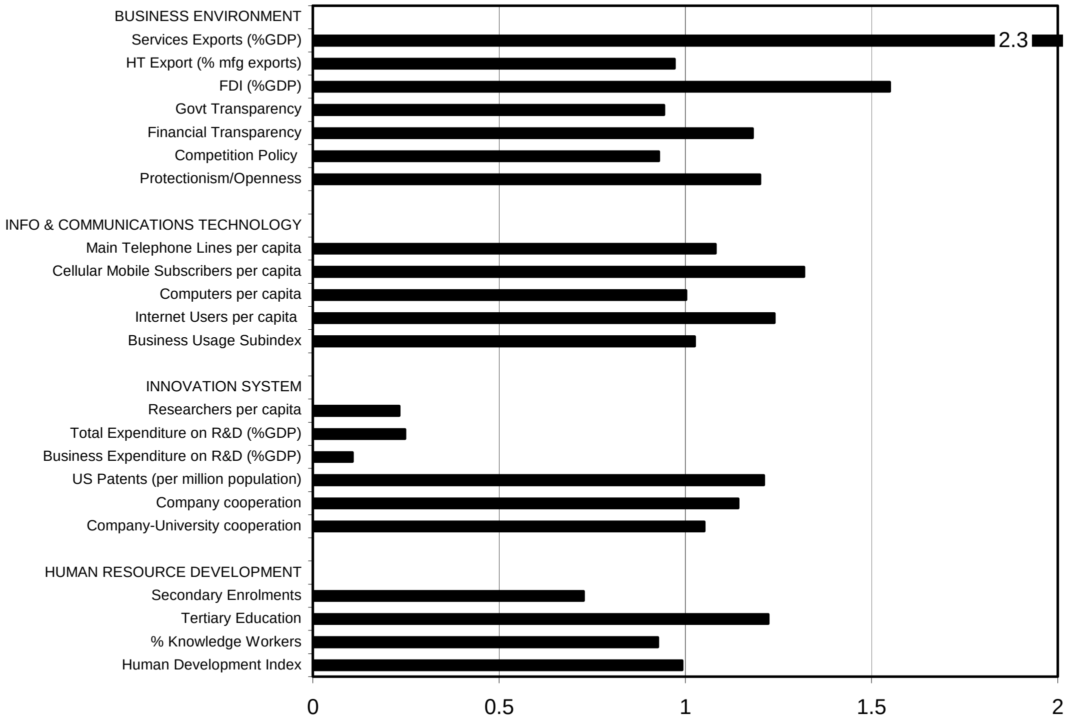
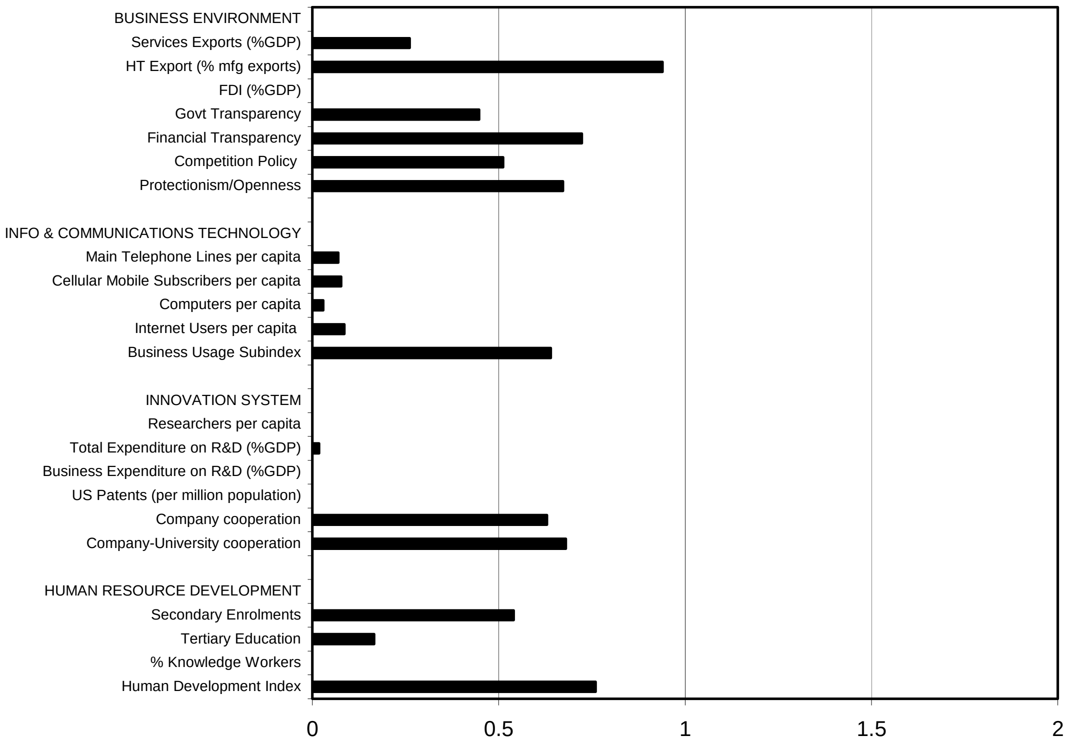
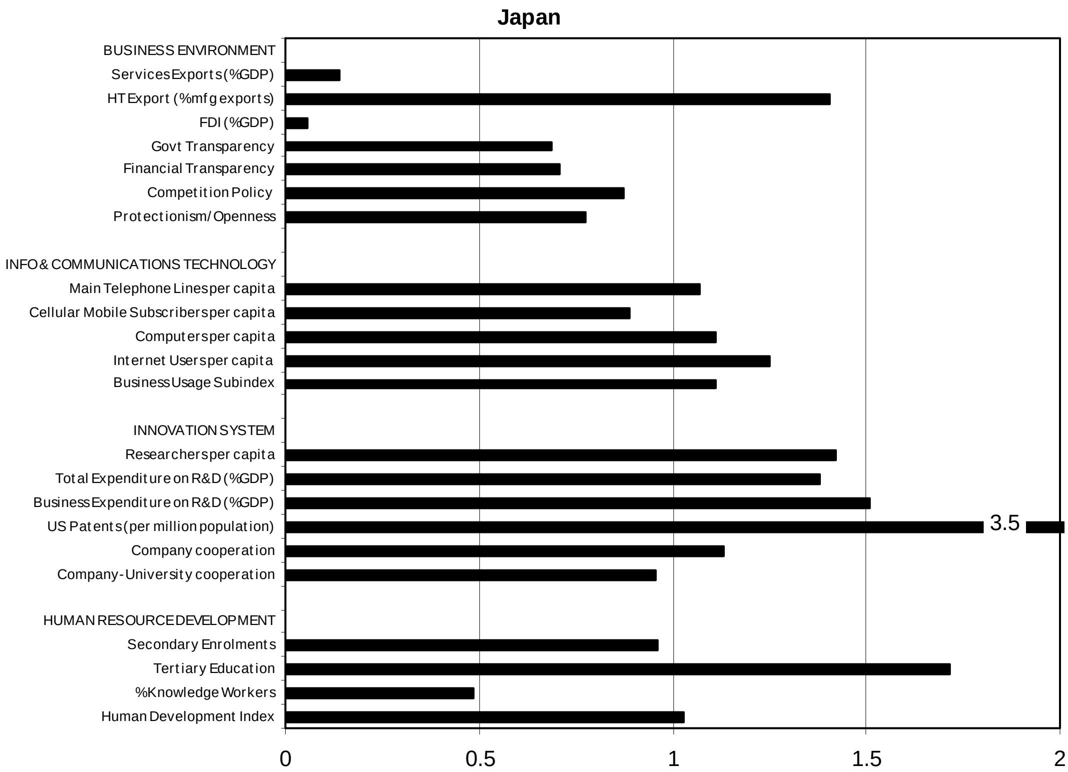
2

Hong Kong, China



Indonesia




Japan
BUSINESS ENVIRONMENT
Services Exports (%GDP)
HT Export (%mfg exports)
FDI (%GDP)
Govt Transparency
Financial Transparency
Competition Policy
Protectionism/Openness
INFO & COMMUNICATIONS TECHNOLOGY
Main Telephone Lines per capita
Cellular Mobile Subscribers per capita
Computers per capita
Internet Users per capita
Business Usage Subindex
INNOVATION SYSTEM
Researchers per capita
Total Expenditure on R&D (%GDP)
Business Expenditure on R&D (%GDP)
US Patents (per million population)
Company cooperation
Company-University cooperation
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
Tertiary Education
%Knowledge Workers
Human Development Index
3.5
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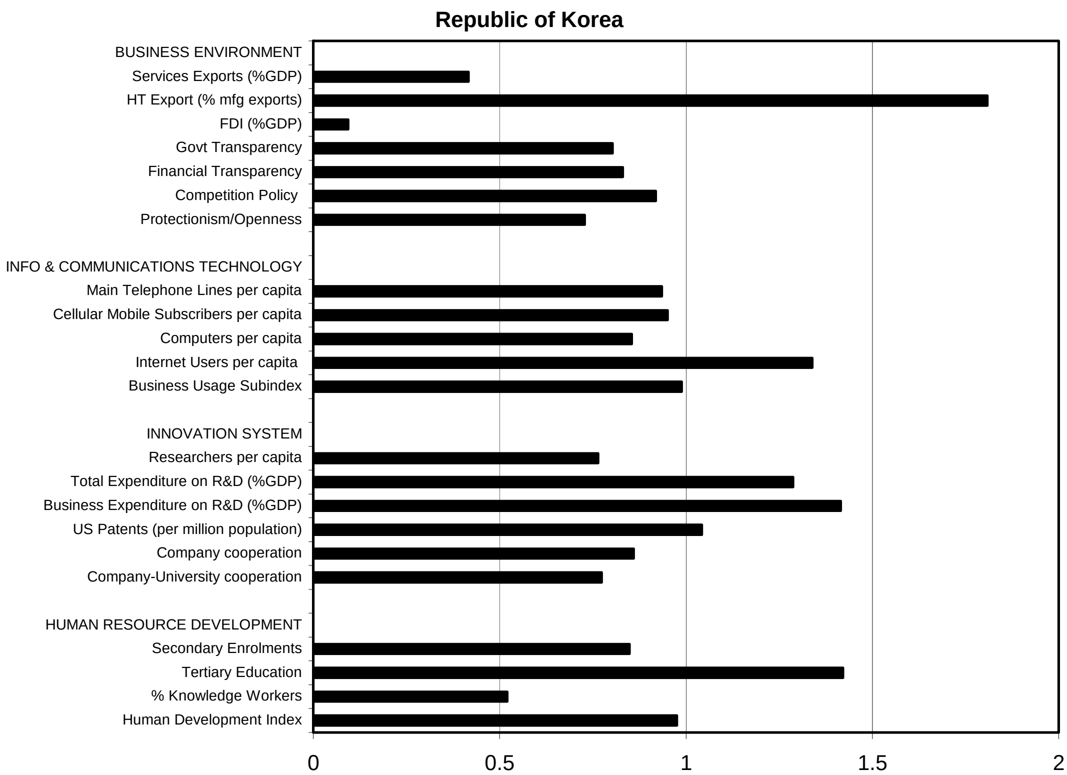
Republic of Korea
BUSINESS ENVIRONMENT
Services Exports (%GDP)
HT Export (% mfg exports)
FDI (%GDP)
Govt Transparency
Financial Transparency
Competition Policy
Protectionism/Openness
INFO & COMMUNICATIONS TECHNOLOGY
Main Telephone Lines per capita
Cellular Mobile Subscribers per capita
Computers per capita
Internet Users per capita
Business Usage Subindex
INNOVATION SYSTEM
Researchers per capita
Total Expenditure on R&D (%GDP)
Business Expenditure on R&D (%GDP)
US Patents (per million population)
Company cooperation
Company-University cooperation
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
Tertiary Education
% Knowledge Workers
Human Development Index
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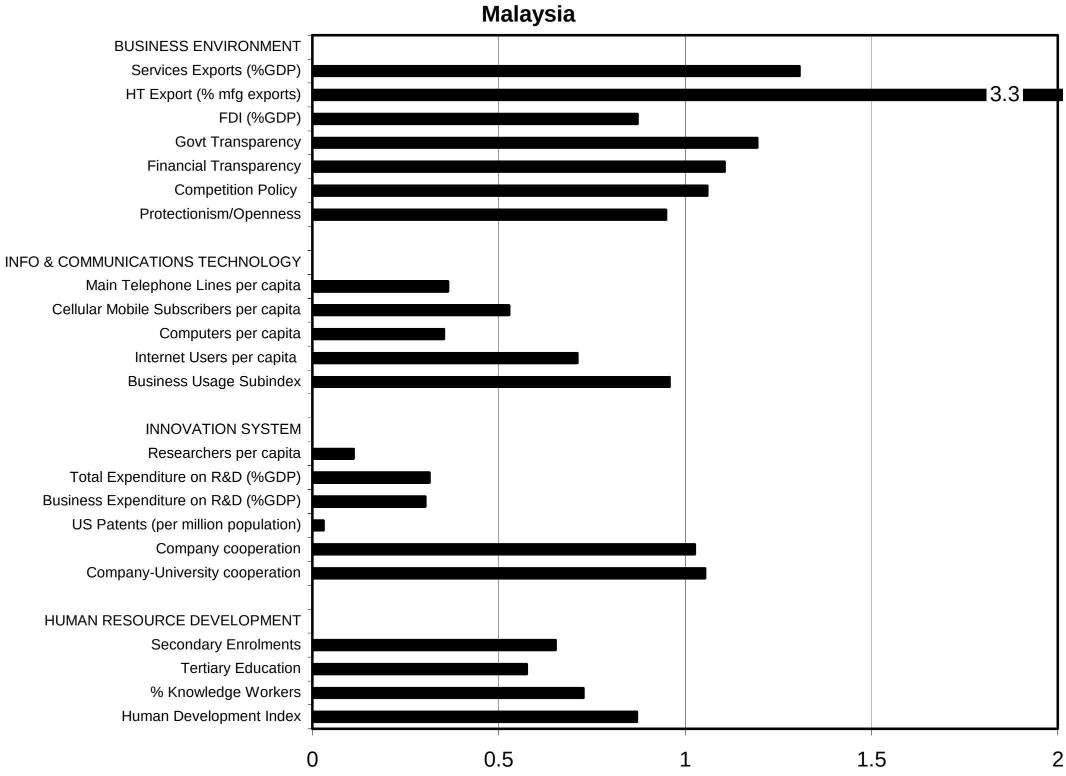
Malaysia
BUSINESS ENVIRONMENT
Services Exports (%GDP)
HT Export (% mfg exports)
3.3
FDI (%GDP)
Govt Transparency
Financial Transparency
Competition Policy
Protectionism/Openness
INFO & COMMUNICATIONS TECHNOLOGY
Main Telephone Lines per capita
Cellular Mobile Subscribers per capita
Computers per capita
Internet Users per capita
Business Usage Subindex
INNOVATION SYSTEM
Researchers per capita
Total Expenditure on R&D (%GDP)
Business Expenditure on R&D (%GDP)
US Patents (per million population)
Company cooperation
Company-University cooperation
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
Tertiary Education
% Knowledge Workers
Human Development Index
0
0.5
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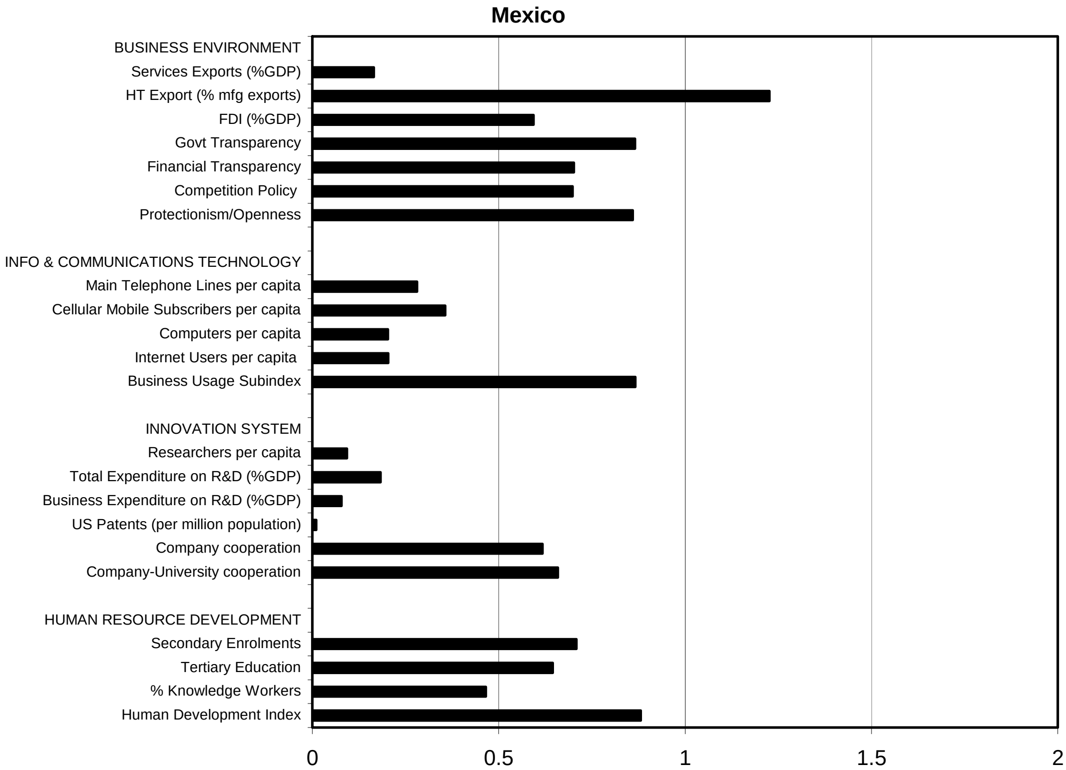
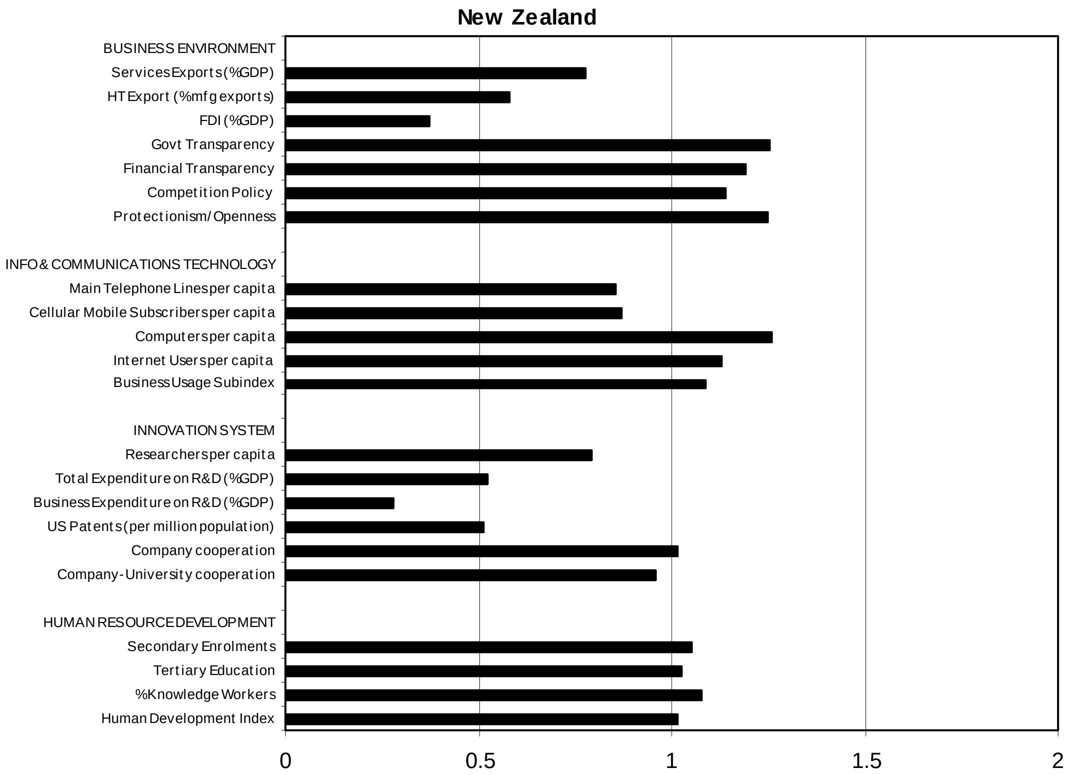
1.5
2


Mexico
BUSINESS ENVIRONMENT
Services Exports (%GDP)
HT Export (% mfg exports)
FDI (%GDP)
Govt Transparency
Financial Transparency
Competition Policy
Protectionism/Openness
INFO & COMMUNICATIONS TECHNOLOGY
Main Telephone Lines per capita
Cellular Mobile Subscribers per capita
Computers per capita
Internet Users per capita
Business Usage Subindex
INNOVATION SYSTEM
Researchers per capita
Total Expenditure on R&D (%GDP)
Business Expenditure on R&D (%GDP)
US Patents (per million population)
Company cooperation
Company-University cooperation
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
Tertiary Education
% Knowledge Workers
Human Development Index
0
0.5
1
1.5
2


New Zealand
BUSINESS ENVIRONMENT
Services Exports (%GDP)
HT Export (%mfg exports)
FDI (%GDP)
Govt Transparency
Financial Transparency
Competition Policy
Protectionism/Openness
INFO & COMMUNICATIONS TECHNOLOGY
Main Telephone Lines per capita
Cellular Mobile Subscribers per capita
Computers per capita
Internet Users per capita
Business Usage Subindex
INNOVATION SYSTEM
Researchers per capita
Total Expenditure on R&D (%GDP)
Business Expenditure on R&D (%GDP)
US Patents (per million population)
Company cooperation
Company-University cooperation
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
Tertiary Education
%Knowledge Workers
Human Development Index
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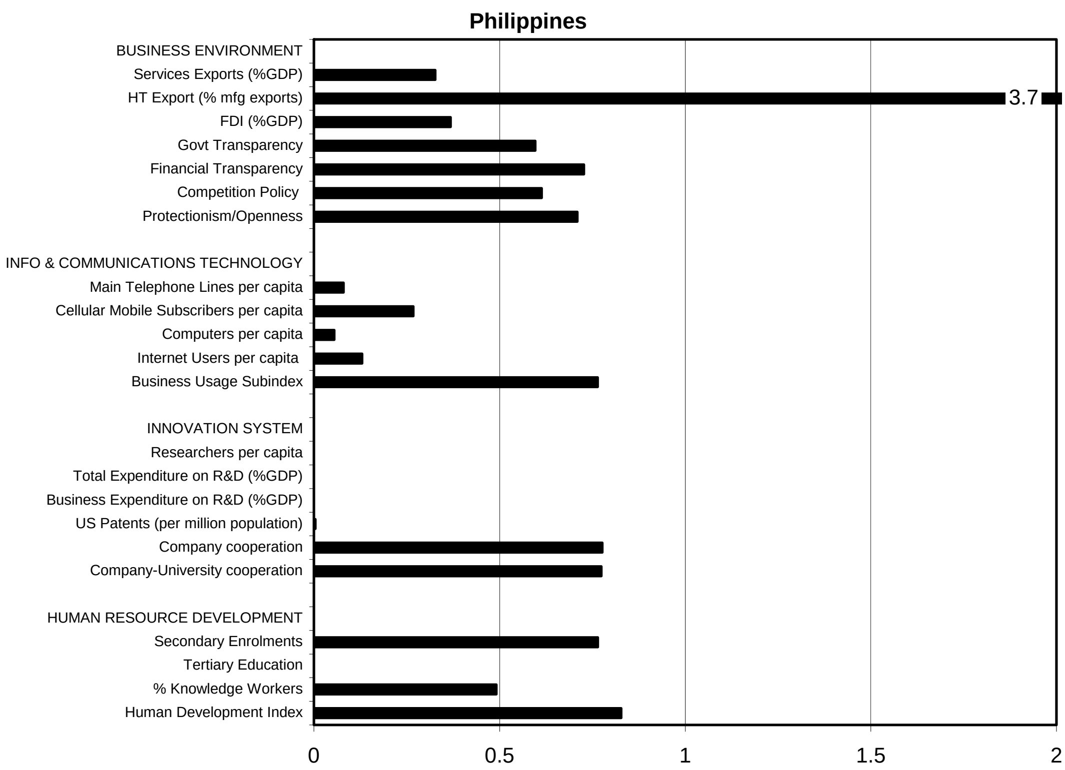
Philippines
BUSINESS ENVIRONMENT
Services Exports (%GDP)
HT Export (% mfg exports)
3.7
FDI (%GDP)
Govt Transparency
Financial Transparency
Competition Policy
Protectionism/Openness
INFO & COMMUNICATIONS TECHNOLOGY
Main Telephone Lines per capita
Cellular Mobile Subscribers per capita
Computers per capita
Internet Users per capita
Business Usage Subindex
INNOVATION SYSTEM
Researchers per capita
Total Expenditure on R&D (%GDP)
Business Expenditure on R&D (%GDP)
US Patents (per million population)
Company cooperation
Company-University cooperation
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
Tertiary Education
% Knowledge Workers
Human Development Index
0
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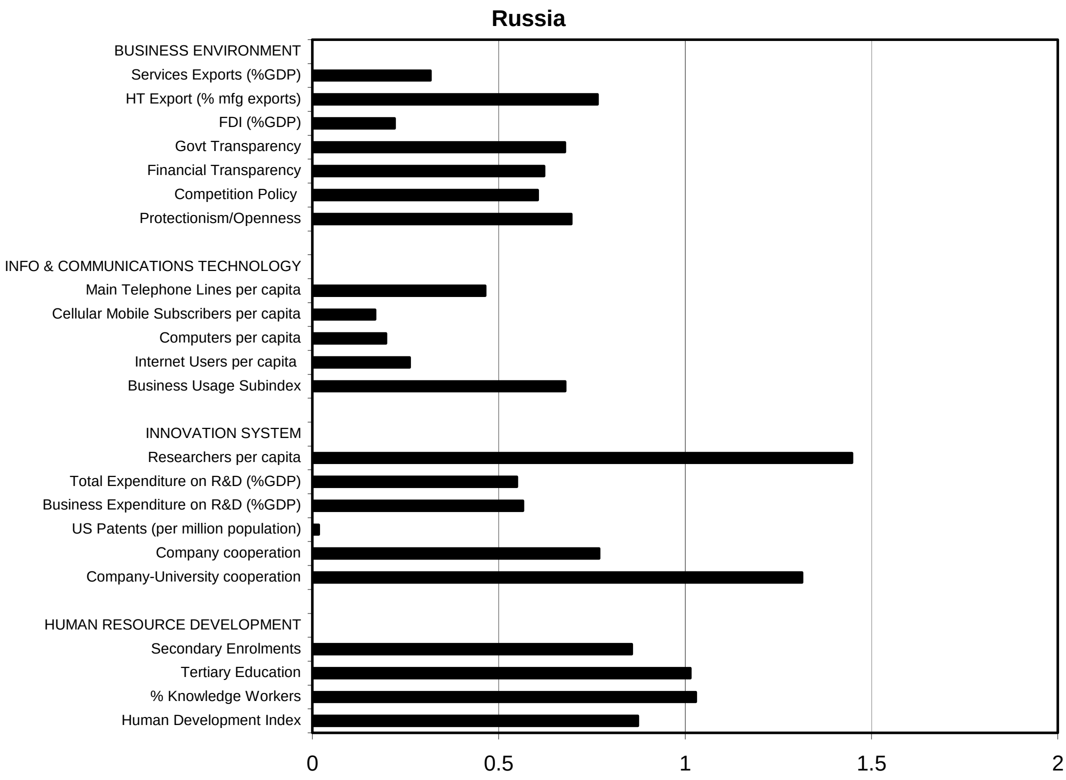
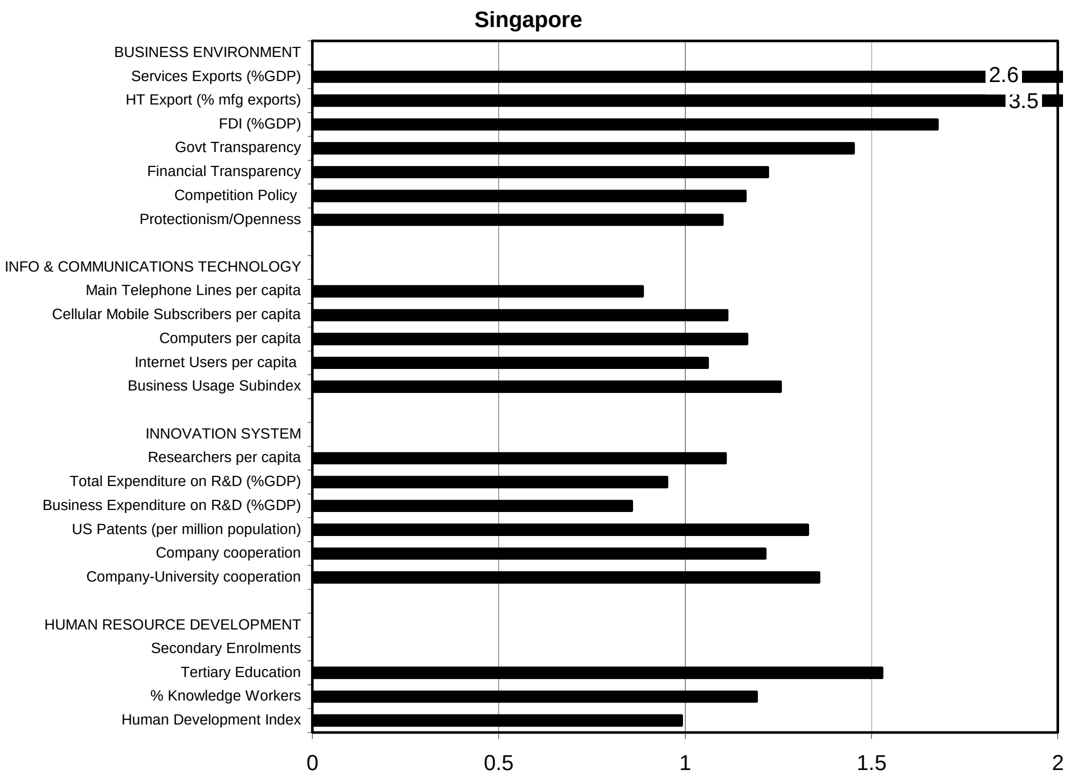
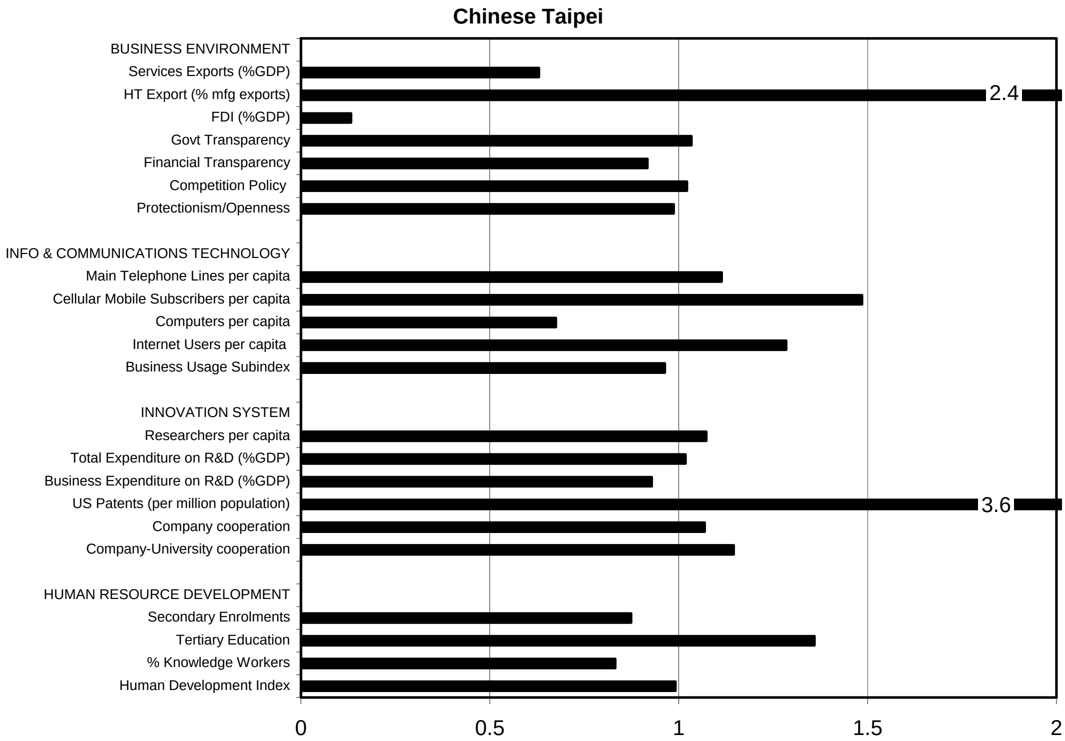
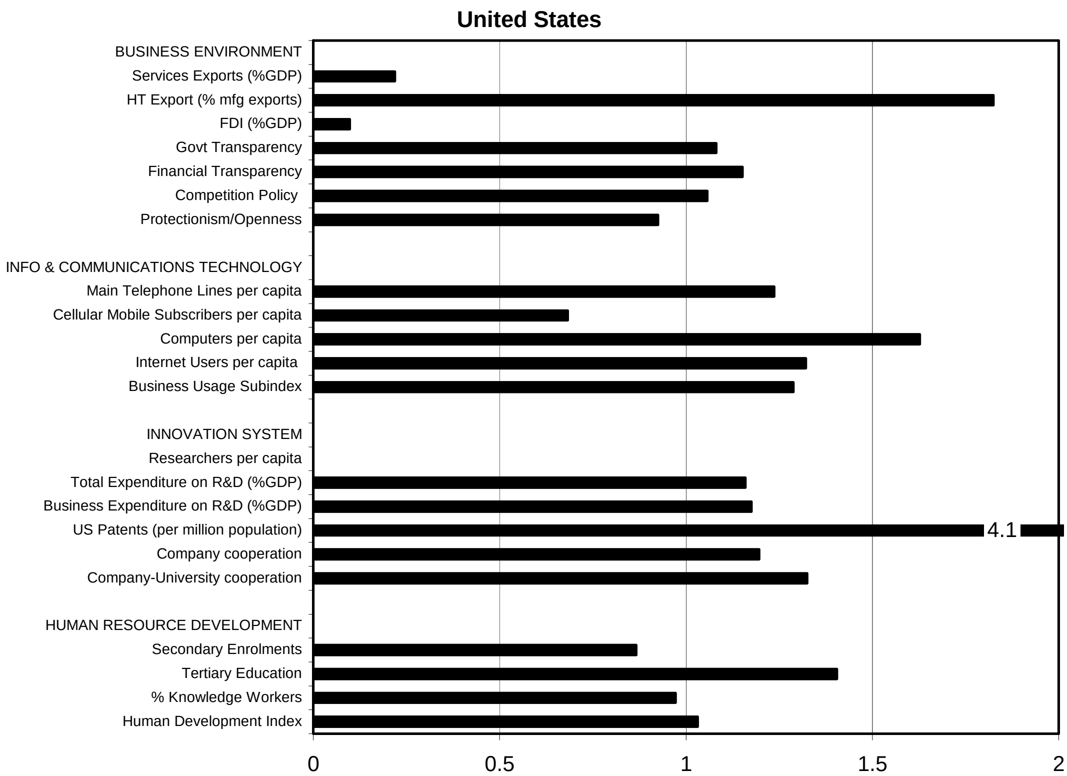
1.5
2


Russia
BUSINESS ENVIRONMENT
Services Exports (%GDP)
HT Export (% mfg exports)
FDI (%GDP)
Govt Transparency
Financial Transparency
Competition Policy
Protectionism/Openness
INFO & COMMUNICATIONS TECHNOLOGY
Main Telephone Lines per capita
Cellular Mobile Subscribers per capita
Computers per capita
Internet Users per capita
Business Usage Subindex
INNOVATION SYSTEM
Researchers per capita
Total Expenditure on R&D (%GDP)
Business Expenditure on R&D (%GDP)
US Patents (per million population)
Company cooperation
Company-University cooperation
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
Tertiary Education
% Knowledge Workers
Human Development Index
0
0.5
1
1.5
2


Singapore
BUSINESS ENVIRONMENT
Services Exports (%GDP)
2.6
HT Export (% mfg exports)
3.5
FDI (%GDP)
Govt Transparency
Financial Transparency
Competition Policy
Protectionism/Openness
INFO & COMMUNICATIONS TECHNOLOGY
Main Telephone Lines per capita
Cellular Mobile Subscribers per capita
Computers per capita
Internet Users per capita
Business Usage Subindex
INNOVATION SYSTEM
Researchers per capita
Total Expenditure on R&D (%GDP)
Business Expenditure on R&D (%GDP)
US Patents (per million population)
Company cooperation
Company-University cooperation
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
Tertiary Education
% Knowledge Workers
Human Development Index
0
0.5
1
1.5
2


Chinese Taipei
BUSINESS ENVIRONMENT
Services Exports (%GDP)
HT Export (% mfg exports)
FDI (%GDP)
Govt Transparency
Financial Transparency
Competition Policy
Protectionism/Openness
INFO & COMMUNICATIONS TECHNOLOGY
Main Telephone Lines per capita
Cellular Mobile Subscribers per capita
Computers per capita
Internet Users per capita
Business Usage Subindex
INNOVATION SYSTEM
Researchers per capita
Total Expenditure on R&D (%GDP)
Business Expenditure on R&D (%GDP)
US Patents (per million population)
Company cooperation
Company-University cooperation
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
Tertiary Education
% Knowledge Workers
Human Development Index
2.4
3.6
0
0.5
1
1.5
2


United States
BUSINESS ENVIRONMENT
Services Exports (%GDP)
HT Export (% mfg exports)
FDI (%GDP)
Govt Transparency
Financial Transparency
Competition Policy
Protectionism/Openness
INFO & COMMUNICATIONS TECHNOLOGY
Main Telephone Lines per capita
Cellular Mobile Subscribers per capita
Computers per capita
Internet Users per capita
Business Usage Subindex
INNOVATION SYSTEM
Researchers per capita
Total Expenditure on R&D (%GDP)
Business Expenditure on R&D (%GDP)
US Patents (per million population)
Company cooperation
Company-University cooperation
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
Tertiary Education
% Knowledge Workers
Human Development Index
4.1
0
0.5
1
1.5
2

ANNEX II:

INDIVIDUAL ECONOMY REPORTS

AUSTRALIA

Growth in the Australian economy was strong in 2003, reflecting solid growth in consumption and investment and a recovery in the rural sector following the drought in 2002. Real gross domestic product (GDP) grew by 3.3 percent in 2003. Unemployment fell steadily through 2003, while inflation remained well contained.

REAL GROSS DOMESTIC PRODUCT

Real GDP increased by 3.3 percent in 2003 (calendar year average terms) following growth of 3.6 percent in 2002.

- The growth of household spending was very rapid in late 2003 and was a key contributor to overall economic growth in the year. Consumption expenditure was underpinned by strong increases in wealth. Solid employment growth and a falling unemployment rate also supported household incomes and thus consumption growth over 2003.

- Dwelling investment grew strongly in 2003 reflecting very strong growth in alterations and additions and a substantial increase in new dwelling construction. The sustained low interest rate environment, continued increases in house prices and ongoing strength in employment supported dwelling investment throughout 2003.

- Business investment grew strongly in 2003. The fundamental drivers of business investment remained very supportive, with low interest rates, relatively high levels of capacity utilisation and solid growth in corporate profits underpinning investment activity. Investment in a number of mining projects and airline fleet upgrades were two key components of the overall strength in business investment.

- Public final demand (abstracting from private sector net purchases of second-hand public assets) rose by 4.7 percent in 2003 after rising by 3.6 percent in 2002.

- The external sector subtracted from GDP growth in 2003, reflecting a combination of strong domestic demand and relatively weak world growth. Net exports subtracted 2.8 percentage points from GDP growth in 2003, after subtracting 2.3 percentage points in 2002.

INFLATION

The consumer price index (CPI) increased by 2.4 percent through the year to the December quarter 2003. The major contributors to inflation over this period were food and housing, but their contributions were partly offset by the effect of lower import prices due to the strong appreciation of the Australian dollar over this period.

EMPLOYMENT

Employment grew by 2.3 percent in 2003, while the unemployment rate fell steadily across the year, from 6.2 percent in January to 5.8 percent in December.

Wages, as measured by the Wage Cost Index (WCI), increased by 3.7 percent through the year to the December quarter 2003. Public sector wages increased by 4.9 percent through the year to the December quarter 2003, while private sector wages increased by 3.3 percent.

CURRENT ACCOUNT

The current account deficit increased to A$46.0 billion or 5.9 percent of GDP in 2003, up from A$30.5 billion or 4.1 percent of GDP in 2002.

In 2003, export volumes fell by 2.6 percent, while import volumes increased by 11.0 percent. The terms of trade increased by 3.8 percent in 2003, following a 2.6 percent rise in 2002. The trade deficit widened to A$23.6 billion in 2003, an increase of A$13.5 billion.

EXCHANGE RATE

Australia has had a floating exchange rate since 1983. The Reserve Bank of Australia (RBA) undertakes foreign exchange market operations for its clients (mainly the Australian Government) and on its own account. Operations on the RBA's own account include interventions aimed at influencing the exchange rate. During 2003, the RBA's purchases of foreign currency more than exceeded the Government's requirements, consistent with the RBA increasing its foreign exchange reserve position as the Australian dollar appreciated.

During 2003, the Australian dollar appreciated (in nominal terms) by 32.5 percent against the US dollar. It appreciated by 10.4 percent against the euro and by 19.4 percent against the Japanese yen. The appreciation of the Australian dollar against these currencies contributed to a 22.9 percent increase in the trade-weighted index.

FISCAL POLICY

Following the large Australian Government budget deficits recorded in the first half of the 1990s, the budget was returned to cash surplus in 1997–98. The 2004–05 budget provides the seventh cash surplus since that time. (Data are not available on a calendar year basis).

In the 2004–05 financial year, the Australian Government is expected to be in an underlying cash surplus of 0.6 percent of GDP (or 0.4 percent measured on an accruals basis). This is higher than the projected cash surplus of 0.3 percent of GDP (or a 0.1 percent deficit on an accruals basis) forecast for 2004-05 in the 2004–05 Budget, primarily reflecting stronger revenue collections. The 2003–04 underlying cash balance was a surplus of 1.0 percent of GDP (or 0.7 percent on an accruals basis).

MONETARY POLICY

The RBA has the primary responsibility for the conduct of monetary policy. The formal objectives of monetary policy require the RBA to conduct monetary policy in a way that will best contribute to currency stability, the maintenance of full employment, and the economic prosperity and welfare of the people of Australia.

The Statement on the Conduct of Monetary Policy, agreed between the Treasurer and the Governor of the RBA in his capacity as the Chairman of the RBA Board in 1996 and updated in July 2003, reinforces the commitment to meeting the above objectives in a transparent and accountable manner. Price stability remains a critical element in achieving these objectives. In pursuing the goal of medium-term price stability, the Treasurer and the RBA have agreed to maintain an objective of keeping consumer price inflation between 2 and 3 percent, on average, over the cycle. The medium-term focus of the inflation target allows for the natural short run variation in inflation over the cycle.

To act pre-emptively against inflationary or deflationary pressures, the RBA targets a publicly announced overnight cash (interest) rate, with the target determined by the RBA Board.

In response to expected inflationary pressures arising, the RBA Board increased the target cash rate from 4.75 percent to 5.00 percent in November 2003 and to 5.25 percent in December 2003.

MEDIUM TERM OUTLOOK

The forecasts are prepared on a financial year basis. In 2004–05, economic growth is forecast to be 3.5 percent. Growth in gross national expenditure (GNE) is forecast to ease to a more sustainable 3.75 percent.

Net exports are forecast to subtract 0.5 of a percentage point from economic growth in 2004–05, as imports continue to grow a little more quickly than exports in response to the still solid levels of domestic spending. Nevertheless, despite the appreciation of the currency over the past two years, 2004–05 should see a significant improvement in export growth compared with the previous two years. The stronger world economy will provide support for exports of non-rural commodities, manufactures and services. The large grain harvest in 2003–04 has contributed to a build up of farm stocks, which will provide continuing support to rural exports into 2004–05, although the prospect of continuing dry conditions in parts of rural Australia is a risk to the outlook for activity in aggregate.

The current account deficit is expected to narrow to 5.0 percent of GDP in 2004-05, from the 5.75 percent forecast for 2003-04. Very strong growth in the terms of trade over recent years has cushioned the current account deficit from the full impact of the deterioration in net exports. Anticipated growth in the terms of trade drives the forecast narrowing of the current account deficit in 2004-05.

Dwelling investment is forecast to fall by 3.0 percent in 2004–05, following forecast growth of 6 percent in 2003–04. A decline in the construction of medium-density housing and a smaller fall in detached housing should dominate modest growth in alterations and additions in the year ahead. Considerable dwelling construction work remains in the pipeline, which should hold activity in the dwelling sector at high levels in the near term.

New business investment is forecast to grow by 7.0 percent in 2004–05, following 11.0 percent growth in 2003–04. The fundamental drivers of business investment remain very supportive and, partly as a consequence, business confidence remains at historically high levels. Profits have increased sharply over the past year, strengthening corporate balance sheets, particularly in sectors more exposed to the domestic economy. Interest rates remain at relatively low levels, capacity utilisation is high, domestic demand remains robust and international demand is strengthening.

Very strong growth in household consumption expenditure over the past year was supported by robust growth in real after-tax incomes, rapid increases in wealth, and continuing high consumer confidence. These factors, in addition to the Government's 2004–05 Budget initiatives, will continue to support consumption growth in the near term. However, a slower pace of wealth accumulation flowing from an assumed flattening in dwelling prices and slightly lower employment growth are expected to see consumption growth moderate to around 4.25 percent in 2004–05.

Employment growth is forecast to ease slightly to 1.5 percent through the year to the June quarter 2005, reflecting the slight moderation in forecast economic growth for 2004–05. Employment growth at this rate would be sufficient to hold the unemployment rate at or below 23-year lows of around 5.75 percent through 2004–05. In line with the forecast decline in dwelling investment, employment growth in the labour intensive residential construction sector and construction related parts of the manufacturing sector is expected to slow. Employment growth in other sectors related to domestic demand remains strong. Farm employment is expected to pick up through 2004–05, in line with the rebound in farm production.

The inflation outlook remains benign, underpinned by moderate growth in labour costs and the substantial appreciation of the Australian dollar over the past two years. Inflation is forecast to gradually decline to around 1.75 percent through the year to June 2005. Wage pressures are expected to remain contained through 2004–05, but recent falls in the unemployment rate are forecast to lead to a slight firming in wage growth in the near term.

STRUCTURAL REFORM

The *Intergenerational Report 2002–03 (IGR)* released with the 2002 Budget continues to inform the structural policy reforms of the 2004 Budget. The *IGR* projected that Australia's changing demographics will be detrimental to long-term growth and the sustainability of public finances over the next 40 years. The 2003–04 Budget suggested that it would be in Australia's long-term interest to address these challenges by pursuing faster economic growth, through increased labour force participation rates and higher productivity. In February 2004, the Treasurer released a discussion paper suggesting ways Australia might achieve these goals. In the 2004-05 Budget, the Government announced a package of major initiatives aimed at providing more help for families, cutting taxes further, boosting retirement savings and investing in Australia's future (see below). This package represents a further major step in meeting the challenge of population ageing.

Australia's *More Help for Families* package increases work incentives and assistance to Australian families and improves the capacity of families to balance their work and family responsibilities. It provides for a new maternity payment, extra financial assistance (subject to means testing) for families with children and a measure to help parents returning to work after having children.

Further tax reforms will improve work incentives and make the Australian tax system more internationally competitive. Personal income tax cuts will improve rewards from working overtime, acquiring skills, or seeking promotion. They will also assist Australia in retaining highly skilled workers by increasing the income thresholds at which higher marginal tax rates apply.

Improved incentives to save for retirement through superannuation will help ensure a sustainable retirement incomes system. They should enable Australians to achieve security and a higher standard of living in retirement. Changes will also make the retirement income system more flexible and adaptable to changing workplace arrangements, and provide Australians with more choices on how they retire and fund their retirement.

Increased investment in education and will improve the capacity of people to participate in the workforce. Australia is significantly increasing funding, as well as setting nationally consistent standards and goals, to prepare the next generation of Australians for future opportunities.

Measures such as research and innovation will enhance productivity. Australia has made an unprecedented 10-year commitment aimed at building a world class innovation system for the 21st century. This will enable Australia to develop new products and better work processes to enhance productivity and employment growth.

Improved transport infrastructure also has the capacity to enhance productivity. Australia's national land transport plan, *AusLink*, will take a long-term strategic approach to produce an integrated and high-performing national land transport network. This is in anticipation of an expected doubling of the non-bulk road freight task by 2020.

Over the next 10 years the *National Water Initiative* will address the establishment of a nationally compatible system of water access entitlements, efficient water markets, institutional arrangements for the recovery and management of water for the environment, improved accounting and best practice water pricing, and urban water issues.

ANNEX I

AUSTRALIA: OVERALL ECONOMIC PERFORMANCE

	1997	1998	1999	2000	2001	2002	2003
GDP and Major Components (percent change, year over year - earlier period, except as noted)							
Nominal GDP (level in billion US$ at market exchange rates)	405.9	363.0	390.6	379.4	358.1	400.6	509.6
Real GDP	3.7	5.4	4.3	3.3	2.7	3.6	3.3
Consumption	3.7	4.3	4.3	3.5	2.4	4.0	4.1
Private Consumption	4.0	4.5	4.9	3.1	2.9	4.0	4.1
Government Consumption	2.6	3.5	2.2	4.8	0.6	3.8	3.8
Investment	10.0	8.2	6.9	1.3	-0.5	15.4	8.0
Private Investment	12.3	10.6	5.4	0.8	-1.8	16.9	8.3
Government Investment	-0.4	-5.9	13.5	1.7	0.4	6.6	6.9
Exports of Goods and Services	11.5	-0.2	4.7	10.9	1.8	0.3	-2.6
Imports of Goods and Services	10.5	6.0	9.3	7.5	-4.2	11.9	11.0
Fiscal and External Balances (percent of GDP)							
Budget Balance**	-1.0	0.2	0.7	2.1	0.9	-0.1	1.0
Merchandise Trade Balance	0.4	-1.5	-2.5	-1.2	0.5	-1.3	-3.0
Current Account Balance	-3.1	-5.0	-5.7	-4.0	-2.3	-4.1	-5.9
Capital Account Balance	0.2	0.2	0.2	0.2	0.2	0.1	0.1
Financial Account	3.5	4.8	5.3	3.7	2.2	4.2	5.8
Capital and Financial Account	3.7	5.0	5.6	3.9	2.4	4.3	6.0
Economic Indicator (percent change, year over year - earlier period, except as noted)							
GDP Deflator	1.6	0.3	0.7	4.3	3.4	2.8	2.7
CPI	0.3	0.9	1.5	4.5	4.4	3.0	2.8
M3	9.31	6.75	9.41	7.63	8.84	9.57	10.6
Short-term Interest Rate (percent)^	5.4	5.0	5.0	6.2	4.9	4.7	4.9
Real Effective Exchange Rate (level, 2000=100)*	114.5	104.7	105.0	100.0	96.2	101.5	114.7
Unemployment Rate (percent)	8.3	7.7	6.9	6.3	6.8	6.4	6.0
Population (millions)	18.5	18.7	19.0	19.2	19.4	19.7	19.9

Notes:

* OECD Main Economic Indicators

** Figures refer to financial year e.g. 2003 is the financial year 2002-03. Source: *Budget Strategy and Outlook 2004-05*, Budget Paper No. 1.

^ 90 Day Bank Accepted Bills, annual average, RBA Bulletin

ANNEX II

AUSTRALIA: FORECAST SUMMARY (Percent Change From Previous Year)

	2004–2005					2005–2006				
	Official *	**IMF**	**Link**	**ADB**	**OECD**	**Official**	**IMF**	**Link**	**ADB**	**OECD**
Real GDP	3.5	N.A.	N.A.	N.A.	N.A.	3.5	N.A.	N.A.	N.A.	N.A.
Exports	9	N.A.	N.A.	N.A.	N.A.	7	N.A.	N.A.	N.A.	N.A.
Imports	11	N.A.	N.A.	N.A.	N.A.	7	N.A.	N.A.	N.A.	N.A.
CPI	2.5	N.A.	N.A.	N.A.	N.A.	2.5	N.A.	N.A.	N.A.	N.A.

*Official forecasts are based on financial years

ANNEX III

AUSTRALIA: MEDIUM-TERM TREND PROJECTION (percent)

	2006–2007 to 2008–2009
Real GDP	3.5
CPI	2.5

* Australia forecasts on a financial year basis.

BRUNEI DARUSSALAM

REAL GROSS DOMESTIC PRODUCT GROWTH

Brunei Darussalam's economy is estimated to have expanded by 3.2 percent in 2003. The growth was fuelled by pickups in both the oil and gas and the non-oil and gas sectors.

The oil and gas sector expanded by 3.6 percent in 2003. This growth is 0.4 percentage points higher than the growth in 2002. This was attributed to the increase in the production and price of both oil and liquefied natural gas.

The non-oil and gas sector expanded by 2.7 percent in 2003. This is higher than the 2.4 percent increase in 2002. This was mainly due to, among others, improved performance in the transport & communications and the insurance sectors.

Activities in the forestry sector grew at an estimated rate of 0.3 percent in 2003, slower than the 14.3 percent expansion in 2002. The fishery sector grew at an estimated rate of 9.3 percent growth in 2003, also slower compared to the 43.4 percent expansion in 2002.

The non-oil mining, quarrying and manufacturing sector turned around from the 25.3 percent contraction in 2002 and grew at an estimated 2.4 percent in 2003. Activities in the construction sector remained weak. The sector shrank further by an estimated 17.1 percent in 2003, on the heels of a 2.4 percent decline in 2002.

The restaurant and hotel sector was estimated to have grown by 6.8 percent in 2003. Economic growth of the hotel sector during the first half of 2003 had been dampened by the sudden acute respiratory syndrome (SARS) outbreak when the occupancy rate for the period dropped from 34.9 percent during the second half of 2002 to 32.0 percent during the first half of 2003. The growth momentum, however, turned up strongly during the second half of 2003 with an increase in the occupancy rate to 37.0 percent.

The transport and communications sector grew at an estimated 17.4 percent in 2003 compared to 0.8 percent growth in 2002. In the air transport sub-sector, the improved growth was mainly attributed to the better performance registered during the second half of 2003 compared to the first half. The SARS outbreak during the first half of 2003 had slowed down the air transport sub-sector during that period. The number of air passengers was down in second quarter (Q2) 2003 compared to Q1 2003 before registering growth in Q3 2003 and Q4 2003. The volume of air cargo was also down in Q2 2003 before registering growth during the second half of 2003. The sea transport sub-sector, however, registered a slowdown for the whole of 2003. The volume of cargo handled contracted in 2003 compared to that handled in 2002.

In 2003, performance of the communications sub-sector was mixed compared to the previous year. The number of internet services subscribers and the volume of postal articles handled fell during the period. On the other hand, the number of mobile phone subscribers continued to increase. International calls durations also showed strong growth in 2003 compared to the previous year.

The banking and finance sector expanded by an estimated 4.5 percent in 2003. This growth is higher than the 3.5 percent increase in 2002, reflecting the strengthening activities in the services of this sector. Banks' lending picked up in 2003 compared to the previous year. Total interest income from loans and advances also showed an improvement during the period. The insurance sector also performed better, registering an estimated 17.9 percent growth in 2003 compared to 15.9 percent growth in 2002.

INFLATION

The CPI for 2003 is 100.3, an increase of 0.3 percent compared to 2002. The calculation of CPI was recently rebased using 2002 as the base year with changes in the major group items. There are now 10 major groups instead of 5. These are food and non-alcoholic beverages; clothing and footwear; housing, water, electricity and maintenance; household goods, services and operation; transport; communication; education; medical and health; recreation and entertainment; and miscellaneous goods and services.

EXTERNAL TRADE

Total and Balance of Trade

In 2003, Brunei Darussalam's total trade was BND 10,015.8 million, an increase of 6.4 percent from BND 9,415.2 million in 2002. The trade surplus increased by 40.3 percent, from BND 3,842 million in 2002 to BND 5,391.2 million in 2003. This was mainly due to the effects of increases in the production and price of both oil and gas.

Exports

Total exports increased by 16.2 percent from BND 6,628.7 million in 2002 to BND 7,704 million in 2003. Petroleum exports increased by 17.2 percent from BND 3,231.5 million in 2002 to BND 3,788.4 million in 2003, reflecting a higher oil price (the oil price increased by 19.1 percent) and increased production. Liquefied Natural Gas (LNG) exports increased by 13.9 percent, from BND 2,603.5 million in 2002 to BND 2,964.5 million in 2003. Total oil and gas exports increased by 15.5 percent from BND 5,834.9 million in 2002 to BND 6,741.4 million in 2003.

The total value of non-oil and gas exports increased by 21.3 percent, from BND 793.8 million to BND 962.6 million during the same period. The value of garments export increased by 3.9 percent, from BND 383.3 million in 2002 to BND 398.4 million in 2003.

Japan remained the dominant exports market which accounted for 41 percent of total exports, followed by ASEAN (20.2 percent), Korea (11.2 percent), Australia (8.4 percent) and China (6.7 percent).

Imports

In 2003, total imports decreased by 17.0 percent from BND 2,786.6 million in 2002 to BND 2,311.8 million. The drop was due to the decline in imports of machinery and transport equipment by 36.2 percent followed by decline in imports of manufactured goods (10.6 percent) and beverages and tobacco (1.2 percent). However there were increases in imports of mineral fuels (204 percent), animal and vegetable oils and fats (46 percent), food and live animals (8.9 percent), crude materials inedible (4.5 percent), chemicals (3.7) and miscellaneous manufactured articles (1.1 percent).

With respect to the origin of imports in 2003, 47.4 percent of total imports were from ASEAN economies. This was followed by the USA (11.5 percent); the European Union (10.8 percent); Japan (10 percent); Hong Kong, China (6.6 percent); China (4.9 percent); and Australia (3.0 percent).

EMPLOYMENT

Compared to 2002, the total labour force grew by about 1.7 percent in 2003, to an estimated 151,440 persons. Out of this total, 27.4 percent (41,505 persons) were employed by the government. The proxy figure for unemployment, the number of local job seekers was 7,075 persons in 2003, slightly lower than the figure for 2002. The increasing employment figures for the government, and, especially the private sector, reflected the growing Bruneian economy.

GOVERNMENT FINANCE

In 2003, the Brunei government experienced a budget surplus of BND 479.93 million compared to a deficit of BND 378.5 million in 2002. The budget surplus was primarily due to an increase in revenue from BND 4,267.8 million in 2002 to BND 4,671.4 million in 2003 and helped further by a decline in government expenditure from BND 4,646.3 million in 2002 to BND 4,191.4 million in 2003.

The increase in total government revenue in 2003 was a result of increases in both tax and non-tax revenues. Significant contributors to the increase in tax revenue were taxes on net income and profits derived primarily from oil and gas production. On the other hand, the increase in non-tax revenue was contributed by the property income of the oil sector. Clearly, in both the tax revenue and non-tax revenue cases, the oil sector played a major role in replenishing government coffers in 2003.

On the expenditure side, savings were derived from both current and capital expenditures. For the former, there was a significant drop of 38.3 percent (BND 436 million) in the charged expenditure component in 2003, compared to the previous year. However, the overall decrease in the latter was less significant in dollar terms and this was contributed by a decline in the development expenditure component (while the OCSE component rose). Development expenditure in 2003 was BND 283.8 million compared with BND 419.8 million in 2002. This decline in development expenditure, however, may limit the expected spillovers on the private sector and the economy as a whole.

MONETARY POLICY

The growth trend in monetary variables has been consistent with output growth over the past four years. In 2003, narrow money (M1) grew by about 2.0 percent on average, contributed positively by growth in demand deposits by approximately 3.0 percent (-0.9 percent for currency in circulation). Demand deposits recorded an increase in terms of its composition of total M1, 69.2 percent at the beginning of the year compared to about 77.0 percent at the end of 2003.

The exchange rate of the Brunei dollar with respect to the US dollar has been quite stable during the year, fluctuating between -4.0 percent and 2.8 percent on a month-to-month basis. Generally, however, the exchange rate has fallen in favour of the Brunei currency by about 0.1 percent based on the period average.

On banking facilities: loans direction has been overwhelmingly dominated by personal loans, which were about 65.3 percent of total loans in December 2003. The construction, general commerce and mortgage sectors each comprised about 10.0 percent of the total.

Non-performing loans as whole declined over the 2003 period, from 15.5 percent in January to 12.5 percent in December of the year.

MEDIUM TERM OUTLOOK FOR 2004

The year 2004 will be another year of positive economic growth. Real GDP is forecast to grow between 3 and 4 percent in 2004. The oil and gas sector will continue to be a major contributor to GDP growth as will the non-oil sector.

The oil and gas sector is expected to post a growth of between 2 and 3 percent in 2004, especially the oil sector whose production could capitalize on the strength of the world market price. Towards the end of 2003, the world’s oil market price was anchored on a higher side of the price range of US$22 to US$28 per barrel. The market demand for commodities is also expected to move positively with regional economies’ favourable growth forecasts, especially those of Japan, China and Korea. These three economies, together, absorbed more than half of the total exports (oil and gas) of Brunei Darussalam in 2003. Currently, Brunei Liquefied Natural Gas (BLNG) is in the process of replacing its main cryogenic heat exchanger to enhance reliability and availability of LNG production in 2004–2005. This project will cause minimal disruption to the current level of production of LNG.

The non-oil sector, which comprises the government and private sector, is also projected to post continued growth of between 4 and 5 percent in 2004. The government, in particular, will still be a significant contributor to the economy’s growth and development. The government finances were in good shape in 2003 and a large budget balance was posted. This may induce greater spending in 2004. Furthermore, the government’s annual commitment to the 8th National Development

Plan is anticipated to improve as more projects are expected to be ready for implementation during the second half of the five-year plan period.

The non-oil private sector is also likely to post positive economic growth, barring unexpected significant events that may affect the economy adversely. Construction and related manufacturing industries, wholesale and retail trades, transport and communication and finance and insurance are among the economic sectors that are projected to support the economic growth. The growth in these sectors will be largely channelled through fiscal and consumption linkages.

External trade will continue to be the main source of income for Brunei Darussalam. In particular, oil and LNG exports are projected to grow in view of the favourable price mentioned above and optimistic economic growth prospects of Brunei Darussalam's import trading partners. The non-oil exports, which to a large extent comprise of garment exports, are also anticipated to grow further. In 2003, non-oil exports grew by 21.1 percent.

The growing economy of Brunei Darussalam is expected to stimulate moderately the growth of monetary variables in 2004. Broad Money Supply [M2 (Narrow Money Supply (M1) + Quasi Money)] has been growing steadily within a narrow band in 2003 and this growth is expected to continue in 2004. Personal loans are a major part of the direction of loans. They, and other major categories such as construction-related loans, general commercial loans and mortgages, are expected to increase further in 2004. Furthermore, an optimistic sign of the growing economy could also be related to the decline in non-performing loans in 2003 (12.5 percent in December 2003 compared to 15.5 percent in January 2003) and this trend is expected to continue in 2004.

Relative price stability has been a feature of the Brunei Darussalam economy for the past few decades, with generally low rates of inflation. In 2003, between January and December, the Consumer Price Index hovered between 99.4 and 100.7 and averaged 100.3 for the year. Compared to 2002, the growth in CPI for 2003 was 0.3 percent. Prices generally are expected to increase modestly in 2004.

Brunei Darussalam continues to accommodate foreign labour by employing them in various occupational categories in the private sector. Between 2002 and 2003, employment as a whole grew by about 2.0 percent, with approximately 2.3 percent growth of employment in the private sector. While the economy has been growing, the number of local job seekers has also increased by 5.9 percent during the same period. With the prospect of a growing non-oil private sector in 2004, employment growth is expected to follow.

RECENT ECONOMIC DEVELOPMENT

National Development Plan Budget For 2003

Brunei Darussalam has allocated a total of BND 1 billion for the implementation of National Development Plan projects. Out of that total, the government has expended a total of BND 280.7 million (28.0 percent). The transport and communications sector spent the most (BND 98.5 million) out of its allocated sum of BND 175 million. The overall low spending capacity was attributed to implementation-related matters such as those which arise from project management. (Table 1)

Table 1
Brunei Darussalam National Development Budget and Expenditure for 2003

SECTORS	ALLOCATION	EXPENDITURE TOTAL	EXPENDITURE As % of Allocation
Industry & Commerce	89,571,500	18,555,746	20.7
Transport & Communications	175,001,659	98,501,261	56.3
Social Services	216,460,593	54,007,657	25.0
Public Utilities	177,710,200	66,567,705	37.5
Public Building	92,401,400	26,448,917	28.6
Security	65,104,217	10,715,704	16.5
Miscellaneous	16,600,820	2,029,305	12.2
ICT	167,149,611	3,903,941	2.3
Total	**1,000,000,000**	**280,730,236**	**28.1**

Source: Department of Economic Planning and Development, Prime Minister's Office

OTHER DEVELOPMENTS AND ECONOMIC ACTIVITIES

Investment Promotions and Developments

In January, the Brunei Investment Agency (BIA) signed a BND 200 million investment agreement with its counterparts in Thailand for the formation of the Thai Prosperity Fund. This investment agency will invest primarily in the private placement of listed securities and equities of state enterprises in Thailand.

The Brunei Economic Development Board (BEDB) unveiled a BND 7.8 billion five year plan to diversify Brunei Darussalam's economy via its "two-pronged strategy" (January). This includes the building of a global mega-port hub for container handling at Pulau Muara Besar (PMB), the development of downstream and manufacturing activities and the building of a 500 megawatt power plant and other infrastructure. This was followed, in April, by a feasibility study of the PMB development by an international consulting firm, the Halcrow Group. Among other things the consultancy was to analyse trends in the global container transport market and to assess PMB as a global competitive port, the development options and private sector participation. In another related development, BEDB has commissioned ALCOA, a large aluminium-related company, to embark on a feasibility study to set-up an aluminium smelting plant in Brunei Darussalam (September).

In July, the BEDB and ACI Corp. Ltd (a UK based company) sealed a memorandum of understanding for a proposal to build a rubber recycling plant in Brunei Darussalam. The BND 1.8 billion project is expected to generate 1,200 jobs.

Oil and Gas Industry Development

Several developments have occurred in the oil and gas industry in Brunei Darussalam. A new gas field was discovered in the Egret production vicinity which will boost the production of liquefied natural gas (August). During the same month, His Majesty the Sultan of Brunei Darussalam visited Kuala Lumpur for talks on the oil field dispute between Brunei Darussalam and Malaysia. This is part of the annual bilateral meeting with Brunei's Malaysian counterparts.

In its effort to diversify oil exports destination, in July Brunei Darussalam signed an agreement with India to supply crude petroleum. In October, Brunei Darussalam has also signed a deal to send between 400,000 – 600,000 barrels of oil to China.

In December, the government of Brunei Darussalam sealed a new partnership deal with Brunei Shell Petroleum Company (BSP), a major oil production company operating for more than half a century. Among other thing this partnership agreement was in recognition of the contribution of BSP to economic and social development in Brunei Darussalam; and to enhance the role of BSP in helping the development of local businesses, Bruneianisation programmes, training and community development.

Information and Communication Technology (ICT) Development

In 2003, Information and Communication Technology (ICT) development in Brunei Darussalam was boosted by the Ministry of Education planned expenditure of BND 145 million on ICT.

Development in the ICT sector was also encouraged by the signing of a memorandum of understanding (MOU) between Universiti Brunei Darussalam and DST Groups. The MOU, among others includes software development and ICT entrepreneurs development programmes. DST Groups was expected to finance the project and facilitate expertise.

In a related development, DST Groups and Alcatel signed a BND 70 million deal in June to develop the existing mobile communication system to enhance mobile data services dubbed “Project Evolution”. The deal also included an effort to improve local expertise in mobile communication technology and nurture talent to become potential resources.

In October, Brunei Darussalam put aside a total of BND 170 million to develop its own ICT incubator in the form of an Eco-Cyber Park.

In December, the government announced its second e-government project, dubbed *PMOnet*, after successful implementation of the Treasury Accounting Financial Information System (TAFIS). The project, costing BND 23.5 million, was aimed at the preparation, distribution, installation, trial development and delivery of an Information Network Centre in Brunei. A MOU was signed between the government and a local IT company.

ANNEX I

BRUNEI DARUSSALAM: OVERALL ECONOMIC PERFORMANCE

	2002	2003
GDP and Major Components (percent change, year over year, except as noted)		
Nominal GDP (level in billion US$)	4.2	4.2
Real GDP	2.8	3.2
Consumption	NA	NA
Private Consumption	NA	NA
Government Consumption	34.0	-10.6
Investment[1]	73.3	20.1
Private Investment	151.0	33.0
Government Investment	-17.2	-6.8
Exports of Goods and Services	-1.1	20.4
Imports of Goods and Services	5.7	9.4
Fiscal and External Balances (percent of GDP)		
Budget Balance	-4.9	9.0
Merchandise Trade Balance	52.1	66.9
Current Account Balance	41.0	52.6
Capital and Financial Non-reserve Assets Balance[2]	-0.02	-0.03
Economic Indicator (percent change, year over year, except as noted)		
GDP Deflator	-0.5	4.3
CPI	-2.3	0.3
M2	-1.4	22.2
Short-term Interest Rate (percent)	0.4	0.23
Real Effective Exchange Rate (level, 1995=100)	1.752	1.711
Unemployment Rate (percent)	4.8	4.7
Population (millions)	0.3	0.3

Note:
[1] Estimated figure for 2003
[2] Capital account balance only (excluding BIA Investment Outflow)

ANNEX II

(Not relevant for Brunei Darussalam)

ANNEX III

BRUNEI DARUSSALAM: MEDIUM-TERM TREND FORECAST (percent)

	2003–2004
Real GDP	2.9
GDP Deflator	2.5

CANADA

REAL GROSS DOMESTIC PRODUCT GROWTH

Following tepid growth in 2001, the Canadian economy surged ahead in 2002 with real GDP expanding by a robust 3.4 percent in the year, markedly higher than the 2.2 percent growth in the U.S. over the same period. Canada's resilient performance reflected strong economic fundamentals, large tax cuts and an increasingly competitive business sector.

During 2003, economic activity slowed because of a series of unforeseen shocks. Severe acute respiratory syndrome (SARS), bovine spongiform encephalopathy (BSE), the blackout in Ontario and the rapid appreciation of the Canadian dollar moderated economic growth to 2.0 percent in 2003. However, while exports suffered as a result of the shocks, domestic demand remained firm through most of the year, supported by low interest rates.

Looking ahead, solid domestic fundamentals, low interest rates and a more favorable global economic environment, particularly a stronger U.S. economy, are expected to support robust Canadian growth. According to the March 2004 survey of private-sector economists, growth in Canada is expected to accelerate to 2.7 percent in 2004 and 3.3 percent in 2005.

INFLATION

Consumer price inflation has remained within the Bank of Canada's inflation target band of 1.0 to 3.0 percent for most of the last five years.

Inflation drifted outside the upper limit of the target band in the final months of 2003, boosted in large part by a number of one-off (temporary) factors (automobile insurance premiums and energy prices) and higher costs for key inputs.

Since that time, inflation has moderated considerably as a result of the unwinding of one-off factors, weaker economic activity and the sharp appreciation of the Canadian dollar *vis-à-vis* its U.S. counterpart.

According to the April 2004 Monetary Policy Report, inflationary pressures are expected to remain subdued for the remainder of 2004 reflecting the slack in labour and product markets. The core rate of inflation is expected to stay around 1.5 percent through 2004, before gradually moving to the 2 percent mark by the end of 2005. Total CPI inflation is projected to be slightly higher than core over 2004 and into 2005 as a result of strong energy prices.

EMPLOYMENT

While the labour market slowed down in 2001 in tandem with economic activity, it recovered rapidly in 2002 as output growth came back to more normal levels. In 2002 the Canadian economy created 560,000 new jobs — the largest number of jobs created over any 12-month period on record (back to 1976) and the fastest growth rate in 15 years (3.7 percent). Moreover, there were job gains in most sectors of the economy and over 60 percent of these new jobs were full-time. This period also saw a marked increase in labour force participation rates, which tempered the impact of the rapid increase in employment opportunities on the unemployment rate. The unemployment rate fell from 9.1 percent in 1997 to a low of 6.8 percent in 2000 and stood at 7.5 percent at the end of 2002.

The economy continued to add new jobs in 2003 though at a slower pace than in 2002. Employment increased by 270,800 while the unemployment rate held more-or-less steady around 7.5 percent over most of the year.

Employment growth has slowed somewhat this year, but the economy still added 86,100 new jobs over the first five months of 2004. Meanwhile, reflecting the job gains and a decline in the participation rate, the unemployment rate stood at 7.2 percent in May 2004, its lowest level since July 2001.

BALANCE OF PAYMENTS

The current account has improved dramatically from the deficits in the 1990s, consistent with significant improvements in government finances. The current account moved into surplus late in 1999 and the surplus has continued to increase despite the U.S. slowdown in 2001.

In 2003, the current account balance as a share of GDP stood at 2.0 percent, up from 0.3 percent of GDP in 1999. In the first quarter of 2004, the current account surplus increased further to 3.0 percent of GDP.

GROSS EXTERNAL DEBT

Thanks in part to the current account surpluses, supported by the improvement in fiscal balances over recent years, Canada's net foreign debt as a share of GDP is down close to its lowest level since the 1950s, from a peak of 44 percent of GDP in 1993 to below 17 percent in the fourth-quarter of 2003.

Canada's net foreign debt now stands below that of the US. With continuing current account surpluses expected in Canada, and continuing deficits anticipated in the US, Canada's net foreign indebtedness should continue to fall and the gap vis-à-vis the US continue to widen.

EXCHANGE RATE

The Canadian dollar has, over recent times, experienced downward pressure as a result of weakness in world commodity prices and 'flight to quality' towards the US dollar. The Canadian (C$) dollar began 2001 at around 67 US cents but trended down to close to 64 US cents by the end of 2002.

Since then, however, the Canadian dollar has gained significant strength vis-à-vis the US dollar. Over the course of 2003 the Canadian dollar appreciated more than 20 percent against its US counterpart, returning to levels last reached in late 1993. The recent rise of the Canadian dollar reflected in part a general weakness of the US dollar against all major currencies.

More recently, the Canadian dollar has come off the highs observed in 2003, averaging about 72.4 US cents in May 2004.

FISCAL POLICY

Thanks to sound fiscal management over the past 10 years, the Federal Government has now recorded six consecutive budgetary surpluses—an achievement unique among the G-7 countries. The federal budgetary surplus in 2002–03 was C$7.0 billion. A balanced budget or better is expected again for 2003–04, which would mark the seventh consecutive balanced budget, an accomplishment unparalleled since the Confederation.

Federal surpluses have helped to reduce the federal debt by C$52.3 billion over the past six years. This has resulted in lowering the federal net debt-to-GDP ratio from 68.4 percent in 1995–96 to 44.2 percent in 2002–03. With the commitment to balanced budgets in each of the next two fiscal years, the federal net debt-to-GDP ratio is forecast to decline to about 38 percent in 2005–06.

MONETARY POLICY

Since 1991, the Federal Government and Bank of Canada have maintained an official target range for the inflation rate. This target range was gradually lowered to 1 to 3 percent. The commitment to keep inflation within that target range was renewed in February 1998 and again in May 2001, with the latter in effect until the end of 2006. The commitment to a low and stable inflation environment enables policy to best contribute to a sustained economic expansion in Canada, thereby leading to the likelihood of lower unemployment and improved productivity.

With the slowdown in global economic growth and a movement toward a position of excess supply becoming evident in early 2001, monetary policy began to ease in the United States and Canada at the beginning of that year. The U.S. Federal Reserve dropped its Federal Funds rate eleven times, for a total decline of 475 basis points during 2001. Between early 2001 and mid-January 2002, the Bank of Canada lowered its target for the overnight interest rate (its key policy instrument) on ten occasions for a cumulative decrease of 3.75 percent (or 375 basis points).

In the early part of 2003 upward pressure on prices and concerns about rising inflation expectations prompted the Bank of Canada to raise its key policy rate by 50 basis points. However, reduced pressure on prices as well as increased economic slack in the face of negative microeconomic shocks led the Bank to lower its key policy rate by 50 basis points, reversing the increases over the earlier part of the year.

Thus far in 2004, the Bank of Canada has continued to lower its key policy rate by an additional 50 basis points to 2.25 percent, citing the negative impact of the rapid appreciation of the Canadian dollar on economic activity.

MEDIUM-TERM OUTLOOK

According to the March 2004 survey of private sector economists, Canadian real GDP growth is expected to average 2.7 and 3.3 percent in 2004 and 2005 respectively. Growth is forecast to average 3.1 percent for the 2006–09 period.

With the persistence of excess supply through 2004, the Bank of Canada’s latest Monetary Policy Report predicts core inflation to average 1.5 per cent over the remainder of the year. The past appreciation of the Canadian dollar may also put some modest downward pressure on core inflation through 2004. But as excess supply diminishes, core inflation is projected to move back to 2.0 percent by the end of 2005. Total Consumer Price Index inflation over this period is expected to be heavily influenced by developments in the markets for crude oil.

Medium-term inflation expectations continue to be anchored at around the mid-point of the Bank of Canada’s inflation bands (2.0 percent).

STRUCTURAL REFORMS

- **Fiscal Consolidation**

  In 1994, the Federal Government determined to reduce, and eventually eliminate, the deficit that had persisted for more than two decades. Deficit reduction targets were established and a prudent approach was implemented to achieve those targets. In four years, the Federal Government eliminated a deficit of C$38.5 billion and placed the federal debt on a permanent downward track. As a result of this prudent approach to budget planning, the Federal Government has achieved six consecutive budgets surpluses and the federal debt has been reduced by more than C$50 billion.

- **Inflation Targeting**

  Low and stable inflation facilitates long-term planning and encourages business investment that ultimately boosts productivity. The Bank of Canada and the Government of Canada jointly agreed to target inflation in 1991 to reduce the inflation to the mid-point of a range of 1 to 3 percent by the end of 1995. In May 2001 the inflation control target was extended to the end of 2006. Inflation expectations remain firmly anchored at 2 percent.

- **Tax Reform**

  Canada implemented important tax reforms to its tax system during the 1990s and into the current decade. For example, in 1991, a goods and services tax (GST) replaced the out-dated Manufacturers' Sales Tax which had been in effect since 1924. In 2000, the Federal Government was able to introduce the largest tax reduction in history. The five-year, C$100 billion tax reduction plan was most important tax reform in a decade.

- **Labour Market Reform**

  The 1990s brought changes for the Employment Insurance (EI) system including an increase in the number of weeks required to qualify for the benefits and a reduction of weeks of benefit entitlement. Beginning on 4 January 2004, individuals who meet the eligibility requirements for special benefits will be entitled to a six-week EI compassionate care benefit to care for a gravely ill or dying child, parent or spouse.

- **Social Assistance Reform**

  Major and far-reaching changes were implemented, motivated by a desire to counteract the dramatic increase in program expenditures that occurred during the early 1990s (between 1989 and 1994 real social assistance expenditures in Canada doubled). These reforms represented a systemic change from those in the 1980s, involving not only changes in program parameters such as benefit levels, but also measures aimed at restricting eligibility through tightened administrative procedures.

- **Pension Reform**

  In 1997, federal and provincial governments agreed on a series of reforms that have placed the Canada Pension Plan (CPP) on a path of long-term term sustainability. The key reforms introduced a degree of prefunding to the plan and adopted a new market investment policy for the reserve fund.

- **Trade Liberalization**

  Canada's Free Trade Agreement with the US in 1989 led to an expansion in trade and an improvement in productivity and living standards. The trade agreement also had a profound impact on the way Canadian corporations operate. By expanding the Canada-U.S. Free Trade Agreement to Mexico, Canadian exports to Mexico doubled between 1994 and 2000. Canada also took steps to reduce barriers to trade within Canada with the Agreement on Internal Trade signed in 1994.

- **Privatization**

  Privatization in the transport sector (Air Canada, CN Rail and NAV Canada) from 1988 to 1996 followed a period of sustained privatization of crown corporations operating in other sectors. The privatization process not only increased operational capacity of those corporations but it also provided over C$10 billion in revenue to the Government to address other fiscal and debt priorities.

- **Financial Sector Reforms**

  Canada has implemented a number of important financial reforms, including a demutualization regime allowing federal mutual life insurance companies to convert to stock ownership; a foreign bank branching regime including greater flexibility to enter the Canadian marketplace; a new holding company option; the creation of a consumer protection agency, and enhanced access to the payment system for life insurance companies, securities dealers and mutual funds.

ANNEX I

CANADA: OVERALL ECONOMIC PERFORMANCE

	1998	1999	2000	2001	2002	2003
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (level in billion US$)	660.8	662.2	724.6	746.1	747.6	776.1
Real GDP	4.1	5.5	5.2	1.8	3.4	2.0
Consumption						
Private Consumption	2.8	3.8	4.0	2.7	3.4	3.1
Government Consumption	3.2	2.1	3.1	3.7	2.8	3.8
Investment						
Private Investment	2.8	6.2	4.8	3.3	1.4	4.6
Government Investment	-0.7	15.6	3.8	10.1	9.1	6.8
Exports of Goods and Services	9.1	10.7	8.9	-2.8	1.1	-2.4
Imports of Goods and Services	5.1	7.8	8.1	-5.0	1.4	3.8
Fiscal and External Balance (percent of GDP)						
Budget Balance	0.1	1.6	2.9	1.1	0.3	0.6
Merchandise Trade Balance	2.6	4.3	6.2	6.3	4.9	4.8
Current Account Balance	-1.2	0.3	2.7	2.3	2.0	2.0
Capital and Financial Non-Reserve Assets Balance	1.3	-0.4	-1.5	-1.1	-1.1	-2.1
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	-0.4	1.7	4.1	1.1	1.0	3.2
CPI	1.0	1.7	2.7	2.5	2.3	2.7
M2	-0.7	2.8	7.1	5.2	6.3	5.8
Short-Term Interest Rate (percent)*	4.7	4.7	5.5	3.8	2.6	2.9
Real Effective Exchange Rate (level, 1995=100)	91.9	92.0	93.8	88.9	87.2	99.2
Unemployment Rate (percent)	8.3	7.6	6.8	7.2	7.7	7.6
Population (millions)	30.1	30.4	30.7	31.0	31.3	31.6

ANNEX II

CANADA: FORECAST SUMMARY (percent change from previous year)**

	2004						2005					
	Official	**IMF**	**ADB**	**OECD**	**PECC**	**Link**	**Official**	**IMF**	**ADB**	**OECD**	**PECC**	**Link**
Real GDP	2.7	N.A.	N.A.	N.A.	N.A.	N.A.	3.3	N.A.	N.A.	N.A.	N.A.	N.A.
Exports	5.6	N.A.	N.A.	N.A.	N.A.	N.A.	5.6	N.A.	N.A.	N.A.	N.A.	N.A.
Imports	7.5	N.A.	N.A.	N.A.	N.A.	N.A.	8.2	N.A.	N.A.	N.A.	N.A.	N.A.
CPI	1.4	N.A.	N.A.	N.A.	N.A.	N.A.	1.8	N.A.	N.A.	N.A.	N.A.	N.A.

ANNEX III

CANADA: MEDIUM-TERM TREND FORECAST (percent)

	2006–2009
Real GDP	3.1
GDP Deflator	1.9

* 90-day Treasury bill rate (nominal)
** Forecast figures are based on the March 2004 Budget

Notes for Annex I

1. Government consumption is total spending on goods and services.
2. Private investment includes investment in machinery and equipment, non-residential construction and residential construction.
3. Government investment is government gross capital formation
4. Budgetary balance is on a national accounts basis for total government (calendar year basis)
5. Capital and financial non-reserve asset balance is total capital account balance, reserve assets.
6. Short-term interest rate is the 90-day Treasury bill rate.
7. Real effective FX rate is the Canada-U.S. real exchange rate calculated as: 1/exp[log(pfx)+log(uspgdp)-log(pgdp)]

Variables and Source List

Nominal GDP (level in billion US$)	v498086*pfx
Real GDP	v1992067
Consumption	
Private Consumption	v1992044
Government Consumption	v1992049
Investment	
Private Investment	v1992052
Government Investment	v1992050
Exports of Goods and Services	v1992060
Imports of Goods and Services	v1992063
Budget Balance	gbal
Merchandise Trade Balance	v114423*4
Current Account Balance	v114421*4
Capital and Financial Non-Reserve Assets Balance	v114553- v114566
GDP Deflator	pgdp
CPI	pcpi
M2	v37198

CHILE

REAL GROSS DOMESTIC PRODUCT GROWTH

The Chilean economy had a recovery in 2003 with a GDP rate of growth of 3.3 percent, in a favorable international environment. Domestic demand experienced a greater expansion of private consumption and investment, in a context of improving labor conditions.

The international trade flows reached important growth rates, pushing the economy to a dynamic performance. Growth in exports that represented 34.0 percent of GDP surged at a rate of 7.8 percent, with notable increases in the mining, fruits, forestry, fishing and chemical sectors, and imports grew faster than the previous year. The signing of the Association Treaty between Chile and the European Union at earlier 2003, allowed an expansion of export markets for Chilean exports.

INFLATION

Price increases in 2003 were lower than expected, due to the impact of supply factors, such as the peso appreciation and less compressed margins in specific sectors, reflecting greater competition and/or efficiency gains in the production and distribution chains of non-perishable goods and fuels. In December 2003, the annual Consumer Price Inflation was 1.1 percent.

EMPLOYMENT

The national unemployment rate fell to 7.4 percent in the last four months of 2003, declining to the lowest rate in the last five years. The number of people employed increased by 3.1 percent, while the workforce increased 2.6 percent, signaling a strong employment recovery in 2003.

BALANCE OF PAYMENTS

In the external sector, the volume of export goods rose 7.5 percent. Annual copper exports (by volume) rose about 5.8 percent. Non-copper exports continued to be the strongest performers amongst foreign sales. The main non-copper exports rose about 8.4 percent in volume, while other non-traditional exports increased more. Import volumes rose 9.5 percent, mainly reflected in the rise of intermediate goods.

In 2003 the balance of payments posted a current account deficit of US$593.8 million. Meanwhile, the trade balance posted a US$3,015.3 million surplus. Exports of goods were US$21,046.0, an increase of 15.8 percent from the previous year, and imports of US$18,030.7 rose 13.3 percent in 2003.

The other current account components—services, income and transfers—posted total negative flows of US$3,609.1 million in 2003, reducing the year's current deficit by US$291.3 million.

GROSS EXTERNAL DEBT

The gross external debt posted US$43,391 million in 2003, growing 5.9 percent from the previous year. The composition of the debt was 78.6 percent held by the private sector, while 17.5 percent of total debt is short-term and 82.5 percent is medium and long-term.

EXCHANGE RATE

The floating system has continued to ensure that the exchange rate is the main variable when correcting for domestic and external changes affecting Chile's economy. Thus, the US dollar's weakness in the main financial markets, better financial conditions, and the improved terms of trade associated with the trends in the copper price, explain most of the real appreciation experienced by Chile's peso.

The US dollar has weakened significantly against the peso, reaching between 570 and 580 Chilean pesos per US dollar for the first time since late 2000. This shift has brought peso appreciation against the dollar of about 18.9 percent from March to December 2003. During this period, the real multilateral exchange rate has been the key variable absorbing important changes in both the financial and the real international environment facing Chile's economy, reflecting the generalized weakness of the US dollar against the main global currencies. The real effective exchange rate (index) grew about 8.0 percent in 2003.

FISCAL POLICY

Public finances (in 2003) had a countercyclical role, reaching an accountable deficit of 0.8 percent of GDP, consistent with a structural surplus estimated at about 0.8 percent of GDP.

For the fourth quarter of 2003, there was a slight surplus, thanks to greater income resulting from the Value-added Tax increase (from 18 percent to 19 percent), the better economic cycle, and the increase in the copper price, combined with spending cuts, considered temporary.

MONETARY POLICY

Monetary and credit conditions on local financial markets remained expansionary during 2003, and became even more so after the latest cuts to the monetary policy rate (MPR), in December 2003 and January 2004, bringing it to 1.75 percent.

This situation has been reflected in a strong rise in personal loans, which have posted double digit 12-month growth rates since the middle of 2003, with consumer credits accounting for a significant share. In contrast, financial system loans to companies remain stagnant, mainly due to demand factors, reflecting major corporate bond issues and still slow investment growth.

In term of monetary aggregates, the M1A ended 2003 with nominal 12-month expansion of 18 percent. Interest rates on the central bank's medium-term nominal promissory notes have fallen to new historic lows. Overall, 2003 stood out for an important rise in personal loans, which increased by a real annual rate of around 17 percent on consumer credit, and 11 percent in the case of mortgages. It should be pointed out that new participants including savings and credit cooperatives, department stores and insurance companies, have joined banks in the consumer credit market. These new agents account for more than one-third of total consumer credits placed on the market, and should be an important source of financing especially for lower income borrowers. They should also encourage more competition in this market segment.

The outlook for corporate credit in coming quarters looks more promising, thanks to the ongoing expansionary monetary policy stance and the better external and domestic demand conditions expected in 2004 and 2005. In fact, the results of the last survey on bank credit, conducted in November 2003, indicate financial institutions perceive a rise in demand for credit from the business sector.

MEDIUM-TERM OUTLOOK

Information about the international scenario, private prospects and the labor market, along with the obvious expansionary nature of current monetary policy, are consistent with economic activity and domestic spending growing more quickly in 2004. The expected growth in activity is between 4.5 percent and 5.5 percent in 2004. The recovery of terms of trade, combined with the real exchange rate remaining at current levels, better prospects for capital flows into emerging economies in general, and the expectations that domestic spending will rise one or two percentage points more than GDP growth, are consistent with a current account deficit larger than 2003, an average annual balance above 1 percent of GDP in 2004 and a large deficit in 2005.

Although negative figures for 12-month inflation are believed to be essentially a temporary phenomenon, they should contribute to decelerating nominal wage growth. Similarly, lower growth in labor productivity, which at some point caused concern due to its potential impact on costs and inflation, has turned around, especially in the manufacturing sector. Thus, the medium-term scenario shows no signs of major pressures from the private sector on unit labor costs.

Recent trends in the copper price (higher than assumed) and actual inflation (lower than assumed) will provoke two opposite effects in the conventional fiscal balance sheets. In any case, the target specified by the structural surplus regulation will be met.

The more expansionary stance, faster growth of activity and spending, and the central bank's commitment to the established targets should make it easier to control inflation, pushing it back, to the center of the 2 percent to 4 percent target range toward the end of the 24 month projection horizon.

With potential growth estimated to rise from 3.5 percent to 4.0 percent in 2004 within a baseline scenario, idle capacity should decline somewhat more quickly than expected, as this is a major element in forecasting price trends. Beyond demand and supply conditions, the current impact of surprises on the costs side is expected to last some time, partly due to the magnitude of changes in these variables, but also because of the greater competition and efficiency apparent in different retail sectors, which should mean only minor price effects from margins. Moreover, comparative evidence indicates that in Chile retail margins are currently tighter than in other markets.

STRUCTURAL REFORMS

Two major developments are to be highlighted in regard to structural reforms undertaken in Chile in the recent year. On the one hand, the Free Trade Agreements with the United States and Korea, respectively, have been implemented this year, which raised to around 70 percent the amount of Chilean trade that is FTA-related. On the other hand, Chile has implemented substantive modifications to improve its competition law through the modification of the attributions granted to the National Economic Prosecutor's Office (FNE, is its acronym in Spanish).

1. Chile's FTAs

This year, the FTAs with the United States of America and the Republic of Korea have entered into force, 1 January, and 1 April, respectively. The USA is Chile's main trading partner, accounting for over 15 percent of total exports in the first half of this year. Moreover, over 85 percent of total Chilean exports have entered the USA duty free this year. Total tariff elimination will be reached in eight years. Likewise, over 80 percent of American exports into Chile are accessing the market duty free this year.

Chile has also implemented an FTA with Korea, which ranks sixth among Chilean trading partners, in the first half of this year. Korea accounted for 6 percent of total Chilean exports in the same period. Total tariff elimination between the two economies will be reached in thirteen years. Since the implementation of the Agreement over 90 percent of present Chilean exports to Korea are entering duty free. Likewise, over 75 percent of Korean exports into Chile will enter duty free following the entry into force of the Agreement.

Regarding competition law, a new law (Law 19.911, published in 2003) fulfils the need for increased independence of the decision-making body and for a more technical assessment of cases. The institutional reform replaces the former Antitrust Commissions with a Competition Tribunal and clearly separates the functions of the enforcement agency, the FNE, and the decision-making body, the new Tribunal. The Tribunal is a special judicial body fully independent of the FNE. To ensure its independence, its members can only be removed by the Supreme Court on legally established grounds. Its members are now remunerated and have a fixed period in office. The Tribunal is no longer supported by the FNE and has its own budget and staff (lawyers and economists). The Tribunal has the power to apply sanctions and provide remedies (including interim measures) and is also responsible for merger decisions. At the same time, the enforcement power of the FNE has been strengthened. It now has clear powers to seek depositions of persons during an investigation and the authority to sign international cooperation agreements.

2. Chile's Competition Laws

Chile's Competition Law was first introduced in 1958. It has recently introduced institutional reform as well as a review of the substance of its Competition Law. First, publication of Law 19.610 in 1999 led to the institutional strengthening of the enforcement agency, the National Economic Prosecutor's Office (FNE). As a result, the economic and human resources of the FNE have increased. For example, the FNE increased its staff from 28 to 56 after 1999.

A new competition law (Law 19.911, published in 2003) fulfils the need for increased independence of the decision-making body and for a more technical assessment of cases. The institutional reform replaces the former Antitrust Commissions with a Competition Tribunal and clearly separates the functions of the enforcement agency, the FNE, and the decision-making body, the new Tribunal. The Tribunal is a special judicial body fully independent of the FNE. To ensure its independence, its members can only be removed by the Supreme Court on legally-established grounds. Its members are now remunerated and have a fixed period in office. The Tribunal is no longer supported by the FNE and has its own budget and staff of lawyers and economists. The Tribunal has the power to impose sanctions and provide remedies (including interim measures) and is also responsible for merger decisions. At the same time, the enforcement power of the FNE has been strengthened. It now has clear powers to seek depositions from persons during an investigation and the authority to sign international cooperation agreements.

The new law explicitly imposes sanctions abuses of a dominant market position (such as resale price maintenance, tying or territorial distribution) by dominant firms and predatory practices.[1] In addition, the new law eliminates criminal penalties with respect to anticompetitive practices but substantially increases the amount of the fine that can be imposed. This is to prevent competition cases being tried by criminal judges, often with no expertise in competition cases, while providing sufficiently deterrent fines.

[1] It should be noted that even though there was no explicit prohibition, abuse of dominant position already attracted sanctions by the Antitrust Commission prior to the reform that took place in 2003 on the basis of a generic reference in Article 6 of Law DL211.

ANNEX I

CHILE: OVERALL ECONOMIC PERFORMANCE

	1998	1999	2000	2001	2002	2003
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (level in billion US$)	79,374	72,995	75210	68418	67,366	72,056
Real GDP	3.2	-0.8	4.5	3.4	2.2	3.3
Consumption	4.3	-0.4	3.6	2.8	2.1	3.5
Private Consumption	4.7	-1.0	3.7	2.8	1.9	3.7
Government Consumption	2.2	2.7	3.0	2.9	2.7	2.1
Investment	2.2	-20.1	14.0	0.5	3.9	3.5
Exports of Goods and Services	5.2	7.3	5.1	7.5	1.5	7.8
Imports of Goods and Services	6.7	-9.5	10.1	4.1	2.4	8.8
Fiscal and External Balance (percent of GDP)						
Budget Balance	0.4	-1.4	0.1	-0.3	-0.8	-0.8
Merchandise Trade Balance	-2.6	3.3	2.8	2.7	3.3	4.2
Current Account Balance	-4.9	0.1	-1.2	-1.6	-1.3	-0.8
Capital and Financial Non-Reserve Assets Balance	2.5	0.3	1.0	2.0	3.1	-0.9
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	1.9	2.4	4.6	3.6	4.5	3.9
CPI (annual average)	5.0	3.3	3.8	3.6	2.5	2.8
M2	12.1	10.6	8.4	7.0	9.2	-1.5
Short-Term Interest Rate (percent)[2]	16.31	10.95	10.76	7.23	3.93	2.77
Real Effective Exchange Rate (level, 1995=100)	-0.2	5.5	4.5	11.3	1.4	8.0
Unemployment Rate (percent)	6.3	9.8	9.2	9.0	9.0	8.5
Population (millions)	14.,8	15.0	15.2	15.4	15.6	15.8

[2] Short-term interest rate is 90 days “Pagaré Reajustable del Banco Central” (PRBC).

ANNEX II

CHILE: FORECAST SUMMARY (percent change from previous year)

	2003				2004			
	Official	IMF	ECLAC	Consensus Forecast	Official	IMF	ECLAC	Consensus Forecast
Real GDP	3.2	3.3	3.2	3.2	4.5 – 5.5	4.5	4.5	4.5
Exports	13.6	N.A.	12.0	12.6	26.2	N.A.	N.A.	12.6
Imports	13.1	N.A.	13.0	12.0	21.2	N.A.	N.A.	12.4
CPI	2.8	3.4	1.0	1.9	0.7	3.0	n.a.	2.6

ANNEX III

CHILE: MEDIUM-TERM TREND FORECAST (percent)

	Period*
Real GDP[3]	3.4 – 4.0
GDP Deflator[4]	3.0

[3] The medium-term forecast corresponds to growth of potential GDP.
[4] Corresponds to center of range of projected inflation.

THE PEOPLE'S REPUBLIC OF CHINA

REAL GROSS DOMESTIC PRODUCT

The national economy of China grew rapidly. China's gross domestic product (GDP) in 2003 reached US$1409.91 billion, an increase of 9.1 percent in comparable prices over the previous year, and 1.1 percent faster growth.

Investment in fixed assets enjoyed a relatively substantial growth. It was particularly noteworthy that the haphazard investment had appeared in parts of industries. The investment in fixed assets for the whole society in 2003 reached US$665.94, which was a 26.7 percent increase over the previous year. The growth of investment in industrial enterprises was obviously faster than that in other industries, and was much higher in some parts of industries, among them, investment in iron and steel grew by 92.6 percent, cement industries by 121.6 percent, automobile industries by 87.2 percent, textile industries by 80.4 percent and coal industries by 52.3 percent. Investment in real estate development grew by 29.7 percent over the previous year.

Consumption demand went up steadily with the continued improvement in the living standards of the people. The total retail sales of consumer goods were US$553.87 billion, with a growth of 9.1 percent year-on-year. When measured by price the growth rate reaches 9.2 percent. The annual per capita governable income for the residents in cities and towns was US$1023.60, the growth rate would reach 9.0 percent if measured by price; the per capita net income of residents in rural areas was US$316.79, with a growth of 4.3 percent year-on-year. The Engel coefficients of residents in urban and rural areas were 37.1 and 45.6 percent respectively, 0.7 percentage points lower than the previous year. The social security system was further consolidated and improved. By the end of 2003, the number of residents covered by the basic old-age insurance system reached 154.90 million, with a growth of 7.53 million over the previous year.

The role of net export playing in stimulating the economic growth diminished. The favorable balance of trade in 2003 reached US$25.6 billion, which was US$4.8 billion lower than that of the previous year.

The scope of foreign investment continued to expand, and the quality of foreign investment utilization constantly improved. A total of US$53.5 billion in foreign direct investment (FDI) was actually utilized, a year-on-year increase of 1.4 percent.

There are still many difficulties and problems in China's economic and social development that we cannot afford to ignore. For example, farmers have difficulties increasing their income; the problem of unemployment and social security remain serious; considerable disparity remains between supply and demand in coal, electricity, oil and transport capacity; too much investment is still put in fixed assets; the problem of haphazard investment and low-level, redundant expansion are worsening in some industries and localities; there is an excessively wide income gap between some members of society, and in both urban and rural areas many low-income people lead a fairly difficult life; the pressure on the environment from developing natural resources and the need for environmental protection becomes more and more serious, etc.

Early in 2004, China's national economy grew rapidly. In the first quarter of 2004, GDP grew by 9.8 percent, but some salient conflicts and problems in China's economic development since 2003 remain serious. These chiefly include:

Investment demand enjoyed a rapid expansion. In the first quarter of 2004, the investment in fixed assets for the whole economy reached a year-on-year increase of 43 percent, 15.2 percentage points higher than 2003. The growth of investment in real estate development rose quickly; investment in some areas, especially in coastal areas was perhaps too fast. Investment in eastern areas increased by 47.8 percent, accounting for 64.2 percent of investment of all FDI in China.

The scale of monetary credit remains too large. By the end of March 2004, the broad money supply (M2) reached a year-on-year increase of 19.2 percent, 0.7 percentage points higher than in 2003, and much lower than the increase in the previous year.

Considerable disparity remains between supply and demand in coal, electricity and transport capacity. In the first quarter of 2004, the production of electricity increased by 15.7 percent. Although the utilization ratios of China's various electricity generating equipments have reached their peak point, 17 provinces still have to switch off the power to limit the consumption of electricity. The situation was worst in East-China and South-China. Also, in the same period, although a considerable disparity remain between supply and demand in coal, the production of coal increased by 14.4 percent over the previous year. However, the demand for coal still could not be met.

INFLATION

Market prices rose throughout 2003. The general level of consumer prices rose by 1.2 percent over the previous year, with the rate rising by 0.9 percent in urban areas and by 1.6 percent in rural areas.

In the first half of 2004, inflation pressure grew. Driven by the rapid growth of investment, the general level of capital goods prices in the field of circulation rose by 8.1 percent over the previous year. A year-on-year increase of 14.8 percent was noted in the first quarter of 2004. In the same period, the general level of consumer prices rose by 2.8 percent, with the influence of grain prices accounting for 2.4 percent. Moreover, the rising prices of iron ore, aluminum oxide and cotton on the international market forced domestic production costs to rise.

EMPLOYMENT

Adjustment of economic structure, reform of state-owned enterprises, shift of surplus rural laborers to non-agricultural industries and the coming peak of employment bring greater pressures to China's human resource market. By the end of 2003, the total number of employees was 744.32 million, which was 6.92 million more than the previous year. Of these, 256.39 million employees were in urban areas, with an increase of 8.59 million year-on-year. By the end of 2003, all laid-off employees had found new jobs. During the same period, the urban registered unemployment rate was 4.3 percent, 0.3 percentage points higher than that in 2002.

The social security system was further consolidated and improved. By the end of 2003, the number of residents covered by the basic old-age insurance program reached 154.90 million, 7.53 million more than the previous year.

BALANCE OF PAYMENTS

Foreign trade continued its high growth in 2003. Total volume of exports and imports for the year reached US$851.2 billion, up by 37.1 percent over the previous year, taking the economy from fifth to fourth in the world. The total volume of exports reached US$438.4 billion, up by 34.6 percent over the previous year. The total volume of imports reached US$412.8 billion, up by 39.9 percent over the previous year. The trade surplus in 2003 reached US$25.6 billion.

Services trade continued to develop. The international tourism industry was influenced by SARS. In 2003, China welcomed 91.66 million tourists from overseas, this was down by 6.4 percent year-on-year. The foreign currency revenue from international tourism was US$29.31 billion, down by 12.3 percent year-on-year.

FDI remained very significant in 2003. The actual value of foreign direct investment utilization was US$53.5 billion, up by 1.4 percent over the previous year.

China's foreign exchange reserves continued to increase. By the end of 2003, the total amount of the foreign reserves was US$403.25 billion.

EXCHANGE RATE

The exchange rate of the renmimbi (RMB) against foreign currency remained stable. By the end of 2003, 1 US dollar was equal to 8.2767 RMB, an appreciation of 6 basis points, in comparison with the rate at the end of 2002.

GROSS EXTERNAL DEBT

By the end of 2003, excluding Hong Kong SAR, Macao SAR, the recorded balance of foreign debt amounted to US$193.63 billion, which was US$22.28 billion more than the previous year (up by 13 percent). Long-term and mid-term debts were US$116.59 billion, which accounted for 60.21 percent, US$1.03 billion more than the previous year; while short-term debt reached US$77.04 billion, accounting for 39.79 percent, 21.25 billion US dollars more than the previous year.

Because of the rapid growth of China's economy, environmental optimization of the utilization of foreign investment and the change in the exchange rate, China's recorded balances of foreign debt and recently-borrowed external debt increased by a bigger margin than expected. However, thanks to China's abundant foreign exchange reserves and strong solvency, according to preliminary calculations, the rate of debt (the recorded balance of the foreign debts divided by the income of foreign currency from cargo trade and services trade) was 39.9 percent and the debt ratio (the recorded balance of foreign debt divided by GDP) was 13.74 percent by the end of 2003. Short term debt divided by the foreign exchange reserves was 19 percent. All in all, every relevant index was kept below the international safety line.

MACRO-ECONOMIC REGULATION

Since 2003, the Chinese economy has been over-heated in some sectors. To deal with the problems such as too much growth in fixed assets investment in some industries and areas; too much monetary credit growth; the tense situation for coal supply; power, crude oil and some crucial raw materials; and rising grain prices, many measures have been taken to regulate the macro-economy, so as to rebuild farmers' confidence in growing grain crops, strictly control unreasonable investment, and tackle the serious problems of low-level redundant construction in certain trades and areas; tighten up management of the real estate and land markets and seasonably adjust monetary credit policy. In the first four months of 2004, the above-mentioned measures taken in 2003 began to bring about the following striking effects.

The rate of increase in fixed assets investment continues to decrease. In the first four months of 2004, the rate of increase was 5 percentage points lower than that of first three months of 2004. In April, the amount of investment reached US$48.20 billion, an increase of 34.7 percent over the previous year, the rate of increase falling by 8.8 percent over this March. The growth of investment in the development of real estate continued to slow down. In the first four months of 2004, investment in the development of real estate reached US$32.45 billion, an increase of 34.6 percent over the previous year. In this April the amount of investment had a remarkable growth of 22.8 percent. Except in some industries, such as petroleum chemical, the rate of increase in the main industries was poised to fall.

Although there was, initially, an increase in the number of newly-started projects, since April this was been brought under control. In the first four months, the amount of new-started projects reached 32,887, an increase of 30.5 percent over the previous year. In April, there were 11,218 new projects in operation, an increase by 5.9 percent over the previous year. The rate of increase was clearly falling.

The rising tendency of monetary credit and supply was put under control initially. The tightened policy, including raising the rate of deposit reserves, which was done in the second half of 2003, has already retarded the rapid growth of monetary credit and investment. In this March and April, other much more strictly tightened policies, such as differential rate of reserves, floating rate of re-loan etc. began to be implemented. Their effects will be felt gradually, so as to further restrain the growth of investment and national economy as a whole. The growth of monetary credit has fallen since 2004. In the first quarter of 2004, the broad monetary supply (M2) increased by 19.1

percent, the balance of RMB credit held by financial institution increased by 20.7 percent, less than in the second half of 2003.

Development of China's economy began to stabilize. The short supply of capital goods has eased up, the prices of steel and electricity began to drop substantially; both the rise in the crude oil price and enterprises' increased demand for the import of raw materials pushed the total amount of exports to rise. As a result, China's unfavorable balance of trade broadened from US$540 million in March 2004 to US$2.26 billion. In April, the rate of growth of China's industry grew by 19.1 percent, the third successive month to post lower growth.

On the basis of the above analysis, we can conclude that China's macro-economic regulation has had four main effects: the rapid growth of investment is slowing down gradually overall and, the rate of increase in real estate has fallen distinctly; in April, newly-started projects were brought under control; the growth in monetary credit fell substantially; the problem of bottlenecks in the economy's development have begun to be tackled.

FISCAL POLICY

In 2003, finance played a more important role in macro-control and in safeguarding the economy. The Government continued to follow a proactive fiscal policy to promote sustained and rapid growth of China's economy. The statistics in this section does not include debt revenues. In 2003, the total fiscal revenue reached US$262.07 billion, a increase of US$33.67 billion, up by 14.7 percent year-on-year and 105.8 percent of the budgeted figure. National expenditures totaled US$297.30 billion, an increase of US$30.86 billion or 11.6 percent year-on-year and 103.8 percent of the budgeted figure. The deficit in the central budget was held to US$38.64 billion as approved at the First Session of the Tenth National Party Conference. The orientation and structure of the use of treasury bonds was improved by giving preference to rural areas, economic restructuring, the central and western regions, science and technology, education, improvement of the ecological environment and public health services. Transfer payments were increased to promote balanced development among different regions. General transfer payments from the central budget to local government in 2003 totaled US$23.10 billion, 17.9 percent more than the previous year. Special transfer payments earmarked for social security, agriculture, science and technology, education, health and poverty alleviation amounted to US$31.14 billion, up 7.3 percent year-on-year.

MONETARY POLICY

The People's Bank of China continued to operate a stable monetary policy, the regulation of monetary credit had positive achievements, the tendency towards rapid growth of monetary credit has been brought under effective control, so as to provide a stable financial background for the sustainable, rapid and healthy development of China's economy. By the end of 2003, the balance of M2 reached US$2670.1 billion, up by 19.6 percent year-on-year. In the first nine months of 2003, the monetary credit of financial institutions increased, but was under effective control in the last quarter.

MEDIUM-TERM ECONOMIC OUTLOOK

In 2004, China's economic development is at its critical juncture. The Government is going to make full use of economic leverage, coordinating other regulating measures to strengthen macro-economic regulation and ensure the stable, harmonious and rapid development of China's economy. The emphasis of macro-economic regulation in 2004 is to solve the following four crucial problems, which affect the overall situation:

Controlling the too fast growing of the investment in fixed assets. Since 2004, investment in fixed assets has been speeding up rapidly. If this tendency were allowed to run its course, China would encounter problems such as a shortage of resources and deterioration of the environment. So regulation in 2004 should focus on controlling this too rapid growth of fixed asset investment, especially by controlling the tendency towards haphazard investment and low-level expansion in some industries and localities, and by strict control of newly-started projects so as to improve management of the government's investment.

Alleviating the disparity between supply and demand in coal, electricity, oil and transport capacity. With the stimulation of a too rapid growth in investment, these disparities become worse and worse. Therefore, the macro-economic regulation requires a balance between the supply of resources and the constraints on their use. On the one side, supply can increase on the basis of ensuring safety; on the other side, the management of demand should be strengthened, emphasizing the economization of resources and their comprehensive utilization.

Strengthening grain production capability and improving China's food security. Every policy and measure, to support the major grain producing areas must be carried out continuously. The government should actually strengthen the supervision and management of the prices of agricultural production materials should be strengthened, and the prices of grain stabilized by regulating the grain market.

Keeping the general level of prices essentially stable. Rising prices of grain and raw materials posits much more pressure for a further rise of general level of prices. It is necessary to measure and take notice of changes in supply and demand as they occur, so that policies and economic measures can be implemented to prevent disruption of the economy.

The various problems in some important industries and for some products should be addressed comprehensively, especially the shortages of energy and raw materials caused by the too rapid growth of those industries and products. By doing so, the optimal allocation of resources and balance between supply and demand can be achieved.

In 2004, China's economy is expected to maintain sound growth.

STRUCTURAL REFORM

During the following year, 2004–05 the Chinese Government will focus on accomplishing the following tasks:

Adopting comprehensive measures to increase rural incomes and maintain and *increase grain production capacity*.

Adjusting the orientation of investment by using treasury bonds, which will be brought into full play in promoting restructuring and balancing development. The Government will ensure the continuity and stability of its macroeconomic policies, adhere to the principle of stimulating domestic demand, and continue to implement a proactive fiscal policy and prudent monetary policy. At the same time, it will make timely and appropriate adjustments to the emphasis and intensity of these policies in response to changes in the economy. This year the focus of these treasury bonds will be shifted from the previous emphasis on expanding domestic demand and stimulating economic growth, to promoting restructuring and balancing economic and social development. The Government will speed up construction on key bond-financed projects, and strengthen inspection supervision and management of bond-financed projects to ensure both more efficient use of the funds and the quality of these projects.

Adjusting and optimizing the industrial structure and keeping the stability of economic growth. In line with the new path of industrialization China will be taking, the Government will promote technological innovation and speed up industrial restructuring, emphasizing rejuvenation of equipment manufacturing industries, exercising appropriate control over the scale of fixed assets investment and rigorously curbing haphazard investment and low-level, redundant construction in some industries and regions, working hard to alleviate bottlenecks in economic development, alleviating the disparity between supply and demand in coal, electricity, oil, transport capacity and important raw and processed materials.

Implementing a proactive employment policy and continuing to expand consumer spending and improve people's lives. The Government will further implement existing measures, such as fiscal and credit support, tax and fee cuts and exemptions, and do everything possible to create more jobs, improve the consumer environment, expand consumer spending and gradually increase the proportion of consumption in Chinese GDP.

Increasing revenue, reducing expenditures and ensuring steady and sound financial operations, controlling the scale of credit reasonably.

Balancing the development of regional economies so that the eastern, central and western regions can complement each other and develop at the same time. The Government will improve and implement all the policies and measures for developing the western region, implementing the strategy for revitalizing northeast China and other old industrial bases. Economic exchanges and cooperation will be increased between the eastern, central and western regions to create economic zones and belts with distinctive features.

Promoting steady growth of foreign trade and utilizing foreign funds better. The Government will coordinate domestic development with opening up the economy and continue to implement policies and measures for expanding opening up and encouraging foreign investment.

Continuing to implement the strategy of sustainable development and balancing social and economic development with population growth, resource exploitation and environmental protection. The Government will raise people's awareness of endangered natural resources and the need to conserve them, vigorously develop recycling industries and establish a conservation-minded society.

Continuing to promote the development of science, technology and education and developing all social undertakings. The Government will implement the strategy of relying on talented personnel to strengthen the economy. The top priority in education will continue to be rural education. The Government will lose no time in improving the mechanism for ensuring adequate funding for rural education to make it more regular and institutionalized, and will actively develop culture, health, sports, radio, film, TV, the press, publishing and other undertakings.

Note:
1. The 2003 statistics of 2003 are quoted from the official statistics (original data) published by the National Bureau of Statistics of China.
2. The statistics for Hong Kong Special Administration Region and Macao Special Administration Region are not included.
3. Statistics do not include the data of Chinese Taipei.
4. The absolute values of GDP and the value-added of the sectors are calculated based on the current value, while the growth rates are calculated based on the comparable price.

ANNEX I

CHINA: OVERALL ECONOMIC PERFORMANCE

	1998	1999	2000	2001	2002	2003
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (level in billion US$)	960.9	991.1	1080	1159	1237.1	1409.91
Real GDP	7.8	7.1	8.0	7.3	8.0	9.1
Consumption	6.8	7.9	10.4	8.1	10.2	9.2
Private Consumption	6.1	6.8	9.5	6.9	13.6	7.7
Government Consumption	8.9	12.0	13.8	12.2	18.2	6.8
Investment	14.41	5.2	9.3	12.1[1]	16.1	26.7
Private Investment	-	-	-	-	-	-
Government Investment	-	-	-	-	-	-
Exports of Goods	0.52	6.1	27.8	6.4	22.3	34.6
Imports of Goods	-1.53	18.2	35.8	8.2	21.2	39.9
Fiscal and External Balance (percent of GDP)						
Budget Balance	-1.5	-2.1	-2.8	-2.6	-3.0	-2.7
Merchandise Trade Balance	5.48	2.9	2.23	1.6	2.5	1.8
Current Account Balance	3.03	1.07	1.90	1.5	2.86	3.26
Capital and Financial Non-reserve Assets Balance	0.00	0.01	0.18	3	2.61	0.37
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	-1.3	-3.0	0.9	0.0	-1.3	3.9
CPI	-0.8	-1.4	0.4	0.7	-0.8	1.2
M2	15.3	14.7	12.3	14.4	16.8	19.6
Short-term Interest Rate (percent)	6.34[4]	5.58	5.58	5.58	5.58	5.58
Real Effective Exchange Rate (level, 1995=100)	8.28	8.28	8.28	8.2766	8.2773	8.2767
Unemployment Rate (percent)	3.1	3.1	3.1	3.6	4.0	4.3
Population (millions)	1248.1	1259.1	1265.8	1276.3	1284.5	1292.3

1 Real Investment in Fixed Asset Growth
2 Current price
3 Current price
4 3 months Inter-Bank rate

ANNEX II

CHINA: FORECAST SUMMARY (percent change from previous year)

	2003						2004					
	Official	**IMF**	**ADB**	**OECD**	**PECC**	**Link**	**Official**	**IMF**	**ADB**	**OECD**	**PECC**	**Link**
Real GDP	9.1	N.A.	N.A.	N.A.	N.A.	N.A.	9.0	8.5	8.3	N.A.	N.A.	N.A.
Exports	34.6	N.A.	N.A.	N.A.	N.A.	N.A.	31	N.A.	N.A.	N.A.	N.A.	N.A.
Imports	39.9	N.A.	N.A.	N.A.	N.A.	N.A.	35	N.A.	N.A.	N.A.	N.A.	N.A.
CPI	1.2	N.A.	N.A.	N.A.	N.A.	N.A.	3.5	N.A.	N.A.	N.A.	N.A.	N.A.

ANNEX III

CHINA: MEDIUM-TERM TREND FORECAST (percent)

	2004–2009
Real GDP	8.5
GDP Deflator	3

HONG KONG, CHINA

REAL GROSS DOMESTIC PRODUCT GROWTH

The economy of Hong Kong, China went through a sharp gyration during 2003, with an abrupt setback caused by the spread of severe acute respiratory syndrome (SARS) in the second quarter followed by a speedy and broad-based recovery in the third and fourth quarters. On a year-on-year comparison, the gross domestic product (GDP) went up by 4.4 percent in real terms in the first quarter, relapsed to a 0.6 percent decline in the second quarter, and then rebounded to distinct growth at 4.0 percent and 4.9 percent respectively in the third and fourth quarters. For 2003 as a whole, GDP still grew appreciably, by 3.2 percent in real terms, better than the 1.9 percent growth in 2002.

Externally, Hong Kong, China's, total exports of goods attained a robust growth of 14.0 percent in real terms in 2003, on the back of hectic growth in the Chinese economy and a pick-up in the global economy after the conflict in Iraq. Exports of services grew appreciably, by 7.1 percent in real terms, in 2003, upon sustained robust offshore trade and a strong rebound in inbound tourism after the setback caused by SARS in the second quarter, especially so after the launch of the Individual Visit Scheme for Chinese visitors in late July.

In the domestic sector, consumer spending rebounded visibly and resumed growth in the second half of 2003, along with the rally in the local stock market, a more active property market, and steady improvement in the employment situation. Yet with the decline in the first half of the year, overall consumer spending still fell by 0.9 percent in real terms in 2003. Likewise, overall investment spending plunged in the SARS-affected months, but bottomed out to resume robust growth upon strong acquisition of machinery and equipment amidst a more benign business outlook towards the end of 2003. For 2003 as a whole, overall investment increased marginally, by 0.1 percent, in real terms.

The recovery of the economy of Hong Kong, China, broadened further to a full-fledged upturn in the first half of 2004, with GDP growth in real terms accelerating to 7.0 percent in the first quarter, and further to 12.1 percent in the second quarter against an exceptionally low base of comparison caused by SARS last year. The robust growth in the second quarter was the fastest in four years, and was characterised by double-digit growth in almost all major economic segments, including merchandise exports, offshore trade, local consumer and investment spending.

The short-term outlook for the economy is favourable. Externally, merchandise exports are expected to continue to fare well, on the back of the generally improved global and regional economic environment. Exports of services are also expected to attain strong growth in 2004, as inbound tourism thrives under the support of Individual Visit Scheme for Chinese visitors and a rebound in visitors from the other major sources, and as offshore trade stays robust. On the domestic front, consumer spending is poised for a notable growth in 2004, while machinery and equipment investment should be supported by the need for companies to reinstate their capacity for meeting the anticipated growth in business. Overall, GDP is forecast to pick up to a 7.5 percent growth in real terms in 2004, an increase from the 3.2 percent growth in 2003.

INFLATION

Overall consumer prices, as measured by the composite consumer price index (CPI), fell by 2.6 percent in 2003, less than the 3.0 percent fall in 2002. Price decline moderated in the first and fourth quarters of 2003, outweighing the accentuated falls in the second and third quarters brought about by the severe blow of SARS on consumer demand and the associated relief measures implemented by the Government. The moderation was more appreciable towards the year-end, when both property rentals and labour wages tended to stabilise amidst the generally improved economic conditions. Also, in face of the surge in inbound tourism and revival in local consumer spending, some of the retailers and service providers reduced the price discounts and other concessions on their goods and services, and some others even raised the prices modestly. Externally, a rebound in the prices of retained imports, under the combined influence of a weaker

US dollar and firmer world commodity prices began to feed through to some of the local retail prices.

Consumer price deflation continued to subside in the first half of 2004, upon further revival in economic activity and rising import prices. The decline in the Composite CPI narrowed from 1.5 percent year-on-year in January to a mere 0.1 percent in June. This was followed by renewed increases of 0.9 percent and 0.8 percent respectively in July and August, reversing the continuous downtrend prevailing since November 1998. For 2004 as a whole, the Composite CPI is forecast to show zero change.

EMPLOYMENT

The labour market remained slack in overall terms in 2003 despite a progressive turnaround in the second half of the year, mostly in the second quarter. Indicating this, the seasonally adjusted unemployment rate rose from 7.5 percent in the first quarter of 2003 to a peak of 8.6 percent in the second quarter, but fell back to 8.3 percent and 7.4 percent, respectively in the third and fourth quarters, as overall economic activity, and in particular inbound tourism and local consumer spending, increased after SARS waned. For 2003 as a whole, the unemployment rate averaged at 7.9 percent, which however was still appreciably above that of 7.3 percent in 2002.

On a quarter-to-quarter comparison, total employment, having declined in the first three quarters of 2003, rose visibly in the fourth quarter, whereas the total labour force increased slightly over the course of the year. As a result, there was a noticeable improvement in the overall manpower resource, and hence a drop in unemployment rate, in the latter part of 2003.

The improvement in labour market conditions continued into 2004. The seasonally adjusted unemployment rate went down to 7.2 percent and 6.9 percent respectively in the first two quarters, and further to a 30-month low of 6.8 percent in June to August. Total employment remained on an uptrend alongside the economy recovery, although this was partly offset by a concurrent expansion in the total labour force following an increased entry of people into the labour market to search for jobs.

EXTERNAL TRADE ACCOUNTS

According to the merchandise trade statistics, Hong Kong, China's, total exports of goods picked up distinctly to an 11.7 percent growth in value terms to HK$1,742.4 billion (US$223.8 billion) in 2003. Imports of goods were likewise robust, leaping by 11.5 percent in value terms to HK$1,805.8 billion (US$231.9 billion) in 2003. On balance, the visible trade deficit, reckoned on a GDP basis, widened marginally in absolute terms, to HK$45.0 billion (US$5.8 billion) or 2.5 percent of the value of imports of goods in 2003. Together with an enlarged invisible trade surplus of HK$155.8 billion (US$20.0 billion), a combined surplus of HK$110.8 billion (US$14.2 billion), equivalent to 5.6 percent of the total value of imports of goods and services, was recorded in 2003.

In the first half of 2004, total exports of goods surged further, by 15.5 percent over a year earlier to HK$926.3 billion (US$118.9 billion). Imports of goods soared even more markedly amidst robust domestic demand, by 19.0 percent to HK$994.5 billion (US$127.7 billion) over the same period. Taken together, the visible trade deficit, reckoned on a GDP basis, widened to HK$62.2 billion (US$8.0 billion) or 6.3 percent of the value of imports of goods in the first half of 2004. Yet with a widened invisible trade surplus, reckoned on a GDP basis, at HK$80.6 billion (US$10.3 billion) in that period, there was a combined surplus of HK$18.3 billion (US$2.4 billion) or 1.7 percent of the total value of imports of goods and services in the first half of 2004.

BALANCE OF PAYMENTS

Hong Kong, China's, overall balance of payments switched back to positive in 2003, with a surplus of HK$7.6 billion (US$1.0 billion), equivalent to 0.6 percent of GDP, in the year. This contrasted against a deficit of HK$18.5 billion (US$2.4 billion), equivalent to 1.5 percent of GDP, in 2002. While this turnaround was primarily attributable to a strong inflow of funds into Hong Kong, China amidst an upturn in the local economy in the fourth quarter of 2003, a surge in net inflow of external factor income and an enlarged invisible trade surplus in that quarter also contributed. Analysed by major component, the current account surplus widened to HK$130.3 billion (US$16.7 billion), equivalent to 10.7 percent of GDP, in 2003, while net outflow of financial non-reserve assets in the capital and financial account fell to HK$143.9 billion (US$18.5 billion) or 11.8 percent of GDP in the year.

GROSS EXTERNAL DEBT

Hong Kong, China's, external debt position remained sound in 2003, with most of its external debt being associated with normal operations of the banking sector and with inward direct investment. Also, the Government had no external debt in 2003. At end-2003, Hong Kong, China's, gross external debt amounted to HK$2,803.4 billion (US$360.0 billion), equivalent to 229.8 percent of GDP in that year. Within the total gross external debt at end-2003, 65.2 percent came from transactions of the banking sector, and 26.4 percent were debt liabilities to affiliated enterprises and direct investors under direct investment. Within the gross external debt of Hong Kong, China's, banking sector, 98.2 percent were short-term liabilities held mostly in the form of currency and deposits.

EXCHANGE RATE

The Hong Kong dollar exchange rate remained stable and stayed close to the target convertibility rate of HK$7.8/US$1 during the first three quarters of 2003, but strengthened markedly at the end of September, reaching 7.70 at one time in early October. The Hong Kong Monetary Authority sold a cumulative HK$31.90 billion of Hong Kong dollars to banks during the year, easing the exchange rate to close at 7.76 to 7.77. The exchange rate continued to ease in the beginning of 2004, approaching the convertibility rate by March 2004. The overall exchange value of the Hong Kong dollar, as measured by the trade-weighted nominal effective exchange rate index, fell further to 98.6 at end-September 2004, largely reflecting the weakness of the US dollar against other major currencies. The nominal effective exchange rate index declined from 102 at end-2002 to 98.8 at end-2003.

FISCAL POLICY

The financial results for 2003–04 (ending on 31 March) showed a deficit of HK$40.1 billion or 3.3 percent of GDP in 2003 as compared with the original budget deficit of HK$67.9 billion. The fiscal reserves stood at HK$275.3 billion at end-March 2004, representing a decrease of HK$40.2 billion from the balance of HK$315.5 billion at end-March 2003. The fiscal reserves at end-March 2004 represented 14 months of government expenditure in 2003–04.

The 2004–05 Budget forecasts a deficit of HK$42.6 billion, equivalent to 3.4 percent of the forecast GDP for 2004. Budgeted government expenditure represents a growth of some 6.5 percent in real terms over 2003–04.

In the remaining years of the medium-range forecast from 2005-06 to 2008–09, government expenditure is planned to fall at an annual average rate of 2.1 percent in money terms.

MONETARY POLICY

Hong Kong dollar interest rates increased briefly in April 2003, largely on concerns about the adverse impact of SARS. Interest rates have fallen notably below US dollar rates since August 2003, reflecting increased fund inflows upon improved market sentiments about the economic outlook. The three-month interbank rate decreased from 1.41 percent at end-2002 to 0.07 percent at end-2003, while its spread over the US dollar counterpart dropped from 9 basis points to -104 basis points. Domestic interest rates started to rise in April 2004 as the US Federal Reserve moved to tighten monetary policy. However, the magnitude of the increases has fallen short of their US dollar counterparts, reflecting ample liquidity in the banking system. The three-month Hong Kong dollar inter-bank rate rose by 0.68 percent between April and September 2004 (from 0.38 percent to 1.06 percent) while that of the US rose by 0.8 percent (from 1.2 percent to 2.0 percent). Similarly, major banks in Hong Kong, China raised the prime lending rate only once, by 0.125 percent in September (from 5.0 percent to 5.125 percent). By contrast, banks in the US put up the prime rate thrice during the same period, from 4.0 percent to 4.75 percent, for a combined increase of 0.75 percent.

Hong Kong dollar narrow and broad money have picked up strongly from the second half of 2003, although growth of the former continued to outpace the latter. Narrow money continued to grow strongly in 2004, rising by 29.9 percent year-on-year in August, on the back of a continued increase in demand deposits associated with buoyant stock market activity and low interest rates. Broad money registered a small rise of 0.6 percent year-on-year in August.

Domestic credit showed some signs of improvement, with loans for use in Hong Kong, China, rising by 2.9 percent in August 2004 on a year-on-year comparison, following a decline of 1.4 percent in 2003. The rise was largely attributable to a rise in demand for credit underpinned by the pick-up in economic activity. The overall quality of the loan portfolio of banks improved. Specifically, the ratio of overdue and rescheduled loans to total loans for retail banks declined to 2.09 percent at end-June 2004[1], compared with 2.83 percent at end-2003 and 3.59 percent at end-2002.[2] Banks remained well-capitalised, with a 15.9 percent consolidated capital adequacy ratio for all locally incorporated Authorised Institutions in June 2004, well above the standard set by the Bank for International Settlements.

MEDIUM-TERM OUTLOOK

The outlook for the Hong Kong, China, economy beyond the short term is positive, along with further economic reform and development and on-going market liberalisation in China. While China's accession to the World Trade Organisation (WTO) is opening up more opportunities for trade and investment, implementation of the Closer Economic Partnership Arrangement (CEPA) between Hong Kong, China, and China as from January 2004 provides even more business opportunities. Hong Kong, China, will continue to serve as an eminent foothold and conduit for business between China and the rest of the world. Also, the closer business links between Hong Kong, China, and other economies in East Asia render added scope. According to the forecasts put out in the 2004–05 Budget, for the medium-term as a whole (2005–08), GDP is expected to grow at a rate of 3.3 percent in real terms.

STRUCTURAL REFORM

Hong Kong, China, has been carrying out reforms to enhance the stability of the financial system through improving regulatory regimes and enhancing transparency and corporate governance of financial sectors.

- Measures have been adopted to improve the regulation and public disclosure requirements of the securities and insurance sectors, and to improve the disclosure of fees, charges and performance of retirement funds.

- A deposit protection scheme is expected to be implemented in 2006 to enhance deposit protection and the stability of the banking sector.

- The sharing of positive consumer credit data, started in 2003, and the sharing of commercial credit data of small and medium enterprises by end-2004 will contribute to banking stability.

- Hong Kong, China, will implement the New Basel Capital Accord (known as "Basel II") to enhance the risk-management capabilities of the banking sector.

- Initiatives under a Corporate Governance Action Plan have been taken forward to enhance corporate governance in Hong Kong, China.

1 Retail banks comprise all the locally incorporated banks and a number of the larger foreign banks which are not locally incorporated but whose operations are similar to those of the locally incorporated banks, in that they operate a branch network and are active in retail banking.

2 Overdue and rescheduled loans refers to loans and bills overdue by more than three months, and rescheduled loans.

- Measures have been taken to simplify the issuance process of debt securities, with a view to further developing the capital markets of Hong Kong, China, which would help strengthen the resilience of the economy against volatile capital flows.

Separately, Hong Kong, China, has been actively participating as part of the China's delegation in the negotiation of a convention on exclusive choice of court agreements applicable between parties in a business-to-business relationship. The draft convention will be complementary to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

One principal objective of the convention is to bring about increased certainty on questions relating to jurisdiction which will help to prevent duplication of effort, costs and procedures caused by parallel litigation. A successful convention that is accepted on a global basis will also facilitate trade and investment because of the certainty and predictability that such a convention may bring to businesses. A copy of the draft convention can be found at the website of the Hague Conference at www.hcch.net.

In late 1999, the Steering Committee on the Review of Legal Education and Training was established to oversee a comprehensive review of legal education and training in Hong Kong, China.

Having regard to the recommendations of a detailed consultancy report, the Steering Committee has proposed various reforms to improve the standards of legal education and training, including extending the length of the Bachelor of Laws programme from three to four years, and adopting a new approach to teaching professional legal skills in the Postgraduate Certificate in Laws course (which is a vocational course for entry into Hong Kong's legal profession). The Department of Justice, in conjunction with the Steering Committee, will continue to support these reforms and oversee their implementation.

To maintain the momentum for improvement after these reforms are implemented, the Steering Committee has proposed the creation of a new statutory body to replace the existing Advisory Committee on Legal Education. The new body will include lay members, together with representatives from the legal profession, all tertiary institutions providing legal education in Hong Kong, China; and the government. It was established on 1 September 2004.

ANNEX I

HONG KONG, CHINA: OVERALL ECONOMIC PERFORMANCE

	1998	1999	2000	2001	2002	2003
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (level in billion US$)	165	161	165	163	160	157
Real GDP	-5.0	3.4	10.2	0.5	1.9	3.2
Consumption(1)	-6.2	1.3	5.5	2.5	-0.6	-0.5
Private Consumption(1)	-6.8	1.3	5.9	2.0	-1.2	-0.9
Government Consumption	0.7	3.1	2.0	6.1	2.5	1.9
Investment	-7.3	-16.6	11.0	2.6	-4.5	0.1
Private Investment	-7.0	-19.8	15.5	3.7	-5.2	0.1
Government Investment	-9.7	0.6	-10.3	-2.3	-1.4	0.3
Exports of Goods and Services(1)	-3.8	4.0	16.6	-1.8	9.2	12.9
Imports of Goods and Services	-6.3	-0.2	16.8	-1.5	7.5	11.3
Fiscal and External Balance (percent of GDP)						
Budget Balance	-1.8	0.8	-0.6	-5.0	-4.9	-3.3
Merchandise Trade Balance	-6.4	-3.5	-6.6	-6.9	-4.7	-5.2
Current Account Balance(1)	1.5	6.4	4.3	6.1	7.9	10.7
Capital and Financial Non-Reserve Assets Balance	-6.6	-0.4	1.6	-4.8	-13.6	-11.8
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	0.2	-5.8	-6.2	-1.9	-3.6	-5.3
CPI (Composite CPI)	2.8	-4.0	-3.8	-1.6	-3.0	-2.6
M2	11.6	8.8	7.8	-2.7	-0.9	8.4
Short-Term Interest Rate (percent)(2)	8.09	5.84	6.11	3.56	1.79	0.96
Real Effective Exchange Rate (level, 1995=100)	121.7	113.7	108.2	108.2	103.9	96.7
Unemployment Rate (percent) (3)	4.7	6.2	4.9	5.1	7.3	7.9
Population (millions) (mid-year)	6.5	6.6	6.7	6.7	6.8	6.8

Notes :

(1) Revised figures after incorporating a new set of visitor expenditure figures as released by the Hong Kong Tourism Board in November 2003.

(2) Three-month HIBOR.

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

ANNEX II

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

	2004						2005					
	Official	**IMF**	**ADB**	**OECD**	**PECC**	**Link**	**Official**	**IMF**	**ADB**	**OECD**	**PECC**	**Link**
Real GDP	7.5	7.5	7.5	N.A.	5.5	N.A.	N.A.	4.0	6.0	N.A.	4.0	N.A.
Exports#	14.0	N.A.	7.0+	N.A.	11.1@	N.A.	N.A.	N.A.	7.0+	N.A.	8.7@	N.A.
Imports#	14.5	N.A.	8.7+	N.A.	10.3@	N.A.	N.A.	N.A.	6.4+	N.A.	8.4@	N.A.
CPI	0.0	0.0	0.7	N.A.	-0.8	N.A.	N.A.	1.0	1.1	N.A.	1.0	N.A.

Notes: # Referring to merchandise trade only.
+ Forecasts in US$ terms.
@ Comprising both goods and services.
N.A. Not available.

Sources: IMF forecasts, *IMF World Economic Outlook (September 2004)*.
ADB forecasts, *Asian Development Outlook 2004 Update* (September 2004).
PECC forecasts, *Pacific Economic Outlook* (June 2004).

ANNEX III

HONG KONG, CHINA: MEDIUM-TERM TREND FORECAST (percent)

	2005–2008
Real GDP	3.3
GDP Deflator	1.6

INDONESIA

During 2003 Indonesia's economic performance has steadily improved, with the economy showing commendable resilience to a number of shocks, including the regional impact of SARS early in the year, the Marriott Hotel bombing in August and the lingering after effects of the Bali bombing in late 2002. Consistent monetary and fiscal policies supported by progress in several areas of economic restructuring helped to achieve economy and monetary stability throughout 2003. The strengthening exchange rate with relatively little volatility, controlled base money, lowered interest rate, subdued inflation and recovered foreign exchange reserve have all contributed to providing a conducive environment for continued recovery.

In the first six months of 2004, Indonesia's economic fundamentals have remained in check with higher economic growth. The ongoing improvement in economic development has enhanced the positive trend in market sentiment as evident in the record high of the Jakarta Composite Index and successful US$1 billion sovereign bond issues, both in March 2004. The current domestic situation is also benefited by the peaceful conduct of the first and second rounds of the presidential election in July and September, the first direct presidential election in Indonesia's history. Against this background, Indonesia's macroeconomic and monetary developments are expected to continue on the path of sustained growth and stability.

REAL GROSS DOMESTIC PRODUCT GROWTH

In 2003, Indonesia's economic performance developed favorably, underpinned by prudent monetary and fiscal policies as well as continued structural reforms. The strengthening exchange rate, subdued inflation, and lower interest rate have all contributed to providing a conducive environment for growth. The favorable condition have successfully restored investors' confidence in the economy. Real GDP in 2003 grew by 4.5 percent driven particularly by consumption although there were also signs of increasing exports and investments.

The Indonesian economy continued to show high growth, posting 4.3 percent in the first half of 2004. The growth was still driven mainly by consumption. Investment and exports also picked up, encouraged by domestic demand and expansion in world trade volume, but they still have had a limited role in supporting domestic economic growth. On the supply side, the economy was supported by growth in most sectors with the highest contributions originating from manufacturing, trade, and agriculture.

Looking forward, the prospect for economic growth in 2004 is encouraging. This projection is based, partly, on the continued improved economic conditions in most developed economies as well as the healthier state of the domestic economy as reflected in the stable exchange rate, lower interest rate and relatively low and stable inflation. The improved economic prospect is also benefiting from the favorable development of the global economy and the existence of a clear package of economic policies after the International Monetary Fund (IMF) program known as the White Paper. In light of these developments, it is estimated that economic growth would be around 4.5 to 5.0 percent in 2004 and 5.0 to 6.0 percent in 2005.

On the demand side, economic growth will continue to depend on consumption, while investment and export growth will remain relatively low, albeit on an upward trend. Low inflation and a relatively stable exchange rate are expected to support purchasing power, encourage private consumption and spark business investment. In the meantime, improved global economic conditions are predicted to boost non-oil and gas exports.

Consumption is predicted to keep growing in 2004, supported by the increase in real disposable income in line with improving Indonesia's economy and the low inflation rate. Investment is forecast to grow moderately as investors are waiting for the economic agenda of the newly elected Government. In the external sector, the projection indicates that exports would grow in line with the favorable development of global demand. Export growth in 2004 is likely to grow slightly above the growth in 2003, which was within the range of 3.6 to 4.1 percent. Meanwhile, in accordance with increased domestic demand and exports, imports are expected to grow considerably at around 8.0 to 8.5 percent in 2004, dominated by imports of capital goods.

By sector, economic growth would be driven by increases in all economic sectors with the industry, agriculture, transportation and communications, as well as trade, hotel and restaurant sectors as the main contributors. The growing activities of some industrial sub-sectors along with the increased utilization of capacity are expected to support the growth of industrial sector. Meanwhile, the trade sector is expected to grow in line with the increase in non-oil exports-imports, domestic consumption, and industrial sector production. Various activities related to the general election are predicted to encourage growth in some sectors, including retail trade, manufacturing, transportation and communications, and government services.

INFLATION

Inflation plunged significantly from 10.03 percent in 2002 to 5.06 percent (y-o-y) in 2003. The downtrend of inflation was primarily due to lower basic food prices, an ample supply of commodities both from domestic and imports, a stable exchange rate and minimal upward adjustment in administered prices.

Recent development however shows the beginning of an increase in inflation. Annual CPI inflation in the third quarter of 2004 stood at 6.27 percent (y-o-y) or 3.80 percent (y-t-d). The rising rate of inflation was largely attributable to increasing aggregate demand, the depreciation of the rupiah and imported inflation as trading partner economies experienced an upward trend inflation. All these developments have also increased public expectation of inflation. The increasing trend of core inflation since the beginning of the year indicates that inflationary pressures have resulted from the demand side.

CPI inflation in 2004 is expected to be slightly higher than previously expected, forecast to grow at 6.5 percent ± 1 percent in 2004. The higher prices have been largely attributable to the weakening rupiah, rising expectation of inflation, administered prices and the hike in the fuel price. External factors such as high commodity prices and the upward trend of global inflation, to some extent have fed through to higher domestic prices. However, in line with the implementation of a tight bias monetary policy stance since mid-2004, such external influence is expected to be minimal. A new disinflation program has been set for the three years ahead, with targets as follows: 6 percent ± 1 percent in 2005, 5.5 percent ± 1 percent in 2006, and 5 percent ±1 percent in 2007.

EMPLOYMENT

The labor market remained sluggish in 2003, as the number of newly created jobs fell well short of the number of new workers entering the work force. Economic development during 2003 added employment opportunities for as many as 1.1 million workers. However, such additional employment opportunities did not reduce the level of unemployment since the number of people entering the labor market increased by 2.4 million. In 2003, unemployment reached 10.1 million, and the unemployment rate rose from 9.1 percent in 2002 to 9.8 percent in 2003, the highest level of unemployment rate since the 1997 crisis. Looking forward, the expected increased economic growth in the next two years is expected to increase the economy’s capacity to utilize its labor force.

BALANCE OF PAYMENT

In 2003, the current account recorded another year of surplus, reaching US$7.7 billion. On the other hand, the capital account remained in deficit at around US$1.7 billion, lower than the previous year, owing to the stronger inflows from both public and private sources. The overall balance of payments for the whole year 2003 recorded a surplus of around US$4.2 billion, contributing to stronger build-up of official reserves to US$36.2 billion. By end of third quarter 2004, the reserves decreased to US$34.8 billion, which is still sufficient for 5.8 months of imports and official debt repayments.

Looking forward, the trade surplus is expected to widen as imports' growth slows down slightly, while exports' performance improves, supported by the export of industrial goods. Hence, the current account would remain in substantial surplus. Nevertheless, pressure on the capital account due to payment of foreign debt is expected to result in a deficit for the year's overall balance to US$1.3 billion. Accordingly, international reserves would decline to US$35 billion, equivalent to 5.8 months of imports and foreign debt payments.

GROSS EXTERNAL DEBT

With the full support of prudent and consistent fiscal and monetary policy, the Government remains committed to repay maturing foreign debts. As Indonesia's sovereign debt indicators are improving, Indonesia's external debt and debt service ratio remain on a declining path. External debt as a percentage of GDP fell to around 64 percent by the end of 2003, slightly lower than the median ratios for comparably rated economies, and significantly below its peak of almost 150 percent in 1998. Following the decline of debt ratios, the debt service ratio is improving, reaching 33.8 percent at the end of 2003, down from 57 percent in 1999. As a result, Indonesia's international credit ratings have improved recently. This reflects a sign of growing investor confidence in the prospect of sustaining Indonesia's economic recovery.

Looking ahead, foreign debt repayment is expected to increase in 2004. The increased foreign debt repayment is closely linked to the ending of government debt rescheduling through the Paris and London Club. Meanwhile, increased private foreign debt repayment is in line with improved corporate capacity to meet their obligations as reflected in the declining exceptional financing. Government foreign debt repayments are expected to increase to US$5.18 billion in 2004 from US$2.6 billion in 2003.

EXCHANGE RATE

In 2003, the rupiah exchange rate has been more stable than at any time since the crisis in 1997, arriving at around Rp8,420 per USD at the end of December 2003. The rupiah appreciated more than 8 percent in 2003 owing to improved country risk, strengthened international reserves, attractive interest rate differential and global depreciation of US dollar.

Although the rupiah exchange rate tended to depreciate in the first half of 2004, it has started to rebound since the beginning of the third quarter. After experiencing 6.0 percent (q-o-q) depreciation in the second quarter, the rupiah exchange rate has become more stable in the third quarter 2004 as reflected in declining rupiah volatility. Depreciation of the rupiah stemmed mainly from high corporate demand for US dollars, while foreign exchange supply conditions in the market was still limited. The pressures on the rupiah also came from market sentiment related to the continuing appreciation of the US dollar and the oil price hike.

An exchange rate stabilization package was launched in early June in order to contain the pressure on the rupiah exchange rate that resulted from speculative activities. The package consisted of three main components namely: (i) lengthening the tenor of the discount facility and raising the reserve requirement so as to mop up excess liquidity in the banking sector; (ii) strengthening bank prudential regulation especially on the net open foreign exchange position; and (iii) improving the monitoring system of foreign exchange transactions.

Following the adoption of the policy package, and benefiting from the successful first round of the presidential election in July, market sentiment has started to improve leading to a recovering rupiah. Increased selling of foreign currencies by exporters through domestic banks and the continued attractiveness of the interest rate differential that encouraged the return of capital inflows also restrained the slide in the rupiah. The effect of the recent Kuningan-Jakarta bombing (8 September 2004) on exchange rate volatility has been contained and the rupiah exchange rate remains stable.

Furthermore, sustaining macro-economic stability, a peaceful socio-political situation during 2004 and the euphoria as a result of the election of the new Government will nurture positive sentiment towards the rupiah exchange rate. In this case, macroeconomic stability is supported by fiscal sustainability. Foreign debt repayment by the Government and the private sector would be high, indicating an improved financial structure which, in turn, will enable both Government and private sector to reduce their debt burden (balance sheet effect). Subsequently, investors' perceptions would improve, especially when international rating institutions further upgrade Indonesia's debt rating.

FISCAL POLICY

The Government's fiscal policy in 2003 is directed toward expanding fiscal stimulus while maintaining fiscal sustainability. The budgetary deficit in 2003 is recorded at around 2.1 percent of GDP, which met the initial budgeted amounts. While the 2003 deficit is higher than that of 2002, which reached 1.5 percent of GDP, the government financial operation is still pursuing fiscal consolidation policies such as improving tax revenue, reducing government debt gradually and reducing some subsidies. With support from the conducive monetary developments, those endeavors resulted in the primary balance surpluses in the budget and the decrease in debt ratio to GDP, which is expected to support fiscal sustainability.

In 2004, the Government commits to continue implementing fiscal consolidation in order to ensure the sustainability of state finances in the future. To this end, several measures were taken including the launching of a US$1 billion international bond on March 2004. The benchmark transaction attracted strong investor demand with an order book of over US$4 million from the initial US$500 million funding target. Due to the challenges pertinent to deficit financing in 2004, fiscal policy will continue to target a lower deficit and sound debt management. Initially the budget deficit is targeted to be 1.2 percent of GDP. However, due to the recent sharp increase in world oil prices that pushed up the amount of the fuel subsidy, the Government increased the deficit target to 1.3 percent of GDP. However, the Government is still committed to achieving a balanced budget in 2006.

MONETARY POLICY

The stable exchange rate and low inflationary pressures during 2003 have provided room for the Central Bank to pursue an accommodative and prudent monetary policy through a gradual decrease in the interest rate, thereby delivering positive signals regarding the sustaining of economic recovery. The Central Bank rate's benchmark (1 months SBI rate), has declined significantly during 2003 by almost 500 basis points reaching 8.31 percent at end-December 2003. The rate fell further, to around 7.37 percent by end of August 2004.

Taking into account economic prospects and several issues confronted especially by the banking sector, monetary policy in 2004 and 2005 will continue to be directed at achieving the medium-term inflation target of 5.5 percent in 2006. Hence, Bank Indonesia will provide economic liquidity in accordance with the economy's needs by guiding base money to grow by 13 to 14.5 percent in 2004 and 11 to 12 percent in 2005. In addition, to maintain stability in the financial markets, Bank Indonesia will continue to use interest rates as its monetary policy signal. In response to higher inflation expectations, Bank Indonesia implements a tight bias monetary policy so as to keep the medium-term inflation target within the target range.

This approach to monetary policy is based on the development of excess liquidity in the banks. Liquidity is estimated to keep increasing during 2004 due to government financial expansion and the higher cost of monetary control compared with the increase in demand for base money. In implementing monetary policy, Bank Indonesia's main instrument will be SBI auctions through open market operations. However, Bank Indonesia will continue its efforts to utilize Government Securities and other alternative instruments in lieu of SBI. In addition, efforts will be taken to encourage use of banks' excess liquidity to finance business activities through bank loan expansion, instead of placements in SBI.

Regarding the exchange rate, Bank Indonesia's policies will continue to be directed at suppressing exchange rate volatility and keeping it in line with the desired framework to achieve the medium-term inflation target. By doing so uncertainty is expected to be reduced, thereby improving public confidence in macroeconomic stability and helping business and investment planning. Meanwhile, in order to address the negative impact of possible turbulent capital flows on rupiah stability, several pre-emptive measures will be taken such as enforcement of bank compliance with prudential banking regulations vis-à-vis foreign currency transactions, a review of related Bank Indonesia regulations, and improved management of foreign exchange flows. Bank Indonesia's recent exchange rate stabilization package coupled with a peaceful presidential election is expected to help lead market expectations toward a stable rupiah.

MEDIUM-TERM OUTLOOK

In the medium term, Indonesia's economy is forecast to improve further in line with favorable improvement of the global economy. Economic growth is projected to pick up to an average around 5.5 to 6.0 percent in 2005–2007, driven primarily by a strong domestic demand accompanied by a rebound in private investment and a recovery in exports, associated with strengthening external demand.

Investment is forecast to increase in line with rising optimism of the business world regarding the long-term prospect for improving growth and foreign capital inflows along with gradual recovery of real sector conditions. As investment improves, capital productivity, which has been suffering since the onset of the 1997 financial crisis, is forecast to improve, thereby upgrading the competitiveness of Indonesian products in both export and domestic markets. For that purpose, various macro-economic and micro-policies and strategies, and certain institutional improvements, are required to strengthen competitiveness and to attract foreign investors.

Export of goods and services in real terms is expected to grow in line with improved economic growth of several major trading partners in Europe and America. Additionally, the increasing world prices of several non-oil and gas commodities (especially minerals and manufactures that have been on the rise or been relatively stable) will provide an incentive for producers to stimulate exports, especially to traditional markets in the US and Europe.

To strengthen macroeconomic stability, Bank Indonesia aims to reduce the inflation gradually towards the medium-term inflation target of 5.5 percent in 2006. This target and the time frame for reaching it are considered optimal in the sense that inflation will edge down to reach a sufficiently low level such over reasonable period of time in a way that achieving the target does not hinder economic recovery.

The exchange rate is expected to be relatively stable and the rupiah should regain its value further. The recent Bank Indonesia's exchange rate stabilization package coupled with peaceful presidential election is expected to help lead the market expectation toward a stable rupiah.

STRUCTURAL REFORMS

Despite an optimistic economic outlook, Indonesia still needs to continue structural reforms in order to maintain macroeconomic stability and ensure sustainable economic growth. Hence, concerted efforts to improve macroeconomic performance have been made by the Indonesian Government by continuing the structural reform on both the fiscal and financial sectors.

Fiscal Sector

The health of Indonesian public finance has a major bearing on the stability of the Indonesian monetary and financial systems, investors' confidence, and overall economic development. In the medium term, the Government's objective in the fiscal sector is to achieve a broad balance by 2006–2007, consistent with lowering public debt to below 50.0 percent of GDP. In order to achieve the objective, the Government's main priority is to enhance non-oil tax revenue with the aim of providing adequate resources for physical and social infrastructure, and reducing reliance on oil revenue.

In line with efforts to achieve this objective, there is a core set of reforms to improve Indonesia's fiscal performance. In 2002, the Government introduced a new system where the tax office was organized by taxpayer, called the Large Taxpayer Office (LTO). The new system replaced the previous one where tax office was established based on the type of tax. Under the new system, one tax officer is responsible for all taxes of a company or individual. The system is now being expanded and pilot schemes added for taxpayers paying medium and low amounts of tax.

The Government has also amended the basic tax laws, including VAT and tax administration. The basic idea of amending the basic tax law is to promote competitiveness, simplify the tax system, increase compliance, and broaden the tax base. Basic objectives include, among others, raising basic worker allowances; creating a single, lower corporate tax rate; accelerating tax refunds; and attaining a better balance between tax payers and tax officers on assessments, audits and other issues.

Another key element of the fiscal policy reform strategy is to strengthen expenditure management and the decentralization framework. The aims of the reforms are to improve control over the public finance, and to limit risks to fiscal sustainability.

On the expenditure management side, the ongoing reorganization in the Ministry of Finance and the establishment of a well-functioning treasury system are the key elements needed to improve budget preparation and execution. The new State Finance Law provides a new streamlined treasury operation, consolidation between debt management and budgeting operations, and a policy unit that separates direction from implementation.

On the decentralization framework side, the Government has submitted an amendment of decentralization laws to the parliament. The objective of amending the law is to reduce the scope for mismatches of revenue and expenditure assignment. With regard to the decentralization process that was started in 2001, the regional government budgets recorded a surplus, and the process of decentralization up to now has not undermined fiscal stability. However, a mismatch between expenditure functions and revenue sources assigned to regional governments, and lack of clarity pose a risk to the implementation of fiscal policy and public service delivery.

Financial Sector

Progress has been made in the key areas of structural reform. Indonesian Banking Restructuring Agency (IBRA) asset recoveries accelerated, the process of establishing a robust financial infrastructure is advancing and the banking system‘s fundamentals have been strengthened. An independent Central Bank is in place, bank supervision is being improved, and a new financial safety net is well on the way to being established.

Over its five-year mandate, IBRA made significant progress towards meeting its primary objectives of securing recoveries from bank assets taken over during the financial crisis and returning the nationalized banks to private ownership. Meanwhile, a new public sector asset management company with a mandate to dispose of all assets within five years will handle the remaining unsold assets. In addition, a new high-level committee, chaired by the Minister of Finance, is responsible for resolving problematic assets. IBRA asset recoveries reached Rp163 trillion by the time of its closure in February 2004, and the Government has divested itself all of the banks taken over during the crisis except one bank whose stock is still owned by the Government.

Progress has also been made in the effort to establish a robust financial stability. Considering the important lesson from the 1997 crisis: that monetary stability is closely linked or — can only be achieved — with financial stability, it should then become a key agenda for the Government and the Central Bank of Indonesia. In this regard, Bank Indonesia has set a financial stability objective, that is, active involvement in creating and maintaining a sound and stable national financial system. The objective can be achieved, among others, through implementing regulations and standard, intensifying research and surveillance, and establishing Financial Safety Nets and a process for crisis resolution.

With regard to implementing regulations and standards in the banking sector, Bank Indonesia aims to gradually implement the 25 Basel Core Principles for effective banking supervision. Bank Indonesia has established a work plan up to 2013 to improve the degree of compliance. Bank

Indonesia also continues its effort to comply with the Payment System Core Principles. Concurrently, the Government prepares the non-bank financial sector and supervisors to gradually comply with the International Organisation of Securities Commissions (IOSCO) core principles (in the capital market) and the insurance supervisory principle.

Surveillance activity is an important step in maintaining financial stability by monitoring and assessing vulnerability in the market system to enable the authority to take pre-emptive action in case of a potential crisis. To this end, participating in the IMF's Financial Sector Assessment Program (FSAP) will complement Bank Indonesia's existing monitoring and early warning system as well as serve as a basis for improving weaknesses and strengthening the health of the financial sector. In this regard, Bank Indonesia will develop an action plan for FSAP implementation, establish a Steering Committee and Working Group to prepare FSAP, coordinate with other supervisory authorities and conduct self-assessment.

In an effort to develop a robust financial sector safety net, the Government and Bank Indonesia have prepared the Indonesian Financial Safety Net (IFSN) framework. The framework covers (i) divisional roles and coordination mechanism of related government agencies in maintaining financial stability; (ii) Bank Indonesia's role as the lender of the last resort for normal and emergency times; and (iii) phasing out the blanket guarantee with an explicit and limited deposit insurance scheme.

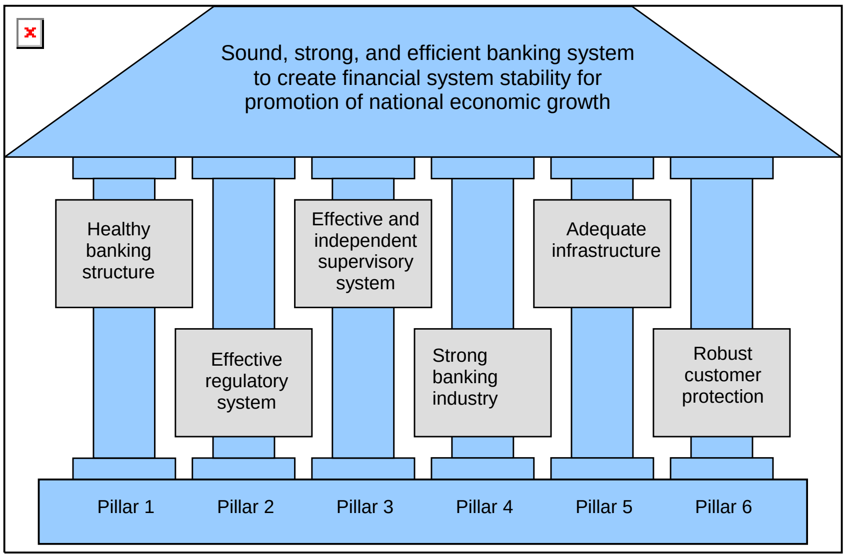
As regard to Central Bank's role as a lender of the last resort, the amendment of Bank Indonesia Law No. 23, 1999 (Bank Indonesia Law No. 3, 2004) provides the central bank with an appropriate lender of the last resort facility, not only for normal times, but also during an emergency or systemic crisis. Under the new law, the Minister of Finance and the Governor of Bank Indonesia signed a Joint Agreement on an Emergency Fund Facility. The agreement is a part of the Financial Fund Facility that is scheduled to be implemented at the end of 2004. This joint agreement contains standard procedures for decision-making to extend the financing under an emergency fund facility, the financial burden of systemic problem banks, and financing of this emergency fund facility from the state burden.

In line with the plan to phase out the blanket guarantee program, the authorities strategic goal is to allow the gradual phase-out of the blanket guarantee along with the establishment of the Deposit Guarantee Institution. The Government and Bank Indonesia have formulated a draft law for a deposit insurance scheme (DIS). The draft law has been approved by the parliament. According to the law, a Deposit Insurance Corporation will be established as an independent agency responsible for deposit protection and resolution of problem banks.

It is expected that the banking sector will improve its intermediary function and continue to play a more important role in stirring up economic activities. Starting with the need for stronger banking fundamentals and aiming to take the ongoing bank restructuring program to the next stage, over the past two years Bank Indonesia has completed work on the design of a blue-print of the Indonesian Banking Architecture (API). The blue-print was launched on 9 January 2004, and will be implemented gradually over the next ten years. Under the architecture, policy direction for the future development of the banking industry is based on the vision of building a sound, strong, and efficient banking system so as to create financial system stability for the promotion of Indonesian economic growth. To bring the vision to fruition, the API has the objectives of:

1. Creating robust structures for the domestic banking system capable of meeting the needs of the public and promoting sustainable development;
2. Creating an effective system for bank regulation and supervision in line with international standards;
3. Creating a strong, highly competitive banking industry, resilient in facing risks;
4. Building good corporate governance for internal strengthening of Indonesia's banking industry;
5. Providing a complete range of infrastructure to support the creation of a healthy banking industry; and
6. Empowering and protecting consumers of the banking services.

The six pillars of the Architecture are designed to ensure the attainment of the following:



ANNEX I

INDONESIA: OVERALL ECONOMIC PERFORMANCE

	1998	1999	2000	2001	2002	2003	2004
GDP and Major Components (percent change, year over year, except as noted)							
Nominal GDP (level in billion US$)	97.5	139.5	150.7	143.4	172.8	156.8	N.A.
Real GDP	-13.3	0.8	4.9	3.83	4.25	4.51	4.5-5.0
Consumption	N.A.	N.A.	2.0	3.9	4.7	4.5	5.5-6.0
Private Consumption	N.A.	N.A.	1.6	3.9	3.8	3.85	5.3-5.8
Government Consumption	N.A.	N.A.	6.5	7.56	12.99	10.03	7.2-7.7
Investment	-33.01	-18.2	16.74	6.5	2.18	1.88	8.0-8.5
Private Investment	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Government Investment	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Exports of Goods and Services	11.18	-31.8	26.48	0.64	-1.02	6.58	3.6-4.1
Imports of Goods and Services	-5.29	-40.68	25.93	4.18	-4.01	2.8	8.0-8.5
Fiscal and External Balance (percent of GDP)							
Budget Balance	-1.6	-3.7	-1.6	-2.8	-1.5	-2.1	-1.3
Merchandise Trade Balance	18.9	14.7	16.6	15.8	13.6	11.6	N.A.
Current Account Balance	4.3	4.1	3.4	4.7	4.5	3.5	N.A.
Capital and Financial Non-Reserve Assets Balance	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Economic Indicators (percent change, year over year, except as noted)							
GDP Deflator							
CPI	77.63	2.0	9.4	12.6	10.03	5.1	5.5-7.5
M2	62.14	11.9	15.6	12.99	4.72	8.42	N.A.
Short-Term Interest Rate (percent)/ SBI rate	64.1	26	12.53	17.62	12.99	8.31	7.39
Real Effective Exchange Rate Index (level, 1995=100, end period)	68.54	77.35	65.61	72.41	85.15	88.82	N.A.
Unemployment Rate (percent)	5.5	6.4	6.1	8.1	9.1	9.5	N.A.
Population (millions)	204.031	202.9	205.843	208.901	212.003	215.152	N.A.

ANNEX II

INDONESIA: FORECAST SUMMARY (percent change from previous year)

	2003	2004					2005				
		Official	IMF	ADB	OECD	PECC	Official	IMF	ADB	OECD	PECC
Real GDP	4.5	4.5-5.0	4.8	4.5	N.A.	N.A.	5.0-6.0	5.0	4.5	N.A.	N.A.
Exports	6.6	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Imports	2.8	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
CPI	5.1	5.5–7.5	5.0	6.5	N.A.	N.A.	5.5	4.5	6.5	N.A.	N.A.
Budget Balance	-2.1	-1.3	N.A.	N.A.	-1.3	N.A.	-0.8	N.A.	-0.8	N.A.	N.A.

ANNEX III

INDONESIA: MEDIUM-TERM TREND FORECAST (percent)

	2005
Real GDP	5.5-6.0
GDP Deflator	N.A.

JAPAN

REAL GROSS DOMESTIC PRODUCT GROWTH

The Japanese economy has made a breakthrough from its long-lasting economic downturn and is now poised for a new leap forward. Japan was in a economic environment of negative growth with large amounts of non-performing loans (NPLs) when the intensive changes for structural reform began. In the process of structural reform, the Japanese economy recovery was led by private demand with no dependence on fiscal stimulus.

There are signs that booms in the corporate sector are having a positive impact on households through recovery of employment, and, together with stabilization of the financial system and increase in stock prices, there have been improvements in consumer confidence. As a result, the average annual growth rate for the economic recovery phase since the beginning of 2002 is 2.9 percent of which private demand accounts for 2.3 percent, indicating that private demand-led growth is being realized. The real GDP growth rate in FY2003 is 3.2 percent.

As for short-term prospects, the Government projected the real GDP growth rate for FY2004 to be about 1.8 percent (with the nominal GDP growth rate about 0.5 percent) in the *Economic Outlook for FY2004 and Basic Economic and Fiscal Management Measures* (hereinafter referred to as *Outlook*) decided by the Cabinet in January 2004. In July, the Cabinet Office made a forecast of the economic situation for FY2004. In *A Forecast of Economic Situation for FY 2004 (Calculated by Cabinet Office)* (hereinafter referred to as *Forecast*), the Cabinet Office forecast the real GDP growth rate to be about 3.5 percent (with the nominal GDP growth rate about 1.8 percent). According to the *Forecast*, since the world economy continues to recover industrial production and private nonresidential investment are expected to increase. These improvements in corporate sectors, through the pickup in the employment and income situations, are expected to further spread to household sectors. Accordingly, the Japanese economy’s recovery will continue to be led by private demand.

INFLATION

Price deflation has continued since the mid-1990s. Domestic corporate goods prices had been on a declining trend. In 2003, the corporate goods price index (CGPI) (base year =2000) fell by 0.7 percent from the previous year.

The consumer price index (CPI), excluding fresh food, has continued to fall on a year-on-year basis since October 1999. However, the index has stayed flat on a month-on-month basis since the spring of 2003.

At present, although the CGPI has been rising, the CPI is slightly declining compared with the previous year. These movements show that the Japanese economy is in a mild deflationary phase.

Looking forward in the *Outlook*, the Government projected the percentage changes over the previous fiscal year of CGPI and CPI to be about -0.4 percent and -0.2 percent, respectively. According to the *Forecast*, they are estimated to be about 0.6 percent and -0.1 percent, respectively.

EMPLOYMENT

The employment situation was severe as the unemployment rate remained at a high level in the last few years. However, the number of employees has increased since the end of 2003, following an increase in job openings. The unemployment rate rose from the 4.5 percent to 5.0 percent range in 1999–2000 to about 5.5 percent in 2001, but then declined and remained within the 5.3 percent to 5.5 percent range from late 2001 to about the middle of 2003. The unemployment rate has fallen gradually to the 4.6 percent to 5.0 percent range.

Looking ahead, the Government has projected the unemployment rate for FY2004 to be about 5.1 percent in the *Outlook*. According to the *Forecast*, it is estimated to be about 4.5 percent.

BALANCE OF PAYMENTS

Exports started to increase in the beginning of 2002. The growth stopped from the end of 2002 to mid-2003 with the weakening of global economic resilience as the main cause. Since the second half of 2003, exports have been on an upward trend following the sharp rise in exports to Asia along with the recovery in the IT market and the world economy.

Imports have been on an increasing trend since the beginning of 2002 with a recovery of domestic demand.

As for the balance of payments for 2003, the current account surplus registered 15.8 trillion yen, an increase compared with the surplus of 14.1 trillion yen in 2002. This reflects a higher surplus in the trade account, and a lower deficit in the services account, which was caused by the decrease in overseas travel due to SARS. The capital and financial account recorded a net inflow of 7.7 trillion yen, lower than the net outflow of 8.5 trillion yen in 2002, primarily reflecting the large inflow in the financial account. The year-on-year growth in reserve assets was 21.5 trillion yen, up from 5.8 trillion yen in 2002.

Looking forward, the real contributions of net exports to GDP growth was projected to be about 0.2 percent in the *Outlook*. According to the *Forecast*, it is estimated to be about 0.5 percent.

EXTERNAL DEBT

At the end of 2003, net external assets were 172.8 trillion yen, down from 175.3 trillion yen in 2002. External assets increased to 385.5 trillion yen due to the purchase of foreign bonds and notes. External liabilities increased to 212.7 trillion yen because the prices of stock held by nonresidents rose.

EXCHANGE RATE

The yen against the US dollar sharply appreciated, from the 120 level in early August 2003 to the 105 level in early February 2004. It reached the 103 level in early April. The Government had intervened in the foreign exchange market exchanging, over 20 trillion yen in total in 2003 and over 14 trillion yen in the first quarter of 2004. The yen against the US dollar has moved to around the 110 level since June.

FISCAL POLICY

Japanese public finance is confronted with a considerably severe problem with the national and regional long-term debts amounting to approximately 700 trillion yen at the end of FY2003, which is about 140 percent of the nominal GDP.

As for the medium-term fiscal management, the Government has set medium-term fiscal goals. The measures aiming to achieve these goals include: until FY2006, the Government maintains its expenditure (ratio of general expenditure to GDP) at or below its FY2002 level. By FY2006, with the continuing efforts of both central and local governments to reduce expenditure, based on the assessment of necessary public services and expenditure levels, as well as on the status of economic revitalization and fiscal conditions, the Government will judge what tax measures are required. Beyond FY2007, the Government aims to achieve a primary surplus (excluding social security) in the early 2010s by continuing the same level of effort to improve the fiscal balance and a realization of sustainable economic growth led by private demand.

The Government steadily tackled important challenges, such as the reform of the financial relationship between local and central government, the reform of the pension system, and innovation in the budgetary process through expanding budget execution surveys and introducing the "model project" method as well as the "policy package" method.

Through the reform of expenditure, the Government restrained government bond issuance as much as possible.

As for the FY2005 budget, based on the *Basic Policies for Economic and Fiscal Management and Structural Reform 2004*, the Government will maintain and strengthen its commitment to its fiscal policy, under which general expenditures and general account expenditures have been contained substantially at or below the level of the previous year's budget.

MONETARY POLICY

The Bank of Japan (BOJ) has gradually raised the target balance of current accounts held at the BOJ since it adopted the quantitative easing policy in March 2001. In January 2004, BOJ decided to change the main operating target in its guidelines for money market operations. The target balance of current accounts held at the Bank was raised from "around 27 to 32 trillion yen" to "around 30 to 35 trillion yen". The growth of the monetary base has been at the 4.0 to 5.0 percent level against a background of ample fund supplies from the BOJ. The growth of M2+Cash Deposits has remained at around the 2 percent level.

MEDIUM-TERM OUTLOOK

According to the *Structural Reform and Medium-Term Economic and Fiscal Perspectives—FY2003 Revision* decided by the Cabinet in January 2004, the deflationary pressure is expected to decrease gradually through the combined efforts of the government and BOJ.

As for the growth rate, the economy will go on a medium-term growth path of 1.5 percent or higher in real terms, and will achieve a growth path of around 2 percent or higher in nominal terms after the "Intensive Adjustment Period". The ratio of the primary balance to nominal GDP will improve from -5.4 percent in FY2003 to -4.6 percent in FY2004 and is forecast to be positive in the early 2010s.

STRUCTURAL REFORM

The Government has steadily engaged in a wide range of structural reforms in line with the policy that there can be "no growth without reforms".

Structural reform represents ceaseless efforts to reform various systems, policies and the Government, so that corporations, regions, and individuals can flexibly respond to the new socio-economic environment and can harness their potential to the maximum extent.

The progress of structural reform, including the steady progress in disposal of NPLs, the broad range of efforts for regulatory reform, the reorganization and revitalization of corporations, the promotion of the reform on expenditure and tax, has led to the elimination of several factors that have suppressed the Japanese economy since the burst of the 'bubble economy'. As for the disposal of NPLs, the amount of NPLs in major banks has decreased by over 13 trillion yen in the past two years and the stock prices of banks and real estate industry have enjoyed steady gains. Further, in addition to a tax cut on business capital investment and R&D expenses, there has been an active revitalization and restructuring of corporations as can be seen from the drastic increase in new businesses, (over 10,000), emerging in the past year under the Special Regulations Governing Minimum Capital Requirements.

At the same time, the unemployment rate has decreased for the first time in 13 years. There is definitely a significant difference compared with the past two economic recoveries after the burst of the 'bubble' economy, during which the unemployment rate rose or hovered at a high rate. It shows that the recovery this time is due to the achievements of structural reform.

The task of the government after FY2005 is to put forth further full-fledged efforts for the implementation of reforms carried out thus far. The principles of the reform are: "from Public Sector to Private Sector" and "from the State to the Regions"; and to establish a basis for growth under the new circumstances Japan faces, such as the decrease of population and changes in the international environment. Defining the two-year period between FY2005 and FY2006 as the “Concentrated Consolidation Period”, the government intends to ensure a break away from deflation through its policy efforts together with BOJ, and to focus on consolidating the fundamentals for the new growth. As a result of these efforts, the nominal growth rate after FY2006 is projected to be around 2 percent or more.

Main issues of the structural reform are as follows:

1. *Privatization of the postal services*
   The privatization of postal services is regarded as a centerpiece of the Koizumi administration’s reform, and the issue has been discussed vigorously in the Council on Economic and Fiscal Policy (CEFP).

   The “Basic Policy on the Privatization of Japan Post” was decided in September 2004. In accordance with the Basic Policy, the necessary conditions for the privatization are as follows: (1) expansion of operational freedom, (2) ensuring equal footing with the private sector, and (3) clarification of profits and losses of each business and elimination of risk of being affected by other businesses.

   The Government will privatize Japan Post in 2007, with privatization being fully realized after a transitional period which shall end by 31 March 2017 at the latest.

2. *Regulatory reform*
   The government has implemented vigorously more than 5,000 regulatory reforms in public administration based on the “Program for Promoting Regulatory Reform”. The reform is still on the road to success because many challenges remain, although each structural reform has been progressing.

   The government established the “Council for the Promotion of Regulatory Reform” to implement the regulatory reforms strongly and intensively. Various opinions from scholars and business people are reflected in the discussions of the Council.

3. *Special zones for structural reform*
   The purpose of special zones for structural reform is to enable exceptions to regulations to match the special local characteristics of the planning of local governments and private sector corporations in their own initiatives. To make the reform a structure in which the latent potential of local communities can be freely realized, a "spirit of self-help and self-reliance" is necessary. From this perspective, by establishing special measures for individual regulations, in cases where measures are necessary to prevent hindrances that may arise both inside and outside special structural reform zones, the special measures will call on local governments to actively respond to the contents of the special measures.

   There are 386 special zones in Japan. The government will realize as many regulatory reforms as possible. Moreover, based on the assessment of the effects of the exceptional measures in regulatory reform, it will implement regulatory reform on an economy wide basis starting in 2004.

4. *Fiscal reforms of local and central government*
   For the fiscal reforms of local and central government, the government will promote the “Reform Package of Three Issues”— the national treasury disbursements reform, tax resource transfer, and local allocation tax reform — in an effort to increase autonomy and responsibilities of local governments, from the perspective of streamlining the administration and budget processes in central and local governments.

   The reform proposal on the national treasury disbursements submitted by the representatives of local governments in August 2004 included a reduction of the national treasury disbursements by 3.2 trillion yen over the next two years (to FY2006), and the transfer of tax resources by around 3 trillion yen from the central government to the local governments. The government will consider the “Reform Package of Three Issues” based on discussions with local governments.

5. *A vision of Japan in the 21st century*
The CEFP, bringing together public and private wisdom, will compile “A vision of Japan in the 21st century” by the end of FY2004. The vision is a strategy for the further development of Japanese socio-economy in the long-run.

6. *Financial system reform*
In FY2004, the government will strengthen the financial system by bringing the NPL problems to an end by steadily implementing the “Program for Financial Revival”, and reinforce the function of small and medium-sized or regional financial institutions.

In 2004, the government will formulate the “Program for Concentrated Consolidation of the Financial System (tentative name)”. Based on this program, the government will further strengthen and enhance Japan’s financial sectors through structural reform and vitalization of the financial and securities markets, to supply the world’s highest level of financial service to users, meeting their needs and contributing to further social and economic growth.

7. *Strengthening of job creation*
The government will support job creation by steadily promoting the “5.3 Million Jobs Creating Program”, mainly in the fields of elderly-care-related services, information and communications, and the tourism industry.

The government will focus on policies concerning: the elimination of the labor demand-supply mismatch; manpower development and job training; and support for the labor movement. In doing so, the private sector will be activated.

Efforts will be made on intensive capacity building among the younger generation to deal with the high rate of youth unemployment (at approximately 10 percent). The Government is promoting the “Independence and Challenge Plan for Young People” providing job assistance for school graduates.

8. *Social security system reform*
A comprehensive reform will be made of the social security system which would include pensions, medical care, nursing care and public assistance, etc. The pension system has been reviewed to ensure its reliability in 2004. Any increase in social security benefits is expected to be much greater than the economic growth considering the progressive decline in birth rates and the aging society. To establish a sustainable social security system and provide security to Japan and vitality to the economy, the comprehensive reform of the social security system will continue to be implemented.

9. *Revitalization of regional economies*
The Japanese economy is recovering steadily as a whole, however there are differences in the progress of the recovery among the regions, based on their different industrial composition and export competitiveness. It is necessary to implement the structural reform to resolve problems such as the decline of local industries, which causes unemployment and the ‘hollowing out’ of local cities.

The government established the “Headquarter of Regional Revitalization”, which coordinates intra-government agencies, local government and private companies to implement the revitalization of regional economies and create jobs.

10. *Promotion of economic partnership and acceleration of foreign direct investment*
The government promotes economic partnership with other economies as well as the new round of trade negotiations at the WTO. The government, taking leadership in Asia, accelerates economic partnership negotiations with Asian economies along with its domestic structural reform.

The government steadily implements the “Program for the promotion of Foreign Direct Investment into Japan”, which may create new markets and job opportunities through the introduction of new management know-how and technology.

As the Japanese economy has recovered, the results of structural reforms are beginning to show. The government will implement further structural reform to utilize the power of the private sector to resolve these challenges to establish and sustainable economic growth path.

ANNEX I

JAPAN: OVERALL ECONOMIC PERFORMANCE

	1998	1999	2000	2001	2002	2003
GDP and Major Components (percent change, year over year - earlier period, except as noted)						
Nominal GDP (level in billion US$)	3,953	4,473	4,745	4,162	3,985	4,305
Real GDP	-1.1	0.1	2.8	0.4	-0.3	2.4
Consumption	0.4	1.1	1.8	2.0	1.3	0.9
Private Consumption	-0.1	0.2	1.0	1.7	0.9	0.8
Government Consumption	2.0	4.6	4.9	3.0	2.4	1.0
Investment	-1.9	-1.0	3.1	-0.3	-6.5	3.7
Private Investment	-2.0	-4.0	9.6	1.1	-7.2	9.3
Government Investment	-1.7	5.5	-10.1	-4.0	-4.6	-10.4
Exports of Goods and Services	-2.4	1.5	12.4	-6.1	8.0	10.1
Imports of Goods and Services	-6.6	3.3	9.2	0.1	2.0	5.0
Fiscal and External Balances (percent of GDP)						
Budget Balance*	-7.5	-8.6	-7.0	-6.6	-8.0	N.A.
Merchandise Trade Balance	3.1	2.8	2.5	1.7	2.4	2.5
Current Account Balance	3.0	2.6	2.5	2.1	2.8	3.2
Capital and Financial Non-Reserve Assets Balance	-3.3	-1.2	-1.8	-1.2	-1.7	1.6
Economic Indicator (percent change, year over year - earlier period, except as noted)						
GDP Deflator	-0.1	-1.5	-2.0	-1.5	-1.2	-2.5
CPI	0.6	-0.3	-0.7	-0.7	-0.9	-0.3
M2	4.0	3.6	2.1	2.8	3.3	1.7
Short-Term Interest Rate (CD New Rate, percent)	0.7	0.2	0.2	0.1	0.03	0.01
Real Effective Exchange Rate (level, 1997=100)**	102.1	114.7	119.1	106.1	100.3	100.7
Unemployment Rate (percent)	4.1	4.7	4.7	5.0	5.4	5.3
Population (millions)	126.5	126.7	126.9	127.3	127.4	127.6

* Refers to fiscal year (April to March)

** The calculation method of the real effective exchange rate was changed in February 2002, and the figures are retroactively revised accordingly.

ANNEX II

JAPAN: FORECAST SUMMARY (percent change from previous year)

	2003						2004					
	Official	**IMF**	**ADB**	**OECD**	**PECC**	**CAO**	**Official**	**IMF**	**ADB**	**OECD**	**PECC**	**Link**
Real GDP	1.8	4.4	2.5-2.8	3.0	2.8	3.5	N.A.	2.3	1.5-2.0	2.8	2.2	N.A.
Exports	5.5	15.1	N.A.	12.5	9.3	N.A.	N.A.	6.8	N.A.	12.1	7.0	N.A.
Imports	5.2	8.8	N.A.	6.9	3.7	N.A.	N.A.	4.8	N.A.	7.2	3.5	N.A.
CPI	-0.2	-0.2	N.A.	-0.2	-0.3	-0.1	N.A.	-0.1	N.A.	0.1	0.1	N.A.

-as of September 2004

Note:
The Official figure and the CAO figure for 2004 refer to FY 2004 (from April 2004 to March 2005).
IMF: *World Economic Outlook* (September 2004)
ADB: *Asian Development Outlook 2004*(April 2004)
OECD: *Economic Outlook 75*(May 2004)
PECC: *Pacific Economic Outlook 2004-2005* (June 2004)
CAO: *A Forecast of Economic Situation for FY 2004 (Calculated by Cabinet Office)* (July 2004)

ANNEX III

JAPAN: MEDIUM-TERM TREND FORECAST (percent)

	Average for 2005–2008
Real GDP	2.1
CPI	1.3
DCGPI	0.8
GDP deflator	0.2

Note: The figure refers to FY 2005–FY2008
Source: Reference Estimates (Presented to the Council on Economic and Fiscal Policy on January 16, 2004)

KOREA

REAL GROSS DOMESTIC PRODUCT GROWTH

Last year, Korea's real gross domestic production (GDP) grew 3.1 percent year-on-year. By quarter, the pace of growth slowed to 3.7 percent during Q1 with Q2 recording 2.2 percent and Q3 2.4 percent. However, in Q4, as export and industrial production began to pick up, growth gradually recovered to 3.9 percent.

By expenditure item: due to sluggish domestic demand, private consumption recorded a 1.4 percent negative growth compared to 2002. Facility investment posted a 1.5 percent negative growth. However, construction investment grew at an impressive rate of 7.6 percent. Export growth increased 2 percent point to 15.7 percent from 13.3 percent but import growth plummeted to 9.7 percent from 15.2 percent due to shrinking domestic demand, thus greatly contributing to the rise in net export.

In Q1 of 2004, while growth momentum was being built (as evidenced by the GDP growth rate of 5.4 percent year-on-year) on the back of brisk export, recovery in domestic demand such as private consumption and facility investment is due later than expected.

Table 1: Trends in Real GDP Growth Rate

(percent)

	2001	**2002**	**2003**					**2004**
			Q1	Q2	Q3	Q4	Yearly	
Real GDP	3.8	7.0	3.7	2.2	2.4	3.9	3.1	5.3
Private consumption	4.9	7.9	0.3	△1.8	△1.9	2.2	△1.4	△1.4
Construction investment	6.0	5.3	8.0	7.3	7.9	7.4	7.6	4.1
Facility investment	△9.0	7.5	1.9	△0.6	△5.0	△2.4	△1.5	△0.3
Total export	△2.7	13.3	15.9	8.4	14.9	23.1	15.7	26.9
(Total import)	(△4.2)	(15.2)	(14.2)	(5.2)	(7.7)	(11.7)	(9.7)	(11.8)
Agriculture, forestry and fishery industries	1.1	3.5	△7.1	△5.1	△1.3	△9.1	△7.1	8.6
Manufacturing	2.2	7.6	5.1	2.6	3.3	8.0	4.8	12.1
Construction	5.5	2.8	8.4	7.7	8.1	8.4	8.1	4.5
Service industry	4.8	7.8	1.9	1.1	1.6	2.4	1.8	1.6

With regard to recent economic developments, various measures aimed at stimulating investment and creating jobs have been implemented without producing any tangible results up to date. Consequently, the expectation of economic recovery has been attenuated in the interim due to external variables such as stubbornly high oil prices, belt-tightening in China, and the earlier than expected increase in interest rates in the United States.

By sector: in April and May industrial production increased 12.3 percent from the same period of the previous year while inventory growth lost its steam steadily demonstrating that production growth in the manufacturing sector is building momentum. However, service sector production fell 0.2 percent, compared with the same period of the preceding year, dragging economic indicators on to a moderate downward curve due to the slowing service sector. This indicates a delayed economic recovery.

The Korean government has, as top economic policy priorities, plans to keep stimulating investment and creating jobs. If this policy direction is pursued without a hitch, the economy is projected to grow by an average 5 percent per year given the continued briskness of exports and signs of gradual recovery in domestic demand, and with investment playing a major role.

INFLATION
In 2003, the consumer price index (CPI) rose by an annual average of 3.6 percent proving, it is being stabilized close to the target rate of 3.0 percent, and recorded a 3.4 percent increase compared to the end of 2002. In addition, core inflation, the barometer of price movements, increased by an annual average of 3.1 percent hovering around the stabilizing rate of 3.0 percent.

With regard to macroeconomic developments: due to the rise in international oil prices and raw materials, there was much room for a price hike in light of costs but from a demand-side perspective the room for a price increase shrank due to weak consumption. Touching on variables by sector, prices of agricultural, fishery and livestock products jumped due to the typhoon in the middle of the year. And a house rents climbed steeply owing to the rise in real estate prices but public utilities charges, prices of industrial goods and individual service fees showed a more stable than preceding years.

There were difficulties in controlling prices in 2004 due to mounting pressure for cost increases derived from soaring oil prices. The CPI growth rate increased 1.5 percent in the Q1 to 3.2 percent from the same period in 2003 but in the Q2 the rate grew by a mere 0.7 percent decelerating the pace showing signs of a slight improvement. The producer price index (PPI) has maintained its upward trend because of the rise in oil prices. However, while the PPI increased by 3.1 percent in Q1 year-on-year, its pace of growth lost its momentum in Q2 as service charges showed signs of stabilizing.

Table 2: Price Movement (Growth rate compared to the preceding quarter (month)

(Unit: percent)

	2003					**2004**	
	Yearly	Q1	Q2	Q3	Q4	Q1	Q2
Consumer price	3.4(3.6)	1.8(4.1)	0.6(3.4)	0.3(3.2)	0.8(3.5)	1.5(3.2)	0.7(3.4)
Producer price	3.1(2.2)	1.4(2.9)	△0.2(1.3)	△0.1(1.9)	1.2(4.2)	1.7(6.2)	0.9(4.4)

In the second half of 2004, difficulties are expected to persist due to unfavorable external conditions such as skyrocketing oil prices, and the increase in international raw materials' prices. However, the government intends to focus its efforts on achieving price stability by flexibly responding to each oil price hike according to countermeasures drawn up on a case-by-case basis. If pertinent measures are implemented without any setback, the CPI rate is projected to reach the mid-3 percent rate despite adverse external factors such as soaring oil prices.

UNEMPLOYMENT RATE
Overall job trends in 2003 showed poor performance reflecting the economic downturn. The number of economically active persons increased by 0.2 percent year-on-year while that of the economically non-active persons rose by 2.4 percent. The labour force participation rate stood at 61.4 percent, a 0.5 percent decrease year-on-year.

In 2003, the number of the unemployed was 777,000, an increase of 69,000 compared to the previous year and the unemployment rate reached 3.4 percent posting a 0.3 percent increase.

In 2004, the economy has been visibly on the path to recovery as evidenced by the increase in the number of economically active persons and the number of employed people but the pace of improvement is rather slow. During Q1, the number of economically active persons rose by 2.4 percent from the same period last year, while that of the economically non-active persons fell by 1.1 percent.

Table 3: Trends in Employment

	2002	2003					2004	
		Yearly	Q1	Q2	Q3	Q4	Q1	Q2
Economically active population (1,000s)	22,877	22,916	22,439	23.055	23,050	23,119	22,982	23,527
Participation rate (%)	61.9	61.4	60.3	61.8	61.6	61.7	61.2	62.5
Employed (1,000s)	22,169	22,139	21,633	22,303	22,295	22,325	22,104	22,783
Unemployed (1,000s)	708	777	806	751	756	794	878	788
Joblessness rate (%)	3.1	3.4	3.6	3.3	3.3	3.4	3.8	3.3
Economically non-active persons (1,000s)	14,086	14,424	14,755	14,243	14,341	13,357	14,595	14,144

BALANCE OF INTERNATIONAL PAYMENT

Korea's current account surplus in 2003 was US$12.32 billion recording a surplus for six consecutive years since 1998. As the merchandise trade surplus (US$22.16 billion) rose significantly and a slight improvement was made on deficits in trade in services (US$7.61 billion), a current account surplus rose by US$6.93 billion compared to 2003(by US$5.39 billion).The income account balance was US$600 million, an increase of US $160 million from 2002, thanks to the decrease in deficits in investment income and the increase in a surplus in wages and money received. The current transfers account balance (CTAB) reached US$2.82 billion due to the rise in deficits as a result of remittances abroad by residents in Korea. In 2004, because of a rising merchandise trade surplus, the current account balance remains positive.

The capital account balance recorded an inflow surplus of US$13.13 billion due to the increasing capital inflow for securities investment by foreigners in 2003. While the financial account recorded an inflow surplus of $ 14.53 billion because of rising securities investment by foreigners, other capital and financial accounts posted an outflow surplus of US$1.4 billion owing to rising emigration fees.

In Q1 of 2004, securities investment by foreigners amounted to US$10.74 billion marking an inflow surplus. However, as securities investment by foreigners reversed to a net outflow (a negative US$2.99 billion) an outflow surplus was recorded in May 2004.

Table 4: Trends in Balance of International Payment

(Unit: $ hundred million, Growth rate (%) compared to the same period of the previous year)

	2003					2004	
	Yearly	Q1	Q2	Q3	Q4	Q1	May
Current account balance	123.3	△15.2	24.3	37.6	76.6	61.5	37.6
Merchandise trade balance	221.6	12.4	57.6	68.2	83.5	86.1	38
Export (Increase rate)	1976.4 (20.9)	445.4 (23)	465.2 (13.9)	490.5 (19.2)	575.3 (27.2	603.8 (35.6)	212.1 (42.7)
Import (Increase rate)	1754.8 (18.1)	433 (31.4)	407 (12.1)	422.3 (10.8)	491.8 (19.4)	517.7 (19.6)	174 (31.7)
Service balance	△76.1	△23	△16.7	△26.5	△9.9	△18.8	△1.9
Income account balance	6.0	2.5	△10.4	4.8	9.0	2.3	3.0
CTAB	△28.2	△7.2	△6.2	△8.9	△5.9	△8.0	△1.5
Capital account balance	131.3	20	25	37.6	48.8	26.5	△16.5

FOREIGN DEBTS

As of the end of Q1 of 2004, Korea's total foreign debts were US$169 billion, an increase of US$ 8.1 billion from the end of 2003, while foreign bonds amounted to US$242.9 billion, up by US$17 billion.

In the same quarter, long-term debts grew by US$4.9 billion to 110.5 billion due to the increase in the issuance of long-term foreign currency- denominated bonds (by US$3 billion) by banks and the rise in advance payment for export by firms (by $1.8 billion). Short-term debts recorded a quarterly growth of US$3.2 billion reaching $58.5 billion due to the rise in bank deposits by non-residents, an increase in customer deposits (by US$2.8 billion) and the net purchase of Monetary Stabilization Bonds (MSB) (US$300 million).

On the other hand, Korea's net lending hit US$73.9 billion, up by US$8.9 billion, from the end of 2003, maintaining its status as a net creditor economy since June 2000.

Table 5: State of Total Foreign Debts and Foreign Bonds

(Unit: $ Hundred million)

	End 2001	End 2002	End 2003	End March 2004
Foreign Debts(A)	1,308	1,440	1,609	1,690
Long-terms Debts	889	939	1,056	1,105
Short-term Debts	419	501	553	585
Foreign Bonds(B)	1,655	1,861	2,259	2,429
Net bonds(B-A)	347	421	650	739

FOREIGN EXCHANGE RATE

In 2003, the won-dollar exchange rate stood at 1,192.4 won (a 0.5 percent depreciation), which was an increase of 6.4 won, compared to the end of the previous year (1,186.2 won) based on the year's closing value. The annual average of the won-dollar exchange rate was 1,191.89, which was a 5.0 percent appreciation in the value of the won, compared to 1.251.24 on average in the previous year.

During Q1 of 2004, the won-dollar exchange rate declined due to the massive influx of funds for securities investment by foreigners and the fall in the yen-dollar exchange rate. And in Q2 the won-dollar exchange rate tumbled to 1184.4 at one point, owing to austere policies in China and the weakened Japanese yen.

However, as of the end of June as funds for securities investment by foreigners were channeled into net buying, the exchange rate recorded 1152.5 won, down by 1.1 percent from the end of the previous quarter.

Table 6: Trends of the Won-dollar Exchange Rate

(as of the end of the quarter)

	2003				2004					
	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June
won/dollar	1150.2	1177.3	1203.6	1197.8	1174.9	1176.5	1153.6	1165.7	1165.7	1152.5
yen/dollar	111.8	108.7	109.6	107.0	105.8	109.1	105.8	10.9.9	110.4	108.3
won/100yen	1028.9	1083.5	1097.6	1119.6	1111.0	1078.4	1090.0	1062.1	1056.2	1064.0

MONETARY POLICIES

1. In consultation with the government, the Bank of Korea has set a target range of 2.5 to 3.5 percent for the average rate of increase in core inflation for the three year period 2004 to 2006.

2. Recently, consumer and producer price inflation continued to show a relatively rapid rise. This was mainly due to the upswing in the prices of international raw materials and seasonal factors but the increases are within the inflation target range.

3. In the financial markets, overall liquidity conditions have been favorable due to subdued demand for funds. However, concern over the deteriorating soundness of some financial institutions notably a few credit card companies has grown and risk aversion from low-rated

companies has not yet lessened. Fund-raising conditions have remained unfavorable for small- and medium-sized enterprises (SMEs) with a low credit rating.

4. The Korean government aims to resolve smoothly issues such as household debts, credit delinquency and difficulties in borrowing by SMEs to promote financial market stability. To solve the problem of household debts, the government will induce the extension of debt maturities and the reclassification of short-term loans as long-term loans, thus engineering the soft landing of household debts.

   By strengthening supports for credit delinquents through the ‘bad bank system’ and efficiently operating the ‘individual workout system’, the government plans to step up its efforts to help credit delinquents recover their credit.

FISCAL POLICY

1. The government adopted expansionary fiscal policies to remove economic uncertainties in 2003. Speeding up budgetary expenditures will help restore confidence by demonstrating that the government has adopted a proactive approach to dealing with the economic situation.

2. First, the government front-loaded its budget spending in the first half of 2003. The 4.2 trillion won (US$3.5billion) and 3 trillion won (US$2.5 billion) supplementary budgets were approved in the second half of 2003. Frontloading the budget in first half was estimated to increase real GDP by 0.2 percent point and two times supplement budgeting in the second half is also projected to increase GDP, by 0.5 percent.

3. The government will continue to pursue the fiscal policy which is similar to that of last year. The fiscal policy focuses on recovering the economy, and especially on fostering domestic demand, to enhance the government's role in revitalizing the economy. In spite of expansionary policies last year, the Korean government recorded a consolidated fiscal balance surplus. In 2002, Korea’s public debt-to-GDP ratio was projected to be around 22.4 percent, much lower than the average in the Organisation for Economic Cooperation and Development (OECD) nations of 70 percent. Considering the degree of fiscal soundness, the Korean government has much room for selection of fiscal policies to boost the economy. It, was and will be, possible to implement aggressive government spending while maintaining sound fiscal management.

4. During the second half of 2004, the government will continuously strive to increase fiscal spending which is conducive to recovery in domestic demand. The fiscal spending is expected to hit 4.5 trillion won by fully utilizing reserve funds. The fiscal expenditures will be funneled mainly to vulnerable groups such as struggling SMEs and low-income families. In particular, by focusing efforts on easing cash crunch and strengthening competitiveness of SMEs, the government will ensure that the benefits of the export- and conglomerate-led economic recovery will spread to every corner of the economy.

STRUCTURAL REFORM

1. Financial Sector

Since the financial crisis, the government has vigorously carried out financial restructuring to restore the financial market function. In this process, 809 financial institutions were either merged or liquidated while 1661.1 trillion won worth of public funds was injected to enhance the soundness of financial institutions. Consequently, the soundness of financial institutions recovered as evidenced by the amount of non-performing Loans in financial institutions, which decreased to 40.2 trillion won or 4.2 percent of the total loans as of the end of September 2003 from 88 trillion won or 14.9 percent of the total loans in 1999. Profitability of financial institutions such as banks has significantly improved.

The government plans to steadily implement financial restructuring based on market principles to prevent a delay in restructuring from turning into a destabilizing factor in the financial market. In order to solve the credit company problem, a major source of controversy, the government plans to demand intensive self-rescue measures and to strengthen the overall supervision and management systems of credit card companies, such as risk management.

The government will carry out the privatization of the remaining banks that received public funds without delay and also plans to implement restructuring of the non-banking sector including investment trust companies on a continual basis.

2. Corporate Sector

The corporate restructuring implemented in the aftermath of the financial crisis has remarkably enhanced corporate financial status. The debt-to-equity-ratio in the manufacturing sector dropped to 123 percent as of 2003 from the pre-crisis level of about 400 percent. This ratio is lower than that of developed economies such as the United States and Japan.

Concerning restructuring of non-viable companies, a total of 83 firms have undergone restructuring through the workout program since the financial crisis. In accordance with the workout procedure, 57 companies took the path to management normalization, 19 firms completed an early liquidation process and 7 firms are currently in the workout program.

Along with such efforts, a basis for constant corporate restructuring based on market principles has been laid. The constant assessment system of the credit risk of companies was introduced (in February 2003) with creditor banks taking on a leading role. The Corporate Restructuring Promotion Act, enacted in September 2002, established the laws and institutions under which companies that prove problematic according to evaluation results will go swiftly through a restructuring based on market principles. In accordance with the pre-prepared guidelines of corporate restructuring, further restructuring will be implemented in a drastic and swift manner. In addition, to ensure a level playing field, the government aims to establish a fair and transparent economic system based on the "Three-year Market Reform Action Plan" announced in October 2003.

ANNEX I

KOREA: OVERALL ECONOMIC PERFORMANCE

	1998	1999	2000	2001	2002	2003
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (billion US$)	346	445	511	482	546	605
Real GDP*	△8.3	9.4	5.5	3.8	7.0	3.1
Consumption*	△10.6	9.7	7.1	4.9	7.6	△0.5
Private Consumption	△13.4	11.5	8.4	4.9	7.9	△1.4
Government Consumption	2.3	2.9	1.6	4.9	6	3.7
Investment	△22.9	8.3	12.2	△0.2	6.6	3.6
Private Investment	N.A	N.A	N.A	N.A	N.A	N.A
Government Investment	N.A	N.A	N.A	N.A	N.A	N.A
Exports of Goods and Services	46.2	39.1	40.8	37.8	35.3	38.2
Imports of Goods and Services	33.3	32.4	37.7	35.5	33.9	35.6
Fiscal and External Balance (percent of GDP)						
Budget Balance	△4.2	△2.7	1.3	1.3	3.8	1.3
Merchandise Trade Balance	12.0	6.3	3.3	2.7	2.6	3.6
Current Account Balance	11.6	5.5	2.3	1.6	0.9	2.0
Capital and Financial Non-reserve Assets Balance	△9.2	0.4	2.3	△0.6	1.1	2.1
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	5.8	△0.1	0.7	3.5	2.8	2.3
CPI	7.5	0.8	2.3	4.1	2.7	3.6
M2	23.6	13.5	2.2	6.9	11.5	7.9
Short-term Interest Rate **	14.91	4.92	5.05	4.63	4.16	3.95
Real Effective Exchange Rate	N.A	N.A	N.A	N.A	N.A	N.A
Unemployment Rate	7.0	6.3	4.1	3.8	3.1	3.4
Population (millions)	46.3	46.6	47.0	47.3	47.6	47.9

* 2000 constant prices
** call rate

ANNEX II

KOREA: FORECAST SUMMARY (percent change from previous year)

	2003				2004				
	Official	**IMF**	**ADB**	**OECD**	**Official**	**IMF**	**ADB**	**OECD**	**PECC**
Real GDP	5.0	2.5	4.0	5.2	5.0	8.5	5.5	4.8	5.6
Exports	N.A	N.A	8.0	12.8	N.A	N.A.	N.A	N.A	18.0
Imports	N.A	N.A	9.0	11.4	N.A	N.A.	N.A	N.A	14.0
CPI	3.0	3.3	4.0	3.7	3.0	N.A.	3.1	N.A	3.2

ANNEX III

KOREA: MEDIUM-TERM TREND FORECAST (percent)

	2005
Real GDP	5.9
GDP Deflator	2.3

MALAYSIA[1]

REAL GROSS DOMESTIC PRODUCT GROWTH

The Malaysian economy accelerated its growth momentum in the second quarter of 2004, increasing at a faster pace of 8 percent (Q2 2003: 4.6 percent), the strongest quarterly growth since the third quarter of 2000. Growth continued to be broad-based, led by the manufacturing and services sectors. Private sector expenditure was more robust and reinforced by buoyant growth in external demand.

Domestic demand, led by the private sector, remained sturdy and contributed significantly to overall economic growth. As consumer sentiment remained positive and investor confidence gained momentum, aggregate domestic demand strengthened further, by 8.1 percent, in the second quarter. Private consumption expenditure picked up strongly, by 11.4 percent, due to higher disposable income arising from firm commodity prices, stronger export earnings as well as better employment prospects and positive wealth effects from favourable stock market conditions. Public consumption registered a moderate growth of 7.1 percent, in line with the Government's fiscal consolidation policy. Total investment expenditure continued to increase by 3.5 percent, underpinned by stronger private investment activities following continued decline in the Federal Government's development expenditure.

On the supply side, all sectors, except for construction, recorded growth with manufacturing and services leading the growth with 12 percent and 7.4 percent, respectively. The strong growth in manufacturing and services was due to sustained robust domestic economic activities, higher tourist arrivals and external demand. The agriculture sector moderated by 3.2 percent (Q2 2003: 10.7 percent) due to declining value-added growth of palm oil by 6.6 percent (Q2 2003: 26.8 percent), following lower yields of fresh fruit bunches. Meanwhile, the mining sector grew only marginally by 1.1 percent (Q2 2003: 13 percent), despite higher production in natural gas by 4 percent. This was largely attributed to the 0.1 percent decline in production of crude oil (Q2 2003: 11.6 percent) on account of a temporary shutdown for maintenance of oil production facilities. The construction sector recorded a decline of 1.7 percent during the second quarter of 2004 (Q1 2004: +0.6 percent) largely due to lower public sector construction activity, especially in infrastructure projects. Construction starts in the residential and non-residential sub-sector remained stable during the period.

INFLATION

The consumer price index (CPI) rose by 1.2 percent in the second quarter compared to 0.9 percent in the corresponding period last year. The increase was mainly due to higher prices of food, especially meat that rose by 6.7 percent (Q1, 2004: 0.6 percent), attributed to it being in higher demand following the fear of Avian flu in the region.

EMPLOYMENT

Unemployment remained low at 3.7 percent (Q2 2003: 4.0 percent). A total of 14,660 vacancies were reported in the quarter, representing an increase of 86.7 percent from the previous quarter of 7,850. On a sectoral basis, vacancies in the manufacturing and other services sectors continued to record the highest number, accounting for more than 50 percent of the total vacancies reported.

BALANCE OF PAYMENTS

Amidst the improvement in the external environment, gross exports expanded strongly by 25 percent during the second quarter of 2004 (Q2 2003: 10.8 percent), while gross imports increased at a stronger pace of 32.2 percent reflecting buoyant domestic economic activity in the second quarter of 2004. As at 15 September 2004, Malaysia's international reserves rose further, to its

[1] *As at October 10, 2004.*

highest level of RM210.7 billion (USD55.4 billion), sufficient to finance 7.2 months of retained imports and five times the value of short-term external debts.

EXCHANGE RATE

In the second quarter, the performance of the ringgit was generally positive against the major and regional currencies as the US dollar strengthened, following expectations of interest rate increases. The ringgit appreciated in the range of 1.3 percent to 3.8 percent against the major currencies and in the range of 0.3 percent to 9.4 percent against most regional currencies. The depreciation of most regional currencies was due to concerns over a slower Chinese economy and higher oil prices as well as uncertain political developments in specific economies.

MONETARY POLICY

Monetary policy continued to remain supportive of economic growth in the second quarter of 2004. Bank Negara Malaysia implemented a new interest rate framework on 26 April 2004, whereby the overnight policy rate (OPR) replaced the 3-month intervention rate as the indicator of the monetary policy stance. The OPR was set at the prevailing interbank rate of 2.70 percent and allowed to fluctuate within a margin of $\pm$25 basis points. The new interest rate framework also allowed banking institutions to set their own base lending rates.

FISCAL POLICY

Revenue collection during the second quarter of 2004 increased slightly by 2.9 percent to RM21.8 billion (Q2 2003: RM21.2 billion). On the expenditure front, RM48 billion was expended by the Federal Government in the first half of the year, equivalent to 39.1 percent of the total revised budget of 2004 (first half 2003: RM51.9 billion or 45.3 percent). Operating expenditure as a percentage of total revised allocation was 21.5 percent. This is lower compared to 29.5 percent in the corresponding quarter in 2003, essentially due to the implementation of the Package of New Strategies in May 2003. Similarly, development expenditure as a percentage of total revised allocation was sustained at 23.4 percent (Q2 2003: 23.1 percent). The overall budget deficit for 2004 is expected to narrow to 4.5 percent of GDP compared to 5.3 percent in 2003.

CAPITAL MARKET DEVELOPMENTS

A significant achievement in the development of Malaysia's capital market was the successful demutualisation of the Kuala Lumpur Stock Exchange (KLSE) with effect from 5 January 2004. The demutualisation was in line with a key recommendation of the Capital Market Master Plan launched in February 2001 to strengthen the competitiveness of market institutions. With the demutualisation, the KLSE was converted into a public company limited by shares from a company limited by guarantee. On 20 April 2004, the KLSE became officially known as Bursa Malaysia.

FINANCIAL RESTRUCTURING

Financial restructuring in Malaysia reached another important milestone, with Danaharta, the national asset management company, redeeming the first two tranches of bonds with a face value of RM2.6 billion as scheduled on 31 December 2003. The bonds had been issued to finance the acquisition of non-performing loans during the Asian financial crisis. As at end-March 2004, Danaharta expects to recover RM30.86 billion from its non-performing loan portfolio of RM52.44 billion (loan rights acquired plus accrued interest), representing a recovery rate of 59 percent.

Further repayment was made to Danamodal, the special purpose vehicle, set up to recapitalise the banking institutions during the financial crisis. To date, only RM1 billion remains outstanding of the initial RM7.6 billion capital injection. Danamodal had also redeemed its entire RM11 billion bonds, which matured on 21 October 2003. The bonds were issued in 1998 to fund the recapitalisation of banking institutions.

MEDIUM-TERM OUTLOOK

Most of the developed economies are expected to perform favourably for the rest of the year. Global economic growth, although likely to moderate somewhat following higher oil prices, further hikes in US interest rates and prolonged geopolitical tensions, is expected to remain strong at 4.6 percent for the year 2004.

The Malaysian economy has generated sufficient momentum to sustain strong growth in the remaining quarters as shown by the Leading Index which gained 11.4 percent in the first half of 2004. Consequently, real GDP is expected to post a strong growth of 7 percent for the whole year. Robust private sector activities will continue to drive the economy over the coming months, whilst firm commodity prices and improving stock market activities will further enhance consumer and business sentiments.

ANNEX I

MALAYSIA: OVERALL ECONOMIC PERFORMANCE

	1998	1999	2000	2001	2002	2003
GDP and Major Components (percent change, year over year, except as noted)						
No ***Real*** GDP (1987 real prices) (level in billion US$)	47.9	50.7	55.1	55.4	57.7	61.0
Real GDP	-7.4	6.1	8.3	0.4	4.1	5.3
Consumption	-10.0	5.7	10.5	5.8	6.4	5.7
Private Consumption	-10.2	2.9	12.5	2.5	4.2	5.1
Government Consumption	-8.9	17.1	3.0	17.0	12.2	7.9
Investment	-43.0	-6.5	25.7	-2.8	0.2	2.7
Private Investment	-55.2	-23.1	32.6	-19.9	-6.1	1.1
Government Investment	-8.4	16.3	19.4	14.5	4.6	3.6
Exports of Goods	0.5	13.2	16.1	-7.5	3.6	11.5
Imports of Goods	-18.8	10.6	24.4	-8.6	6.1	4.8
Fiscal and External Balance (percent of GDP)						
Budget Balance	-1.8	-3.2	-5.8	-5.5	-5.6	-5.3
Merchandise Trade Balance	24.4	28.6	23.1	20.9	19.1	35.5
Current Account Balance	13.2	15.9	9.4	8.3	7.6	12.9
Capital and Financial Non-Reserve Assets Balance						
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	8.5	0.0	4.9	-2.7	3.6	3.3
CPI	5.3	2.8	1.6	1.4	1.8	1.2
M2	1.5	13.7	5.2	2.2	5.8	11.1
Short-Term Interest Rate (S3 month weighted average Interbank)	9.43	4.08	3.19	3.13	2.92	2.87
Real Effective Exchange Rate (level, 1997=100)						
Unemployment Rate (percent)	3.2	3.4	3.1	3.6	3.5	3.6
Population (millions)	22.2	22.7	23.5	24.0	24.5	25.1

ANNEX II

MALAYSIA: FORECAST SUMMARY (percent change from previous year)

	2003						2004					
	Official	**IMF**	**ADB**	**OECD**	**PECC**	**Link**	**Official**	**IMF**	**ADB**	**OECD**	**PECC**	**Link**
Real GDP	5.3	5.3	5.2	N.A.	N.A.	N.A.	7.0	6.5	5.8	N.A.	N.A.	N.A.
Exports	11.5	N.A.	12.4	N.A.	N.A.	N.A.	17.3	N.A.	8.6	N.A.	N.A.	N.A.
Imports	4.8	N.A.	5.4	N.A.	N.A.	N.A.	22.1	N.A.	13.5	N.A.	N.A.	N.A.
CPI	1.2	1.1	1.2	N.A.	N.A.	N.A.	1.5	2.2	1.5	N.A.	N.A.	N.A.

ANNEX III

MALAYSIA: MEDIUM-TERM TREND FORECAST (percent)

	Average for 2001–2005
Real GDP	4.2
GDP Deflator	N.A.

MEXICO

REAL GROSS DOMESTIC PRODUCT GROWTH

The economic recovery that began in 2003 continued in the first six months of 2004. Activity in the economy's three principal sectors—agriculture and fishing, industrial production and services—strengthened during the period, and the performance of an increasing proportion of their components improved. The recovery of external demand and the continued stability of domestic demand contributed to improving economic activity and this in turn gave rise to improved expectations and stimulated formal sector job creation.

The economic recovery was aided by the stable financial environment, which was attributable in part to the Government's prudent and consistent economic policy.

Mexico's economic activity, as measured by gross domestic product (GDP), grew at a real annual rate of 3.8 percent during the first half of 2004. During the same period, economic activity improved in all three principal sectors of the economy. In real annual terms, the agricultural sector grew by 4.9 percent, the industrial sector grew by 3.5 percent and the services sector grew by 4.1 percent.

INFLATION

The annual inflation rate, as measured by the change in the national consumer price index *(Indice Nacional de Precios al Consumidor*, or INCP), stood at 4.4 percent for the twelve months ending 30 June 2004. This was 0.4 percent higher than for the year that end 31 December 2003. This increase was attributable in part to the rising international prices of some commodities and their impact on core and non-core price indices.

EMPLOYMENT

Increased economic activity, combined with the strong performance of the manufacturing sector during the first half of the year, stimulated formal sector job creation during the first half of 2004. At 30 June 2004, the number of workers registered with the Mexican Social Security Institute (*Instituto Mexicano del Seguro Social*, or IMSS), a measure of formal sector employment, totaled 12,414,814, an increase of 224,022 formal sector jobs as compared to 31 December 2003. Notwithstanding the improvement in formal employment figures registered during the first six months of 2004, the open unemployment rate (*Tasa de Desempleo Abierta*, or TDA) remained high, averaging 3.7 percent of the economically active population during the first half of the year, 0.9 percent higher than the average for the same period of 2003.

BALANCE OF PAYMENTS

During the first half of 2004, improved global economic conditions, in particular in the United States, helped Mexico's external trade performance. In addition, the rise in international oil prices generated an increase in revenues from oil exports.

Total merchandise exports in the first half of 2004 were US$90,871 million, 14.2 percent higher than for the same period of 2003. Oil exports were US$10,816 million, 17.7 percent higher than for the same period of 2003.

In the first half of 2004, non-oil exports totaled US$80,055 million, 13.7 percent higher than for the same period of 2003. This increase was primarily attributable to the performance of manufacturing exports, which increased 13.5 percent. Within manufacturing exports, *maquiladora* and other manufacturing exports increased 13.8 percent and 13.0 percent, respectively.

During the first half of 2004, total merchandise imports were US$92,226 million, 13.7 percent higher than for the same period of 2003. Imports of intermediate goods by the *maquiladora* industry totaled US$32,293 million, 17.2 percent higher than for the same period of 2003.

Consumer goods imports totaled US$11,149 million in the first half of 2004, 13.1 percent higher than for the same period of 2003, due primarily to an increase in real wages. Imports of intermediate goods, excluding the *maquiladora* industry, increased 13.0 percent, to US$38,460 million. Finally, imports of capital goods imports in the first half of 2004 totaled US$10,324 million, a 7.1 percent increase as compared to the same period of 2003.

The trade balance registered a deficit of US$1,354 million in the first half of the year. Excluding oil exports, the trade deficit was US$12,171 million, 13.9 percent higher than in the first half of 2003.

The factor services balance registered a deficit of US$7,194 million in the first half of 2004, 6.2 percent higher than in the first half 2003. The non-factor services balance registered a deficit of US$1,835 million in the first six months of 2004, 2.9 percent higher than in the same period of 2003.

The current account deficit for the first half of 2004 was US$2,274 million, US$1,278 million lower than that observed in the first half of 2003. This decline resulted from a US$1,614 million, or 24.8 percent, increase in transfers, as well as a US$418 million, or 6.2 percent, decline in the factor services balance.

The moderate current account deficit was completely financed by long-term resources in the first half of 2004. In the same period, the capital account registered a surplus of US$4,904 million. This surplus was primarily the result of inflows channeled to the private sector, the main component of which was foreign direct investment (FDI). During the first half of the year, FDI totaled US$10,292 million. During the same period, the public, private and banking sectors reduced their external indebtedness levels by US$2,300 million, US$1,093 million, and US$246 million, respectively. Foreign portfolio investment in the Mexican Stock Market declined by US$2,652 million in the first half of 2004, while portfolio inflows to the money market increased by US$2,175 million. Furthermore, assets held by residents abroad increased by US$1,272 million in the first half of 2004.

The errors and omissions balance registered outflows of US$934 million in the first six months of 2004. Finally, net international reserves were US$59,128 million at the end of June 2004, a US$1,693 million increase from the end of 2003.

PUBLIC DEBT

The net public sector debt to GDP ratio was 24.8 percent at 30 June 2004, 0.4 percent lower than at 30 June 2003. This decrease is attributable to a decrease in the net domestic public sector debt to GDP ratio of 0.6 percent, which was offset in part by an increase in the net external public sector debt to GDP ratio of 0.2 percent.

EXTERNAL DEBT

At the end of June 2004, the outstanding amount of net public sector external debt was US$80,462 million, US$3,410 million higher than at the end of 2003. The increase was primarily attributable to the following factors:

- A US$1,817 million increase in the outstanding amount of gross external debt, resulting from (a) a net increase in external indebtedness of US$452 million, and (b) net upward accounting adjustments totaling US$1,365 million, resulting from the depreciation of the US dollar with respect to other major currencies in which debt is denominated and the accounting for liabilities associated with PIDIREGAS projects.

- A US$1,593 million decline in the value of the Federal Government's international assets related to external debt, primarily reflecting the recovery of Brady Bond collateral.

The Federal Government plans to continue to reduce the level of outstanding net external indebtedness by year-end 2004.

Of the total amount of resources obtained through financing operations during the first half of the year (US$11,275 million), the majority (45.9 percent) was obtained in debt exchange transactions. The remaining 54.1 percent was attributable to the following: 24.4 percent from PIDIREGAS projects, 12.4 percent from foreign trade related financing, 11.5 percent from bank loans and 5.7 percent from international financial organization financing.

Of the total amount of repurchases and amortizations carried out during the first half of 2004 (US$10,823 million), 28.1 percent resulted from debt exchange transactions conducted by the Federal Government and 2.4 percent corresponded to the prepayment of Interamerican Development Bank (IDB) loans. The remaining 69.5 percent was designated as follows: 24.0 percent to the repayment of external trade-related financing, 14.2 percent to public bonds, 13.3 percent to bank loans, 8.1 percent to loans from international financial organizations, 7.5 percent to debt associated with PIDIREGAS projects and the remaining 2.4 percent to restructured debt.

During the first six months of 2004, the Federal Government issued US$4,779 million of debt in the international capital markets, US$1,578 million less than the US$6,357 million issued during the first half of 2003. The weighted average cost of these issues, expressed as a spread over Treasury bills, was 174 basis points, 62 basis points lower than the spread achieved in the first half of 2003.

The following noteworthy external debt issuance transactions took place during the first half of 2004:

- On 13 January 2004, the Federal Government issued US$1 billion of 5-year floating rate notes. The interest rate on the notes is equal to the 3 month LIBOR rate plus a 70 basis point spread, the lowest spread achieved by the Federal Government on floating rate note issuance with a similar maturity since 1997. This transaction broadened the traditional investor base for Federal Government bonds by tapping the market for floating rate notes.

- On 6 February 2004, the Federal Government issued £500 million (equivalent to US$928.4 million) of 20-year notes with an interest rate of 6.75 percent. This transaction allowed the Federal government to take advantage of favorable financing conditions at a lower cost than available at the time in the US market. Additionally, the transaction permitted the Federal Government to broaden the traditional investor base for Federal Government bonds by tapping the sterling market. This transaction was the largest, in terms of maturity and principal amount, that has been successfully carried out in the sterling market by an emerging market sovereign issuer.

- In April 2004, the Federal Government conducted an exchange offer pursuant to which it issued approximately US$793,267,000 of its 5.875 percent Global Notes due 2014 and US$2,056,822,000 of its 7.500 percent Global Notes due 2033 in exchange for approximately US$669,660,000 of its 8.125 percent Global Bonds due 2019, US$464,395,000 of its 8.00 percent Global Notes due 2022 and US$1,184,356,000 of its 11.50 percent Global Bonds due May 15, 2026.

- In March 2004, the Federal Government repaid 11 loans outstanding with the IDB with an outstanding aggregate principal amount of US$291.9 million.

DOMESTIC DEBT

Net public sector domestic debt totaled Ps.916,147 million at 30 June 2004, Ps.10,950 million less than the Ps.927,097 million outstanding at 31 December 2003. This decline was attributable to an increase in net domestic indebtedness of Ps.64,223 million, which was offset in part by an increase of Ps.77,957 million in the Federal Government's domestic financial assets, and upward accounting adjustments of Ps.2,784 million to reflect the effect of inflation on indexed debt.

In the first half of 2004, the Federal Government's domestic debt issuances consisted primarily of issuances of 28- and 91-day *Cetes*, or Treasury bills, as well as fixed-rate bonds with maturities between one and 20 years. The composition of the Federal Government's domestic debt issuances in recent years has shifted toward issuances with maturities longer than three years. In addition, the proportion of the Federal Government's domestic debt represented by fixed-rate bonds, expressed as a percentage of the Federal Government's total domestic debt, increased from 32.6 percent to 36.2 percent between 31 December 2003 and 30 June 2004. During the same period, the proportion of the Federal Government's domestic debt represented by floating rate declined from 37.1 percent of domestic debt to 32.2 percent. The percentage of the Federal Government's debt represented by inflation-indexed securities (*Udibonos*) declined from 8.8 percent to 7.2 percent.

In the first half of 2004, the average maturity of the Federal Government's domestic debt securities continued to increase, from 907 days at 31 December 2003 to 979 days at 30 June 2004.

EXCHANGE RATE

During the first quarter of 2004, the peso strengthened moderately with respect to the US dollar as a result of improvements in certain factors that traditionally affect currency risk perceptions and, in turn, the value of the peso. For example, expectations of a recovery in the global economy and increased foreign investment inflows resulting from the Bancomer and Apasco transactions all contributed to the strengthening of the value of the peso as compared to the US dollar. Despite temporary declines in the value of the peso during April and May 2004 (attributable to expectations of interest rate increases in the United States), at 30 June 2004 the peso stood at Ps.11.5130 per US$1.00, a depreciation of only 2.5 percent as compared to 31 December 2003.

FISCAL POLICY

During the first half of 2004, the public sector overall balance registered a surplus of Ps.56,757 million, 13.5 percent lower in real terms than that registered in the same period of the previous year. The public sector primary balance, defined as total public sector revenues less expenditures other than interest payments on public debt, registered a surplus of Ps.154,321 million in the first six months of 2004, a 9.5 percent real decline as compared to the figure observed in the same period of 2003. These lower surpluses as compared to the previous year are attributable in part to the advance payment of one month's wages that was made to education sector workers due to the summer holiday period. Excluding that payment, the public sector overall surplus increased by 23.6 percent and the primary surplus increased by 4.8 percent, both in real terms.

The Ps.56,757 million surplus in the public sector overall balance is attributable primarily to a Ps.65,584 million surplus accumulated by public entities under direct budgetary control, which was offset by deficits of Ps.4,871 million and Ps.3,956 million accumulated by public entities under indirect budgetary control and the Federal Government, respectively.

During the first half of 2004, consolidated public sector budgetary revenues totaled Ps.879,386 million, 4.5 percent higher in real terms than for the same period of 2003. Among the components of consolidated public sector revenues, the following merit highlighting:

- Oil-related revenues (including PEMEX) increased 13.9 percent in real terms due to favorable changes in the Mexican oil exports basket and higher international oil prices.

- Non-oil tax revenues increased 2.4 percent in real terms, mainly due to more efficient collection of income tax and value-added tax (VAT).

- Non-tax, non-oil related Federal Government revenues declined by 8.7 percent in real terms as a result of a decrease in non-recurring revenues as compared to the same period of 2003.

- Finally, revenues from public entities under direct budgetary control (excluding PEMEX) declined 1.8 percent in real terms. The decline resulted primarily from changes to the Federal

Revenue Law and the Federation's Expenditure Decree, pursuant to which these entities and their corresponding finances were reclassified as public entities under indirect budgetary control (as opposed to public entities under direct budgetary control). Excluding these entities from revenues from public entities under direct budgetary control for the first six months of 2003, revenues from entities under direct budgetary control increased 0.1 percent in real terms in the first six months of 2004, as compared to the first six months of 2003.

During the first six months of the year, Federal Government revenues were Ps.639,279 million, 2.4 percent higher in real terms as compared to the same period of 2003. This increase is largely the result of the 5.9 percent increase in oil-related revenues (excluding PEMEX), including those collected through the excise tax on gasoline and diesel, as well as the 2.4 percent increase in non-oil tax revenues.

During the first half of the year, revenues from public entities under direct budgetary control, including PEMEX, were Ps.240,108 million, 10.5 percent higher than those registered in the same period of 2003. This increase was primarily attributable to revenues reported by PEMEX, the Federal Electricity Commission (CFE), the Mexican Social Security Institute (IMSS) and the Institute of Social Security for Public Sector Workers (ISSSTE).

Total budgetary revenues for the first half of the year exceeded the estimates published in the Federation's Official Gazette on 30 January 2003 by Ps.53,681 million. Observed revenues exceeded estimated revenues because oil-related revenues exceeded estimates by Ps.46,936 million, non-oil tax revenues exceeded estimates by Ps.7,140 million, and revenues of public entities under direct budgetary control (other than PEMEX) exceeded estimates by Ps.3,802 million. Furthermore, non-tax revenues of the Federal Government were Ps.4,198 million higher than estimates.

MONETARY POLICY

In accordance with its constitutional mandate, the Central Bank's primary objective is to maintain the stability of the purchasing power of the domestic currency and it met this objective during the first six months of 2004. Accordingly, during the first half of the year, the Central Bank increased the "*corto*" three times, as a response to inflationary pressures. The Central Bank increased the *corto* from Ps.25 million to Ps.29 million on 20 February, from Ps.29 million to Ps.33 million on 12 March, and from Ps.33 million to Ps.37 million on 27 April 2004.

The 27 April increase in the *corto*, by Ps.4 million per day, was a response to a decline in short-term funding rates, among other factors. The Central Bank's decision was taken four days after it announced that, given the increase in inflation expectations and the increase in international interest rates, it would be undesirable to relax domestic monetary policy.

The monetary base, which consists of currency in circulation and financial institution deposits with the Central Bank, was Ps.278,847 million on 30 June 2004, 11.3 percent higher in real terms than that registered on 30 June 2003.

Net international reserves, defined as the difference between gross international reserves and the Central Bank's short-term liabilities, increased by US$1,693 million in the first half of 2004, reaching US$59,128 million at 30 June 2004.

Net international assets of the Central Bank were US$60,519 million at 30 June 2004, US$1,460 million higher than at 31 December 2003. The increase in international assets was primarily attributable to purchases of dollars by the Central Bank from PEMEX totaling US$5,753 and other dollar-denominated inflows totaling US$104 million. These inflows were partially offset by sales of dollars by the Central Bank to the Federal Government totaling US$567 million and Central Bank sales of US$3,830 million under the new mechanism implemented to slow the pace of reserve accumulation discussed below.

Net domestic credit of the Central Bank (defined as the difference between the monetary base and net international assets) was negative in nominal terms at the end of June 2004, standing at minus Ps.418,680 million. This is equivalent to a Ps.40,329 million reduction in the Central Bank's cash flow.

On 12 March 2004, the Mexican Foreign Exchange Commission announced that it would adjust the existing mechanism to moderate the rate of accumulation of international reserves that it had adopted on 20 March 2003 and that commenced on 2 May 2003. Under the adjusted mechanism, Banco de México will continue to make quarterly announcements regarding the daily amounts of dollars to be supplied to the currency market pursuant to the same formula, but the total amount announced will be divided into four equal portions to be sold in the following four quarters. The new mechanism commenced on 3 May 2004, and the amount of dollars to be auctioned during the quarter from May through July 2004 (US$22.0 million) was based retroactively on the accumulation of net international reserves registered in the four quarters from 16 April 2003 through 16 April 2004. The total to be auctioned for the quarter from May through July 2004 was therefore equal to the sum of one-fourth of each of the total amounts announced for the quarters ended in July 2003, October 2003, January 2004 and April 2004. The amount of dollars to be auctioned during the quarter from August through October 2004 is US$22.0 million. The total amount of dollars to be sold in a quarter is sold through daily auctions, each for an amount equal to the total for the quarter divided by the number of business days in the quarter.

MEDIUM-TERM OUTLOOK

The economic policy strategy is geared towards strengthening internal sources of growth, the reactivation of investment spending, and to the continued expansion of consumption. Estimated GDP growth for 2004 is 3.1 percent, December to December inflation is expected to be 3.0 per cent, and the current account deficit is anticipated at US$16.4 billion.

Fiscal discipline will continue to be the backbone of the macroeconomic strategy in 2004. The fiscal deficit's target for the year will be 0.3 percent of GDP, and the estimated Public Sector Borrowing Requirements (PSBR) are 2.7 percent of GDP. Congress authorized a reduction of the external indebtedness of US$500 million. This external indebtedness reduction implies that the fiscal deficit will be entirely financed in domestic financial markets for the fourth year in a row.

STRUCTURAL REFORMS

During 2003, the Mexican Congress approved the legal reform to promote bank lending. The reform follows the approval of a reform that incorporated the security trust and the non-possessory pledge as well as their non-judicial execution procedures into the Mexican legal system, in May 2000.

As a second step to strengthen the legal framework for secured credit transactions, the Mexican Congress approved, on 24 April 2003, amendments to seven laws and improved the execution procedures related to the trust, the security trust, the non-possessory pledge, and several credit transactions including commercial and mortgage loans. The reform also includes new provisions regarding financial leasing, factoring and pledge on securities.

This reform is aimed at promoting bank lending by reducing transaction costs and interest rates as well as widening the options for securing credit transactions and promoting competition among trustees. It establishes the obligation of financial institutions to convey all relevant information regarding mortgage financing in a clear and simple manner, and creates mechanisms that promote competition among financial institutions that grant housing credit.

OTHER PERTINENT INFORMATION

Foreign Investment Promotion

In the first six months of 2004, FDI, as recorded in the balance of payments, totaled US$10,292 million. This was composed of US$5,916 million in new investment, US$2,076 million in reinvested profits, US$1,169 million in intercompany transfers, and US$1,131 million in fixed asset imports by *maquiladoras*.

Notably, of the total FDI for the period, US$8,440 million has already been registered with the National Foreign Investments Commission (*Comisión Nacional de Inversiones Extranjeras*, or CNIE). Of the remainder, US$721 million represents estimated FDI still to be reported, and US$1,131 million represents fixed asset imports by *maquiladoras*.

Of the US$9,571 million of FDI representing US$8,440 million registered in the CNIE plus US$1,131 million fixed asset imports by *maquiladoras*, US$4,476 million (46.8 percent) went to the financial services sector, US$3,443 million (36.0 percent) to the manufacturing sector, US$761 million (8.0 percent) to communications and transportation, US$625 million (6.5 percent) to the commercial sector and US$266 million (2.8 percent) to other sectors.

Classified by economy of origin, US$4,805 million of the US$9,571 million of FDI notified to the CNIE originated in Spain, US$3,109 million in the United States, US$1,091 million in Switzerland, US$171 million in Germany, US$105 million in Canada, US$92 million in Denmark, and US$66 million in Holland. Other economies contributed US$132 million.

Of the total amount of imports of fixed assets by the *maquiladora* sector (US$1,131 million), US$1,024 million originated in the United States, US$20 million in Finland, US$19 million in Japan, US$13 million in Singapore, US$12 million in France, US$8 million in Switzerland, US$8 million in Holland, US$8 million in Spain, US$6 million in China and US$15 million in other economies.

During the first six months of 2004, the National Foreign Investment Commission (CNIE) authorized nine new investment projects worth US$793 million. The projects are expected to be carried out between 2004 and 2005 in the following sectors: services (3 projects), construction (3 projects), industry (1 project) and commerce (1 project), transportation and telecommunications (1 project).

Mexican Stock Exchange

During first quarter of 2004, the Mexican Stock Market Index *(Indice de Precios y Cotizaciones de la Bolsa Mexican de Valores*, or IPyC) increased 19.58 percent in peso terms due to positive earnings posted by participating firms and to two significant tender offers: one by Holcim Investments (Spain), S.L., a subsidiary of Holcim Ltd., for the outsanding shares of Holcim Apasco, S.A. de C.V.; and another by Banco Bilbao Vizcaya Argentaria, S.A., for all outstanding shares of Grupo Financiero BBVA Bancomer, S.A. de C.V. Additionally, IPyC equities were aided by the decrease in sovereign risk spreads.

In the second quarter of 2004, the volatility in international financial markets had a temporary negative impact on the domestic stock market. On 10 May, the IPyC stood at 9,441 points, 10.24 percent lower than at the end of March. However, the recovery of economic activity generated improved expectations and at the end of June the IPyC stood at 10,282 points, reflecting a total decline for the quarter of 2.24 percent. Nonetheless, during the first half of 2004, the IpyC registered gains of 16.9 percent in peso terms and 15.1 percent in dollar terms.

ANNEX I

MEXICO: OVERALL ECONOMIC PERFORMANCE

	1998	**1999**	**2000**	**2001**	**2002**	**2003**
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (level in billion US$)	421.0	480.5	580.7	622.0	647.9	626.1
Real GDP	5.0	3.6	6.6	0.0	0.7	1.3
Consumption	5.0	4.4	7.4	1.9	1.2	2.9
Private Consumption	5.4	4.3	8.2	2.5	1.3	3.0
Government Consumption	2.3	4.7	2.4	-2.0	0.1	2.5
Investment	10.3	7.7	11.4	-5.6	-1.0	-0.4
Private Investment	13.8	7.2	9.0	-5.9	-4.0	-5.7
Government Investment	-7.5	10.7	25.2	-4.2	14.2	22.4
Exports of Goods and Services	12.1	12.4	16.4	-3.8	1.5	1.1
Imports of Goods and Services	16.6	14.1	21.5	-1.6	1.4	-1.0
Fiscal and External Balance (percent of GDP)						
Budget Balance	-1.2	-1.1	-1.1	-0.7	-1.2	-0.6
Merchandise Trade Balance	-1.9	-1.2	-1.4	-1.6	-1.2	-0.9
Current Account Balance	-3.8	-2.9	-3.1	-2.9	-2.2	-1.4
Capital and Financial Non-Reserve Assets Balance	4.4	2.9	3.2	4.1	3.4	2.8
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	15.4	15.3	12.2	5.8	7.0	6.5
CPI	18.6	12.3	9.0	4.4	5.7	4.0
M2	8.7	8.6	7.1	12.1	5.4	9.0
Short-Term Interest Rate (percent)*	24.8	21.4	15.2	11.3	7.1	6.2
Real Effective Exchange Rate (level, 1995=100)	72.3	66.4	58.8	53.6	52.2	61.4
Unemployment Rate (percent)	3.2	2.5	2.2	2.5	2.7	3.2
Population (millions)	96.6	98.1	98.7	100.1	101.4	102.7

* Annual average 28th CETES interest rate.

ANNEX II

MEXICO: FORECAST SUMMARY (percent change from previous year)

	2004					
	Official	**IMF**	**ADB**	**OECD**	**PECC**	**Link**
Real GDP	3.1	N.A.	N.A.	N.A.	N.A.	N.A.
Exports	4.3	N.A.	N.A.	N.A.	N.A.	N.A.
Imports	3.7	N.A.	N.A.	N.A.	N.A.	N.A.
CPI	3.0	N.A.	N.A.	N.A.	N.A.	N.A.

ANNEX III

MEXICO: MEDIUM-TERM TREND FORECAST (percent)

	2005–2007
Real GDP	4.43
GDP Deflator	3.47

NEW ZEALAND

SUMMARY

- The New Zealand economy is continuing its strong growth performance of the past couple of years. Real GDP growth is solid, with growth of 3.3 percent expected for the year to March 2004 (compared with the 2.8 percent[1]) and the unemployment rate is at a 16 year low.
- Growth has been dominated by domestic demand, which expanded by 6.6 percent in the 2003 calendar year. Contributing to this strength has been the strong performance of the labour market and increasing household wealth due to rapidly increasing house prices.
- Over the short term, the momentum in growth is expected to continue, owing to continued strong household and business spending. Factors supporting this include high house prices, solid labour income growth and favourable terms of trade.
- This near-term strength is forecast to give way to a period of slower GDP growth over the second half of 2004 and much of 2005. Slowing net migration, slower employment growth, and the lagged effect of the high exchange rate are the main drivers of the forecast easing in growth. Exporters are expected to spend less, with flow-on effects to those who provide goods and services to exporters.
- Around the start of 2006, GDP growth is forecast to pick up, with both the exchange rate acting as less of a drag, given its assumed decline, and continuing global growth providing a greater stimulus to exports. Import growth is forecast to remain subdued leading to net exports making a positive contribution to growth for the first time since late 2001.
- The recovery in the export sector is expected to flow through to business investment and household spending, but by recent standards growth is expected to be more modest.
- The past few years of strong growth has seen the economy steadily absorb previously under utilised labour and capital equipment. This is most readily apparent in the labour market, where the unemployment rate is at a 16 year low and in industries like construction where prices are rising strongly.
- With the economy expected to continue to operate close to or above capacity for some time to come, annual CPI inflation is forecast to increase to 2.6 percent in early 2005. Annual CPI inflation is expected to be above current levels throughout the forecast period, in part due to tradable inflation increasing as the exchange rate depreciates.

INTRODUCTION - DEVELOPMENTS OVER 2003

The economy grew strongly over the second half of the 2003 calendar year, with production-based GDP up 4.1 percent on an annualised basis.

Spending by households was very buoyant, both on consumption items and on investment in new and existing houses and apartments. Private consumption increased 5.2 percent in the year to December 2003. Within this increase, growth in expenditure on durables was particularly strong at 8.5 percent, partly reflecting the increase in new house construction. Growth in residential investment was just under 20 percent for the year to December 2003, with growth particularly strong in the first half of the year.

A number of factors supported the strong growth in household spending. Increased employment and steady wage growth were both positive for household spending over the past year. The unemployment rate at 4.6 percent in the December quarter was low by historical standards and, since finalising our forecasts, has fallen to 4.3 percent in the March quarter of 2004.

Over 2003, average house prices increased by nearly 22 percent. This not only provided a positive stimulus to house building, but because houses are the most widely held type of

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[1] December 2003 Fiscal and Economic Update (available at: www.treasury.govt.nz)

household asset also increased household wealth. Increased household wealth contributed to households being more willing to take on debt to fund expenditure.

Strong positive net migration has been an important influence on the demand for housing over the past couple of years and also contributed to household consumption spending growth. Annual net migration has been positive since October 2001 and rapidly increased to a peak of 42,500 in the year to May 2003. Since then migration numbers have fallen so that by March 2004 annual net migration was 28,000.

Businesses appear to have been operating at levels close to capacity. Capacity utilisation was particularly high in the building sector. Businesses are also finding it increasingly hard to find skilled and unskilled labour and the proportion of firms reporting labour as the single factor that is most limiting their ability to increase production was the highest since 1974.

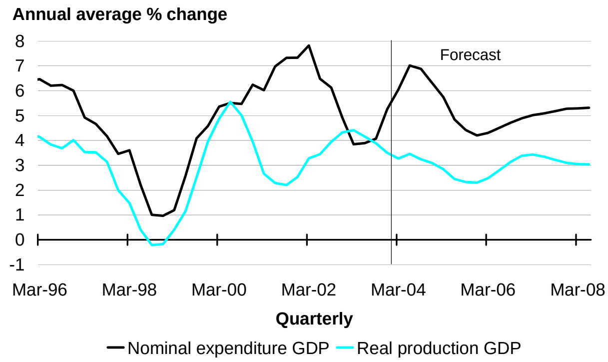
GROSS DOMESTIC PRODUCT GROWTH

Although the annual rate of real GDP growth is slowing, the growth rate for nominal GDP has been accelerating, reaching 5.3 percent for the year December 2003. The implicit GDP price deflator, the broadest measure of overall price changes for final goods and services produced in New Zealand, increased 2.0 percent for the December 2003 year.

The acceleration in the GDP price deflator has largely occurred in two areas. Strong house price growth has partially fed through into the rising price of residential investment. Further contributing to the GDP deflator increase has been the rise in the terms of trade.

Growth in nominal GDP is expected to continue its recent divergence from real GDP, with nominal GDP growth forecast to peak at 7.0 percent for the year ended June 2004. Price movements for residential investment and increases in the terms of trade contribute to the stronger growth in nominal GDP relative to real GDP.

Figure 1 – Nominal and real GDP growth



The strong growth in nominal GDP over the past year helps explain why the fiscal position has continued to improve at the same time as real GDP growth has eased back.

Growth in nominal GDP is expected to begin to converge towards real GDP, with nominal GDP growth slowing, associated with a downward movement in the terms of trade. With less demand for residential investment, the current price pressure in this area is also expected to diminish, which also contributes to slower nominal GDP growth.

INFLATION

Overall headline consumer price index (CPI) inflation at 1.5 percent for the March 2004 year was comfortably within the Reserve Bank's target band. The headline number, however, masks the very different profiles of tradable and non-tradable inflation. Non-tradable inflation for the year to March 2004 was very strong at 5.0 percent, consistent with very strong domestic demand and capacity pressures. Increasing costs associated with the purchase and construction of new dwellings contributed to this strong non-tradeables result. Offsetting this trend, tradable prices fell 1.6 percent over the same period, due in large part to the appreciating New Zealand dollar.

Annual CPI inflation is forecast to peak at 2.6 percent in the first quarter of 2005, prior to declining to 2.4 percent at the end of 2005.

With strong demand pressures and an economy operating above capacity, CPI inflation is expected to rise from its current rate of 1.5 percent to about 2.4 percent over the 2004 year. Prices for housing and household operation are expected to be significant contributors to this increase.

Figure 2 – Tradable and non-tradable inflation

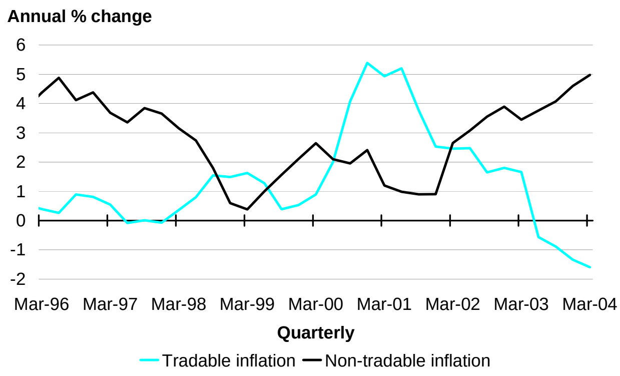
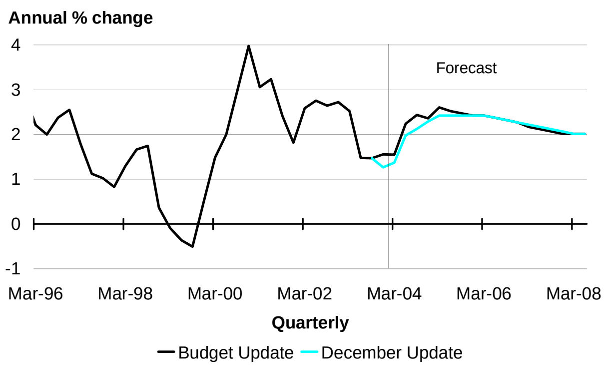


Figure 3 – CPI inflation

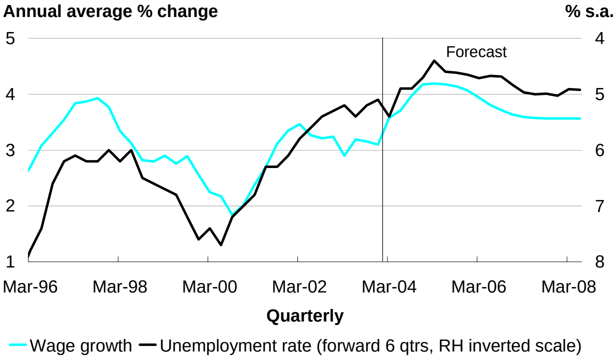


EMPLOYMENT

Annual wage growth drops below 4 percent in early 2006 but is forecast to persist above 3.5 percent. This encourages businesses to continue to seek improvements in labour productivity rather than rapidly increasing employment. As a consequence, employment growth remains relatively modest, with employment increasing by about 1.5 percent per annum from the end of 2006. This rate of increase combined with lower population growth contributes to the unemployment rate falling to 4.8 percent by 2007–08.

By the end of the forecast period, employment and labour force growth is assumed to be relatively stable and the prevailing unemployment rate, at a little under 5 percent, is around the level at which wage growth is expected to be relatively stable.

Figure 4 – Unemployment and wage growth



IMPORTS

With the appreciation of the New Zealand dollar, the price of imported goods has fallen. This has provided a boost to both real private consumption and real business investment as consumers have taken advantage of low-priced consumption goods while businesses have benefited from lower-priced capital equipment. Computer prices, in particular, have fallen dramatically in real terms.

Increased demand for imported goods by both households and businesses has resulted in strong growth in import volumes, which grew 10.2 percent over the 2003 calendar year.

EXPORTS

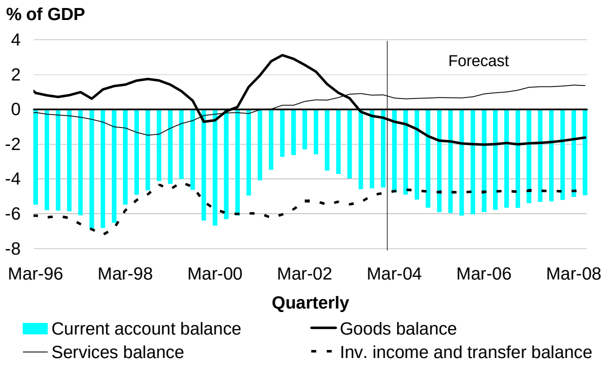
While the appreciation of the New Zealand dollar has enabled the purchase of cheaper imported goods, it has also reduced export earnings. Total export earnings fell 6.5 percent in the year to December 2003. This fall was driven by lower New Zealand dollar prices received by exporters, rather than falling export volumes, which grew by 1.3 percent in the year to December 2003.

Overall, the strength of the domestic economy, the associated demand for imports and relatively weak export growth have resulted in a widening wedge between the contribution of domestic demand and net exports to growth.

CURRENT ACCOUNT

At the end of the forecast period the balance of payments deficit, at about 5 percent of GDP, is expected to be sustainable in the longer term without increasing New Zealand's debt-to-GDP ratio.

Figure 5 – Current account balance (four quarter rolling total)



While net exports subtract from growth throughout the slowdown period, the negative contribution diminishes over time. Contributing to this is a fall in the rate of growth in imports, as slowing domestic demand and increasing import prices reduce the demand for imported goods and services. Annual growth in import volumes falls from a peak of 13 percent for the September 2004 year to around 3 percent by the end of 2005. Growth in import values also slows but to a lesser extent due to the depreciating exchange rate. After growing at approximately the same rate as import volumes over the March 2005 year, annual growth in import values at the end of 2005, at around 7 percent, is much faster than the growth in volumes.

The overall effect of these movements in export and import values is an increase in the annual current account deficit from its current level of 4.5 percent of GDP to a peak of 6.1 percent in September 2005.

GROSS EXTERNAL DEBT

New Zealand's total gross external debt for the year to March 2002 was NZ$93 billion, up slightly from the previous year, but broadly unchanged from levels in the late 1990s. After generally increasing since the beginning of the series in 1989, the net international asset position has remained relatively steady in level terms, more recently around -NZ$93 billion. However, the steady net liability level combined with strong economic growth since 1999 has led to the fall in New Zealand's net liabilities as a proportion of GDP.

FISCAL POLICY

New Zealand has been running an operating surplus since the June 1994 fiscal year. Government operating expenses reduced as a percentage of GDP from 41.6 percent in 1992–93 to 32.4 percent in the 2002–03 financial year.

The operating balance before revaluations and accounting changes (OBERAC) is estimated to be 4.3 percent of GDP for 2003–04, decreasing to 3.2 percent of GDP in 2007–08, reflecting the effects of the significant new spending announced in the 2004 Budget.

Net government debt has fallen from 49 percent of GDP in 1992–93 to 13.7 percent in 2002/03. Looking forward, it is expected that growing surpluses will contribute to building up financial assets to pre-fund future superannuation costs. Net debt is forecast to decrease to 11.5 percent percent of GDP in 2002/03, reducing further out to about 9.0 percent of GDP by 2007–08 (although if the assets of the newly created New Zealand Superannuation Fund this ratio falls to zero), and gross debt fall to around 22 percent of GDP. Current fiscal strategy is geared toward running operating surpluses sufficient to meet the contributions to the New Zealand Superannuation Fund and to slowly reduce gross debt as a percentage of GDP slowly to 20 percent by 2015.

MONETARY POLICY

The Reserve Bank of New Zealand is an independent central bank and through the Reserve Bank Act 1989 it is charged with maintaining price stability in New Zealand. The Act requires that there be a Policy Targets Agreement between the Minister of Finance and the Governor of the Reserve Bank. The most recent Policy Targets Agreement was signed in September 2002, and requires the bank to maintain inflation in the range of 1 to 3 percent on average over the medium term. The agreement also stipulates that in pursuing its primary objective of price stability, the bank shall seek to avoid "unnecessary instability in output, interest rates, and the exchange rate".

When it comes to implementing monetary policy the reserve bank uses the Official Cash Rate (OCR) target. Like other central banks, the RBNZ successively cut rates in the period following September 11, taking the OCR to 4.75 percent in November 2001. Ongoing strength in the domestic economy saw this stimulus gradually withdrawn over the first half of 2002, with the Reserve Bank gradually raising the OCR to 5.75 percent. The OCR remained at this level until April 2003 when it was gradually lowered to 5.0 percent. In April 2004 the RBNZ increased the OCR from 5.25 percent to 5.5 percent owing to domestic inflationary pressures.

MEDIUM TERM OUTLOOK

Economic growth begins to rebound in late 2005 and early 2006. Annual real GDP growth steadily picks up, increasing to around 3.4 percent at the end of 2006 and beginning of 2007.

From late 2005, net exports are forecast to start making a positive contribution to growth for the first time since late 2001. The turnaround is driven by ongoing growth in the world economy and the delayed effects of the depreciation of the exchange rate. Export volume growth accelerates significantly, while growth in import volumes remains relatively subdued relative to the rapid growth experienced recently.

The increase in export volumes contributes to strong growth in export earnings. Nominal export earnings are forecast to grow by 9.4 percent in the March 2007.

By 2007–08, real GDP growth of 3.0 percent is forecast. Domestic demand is forecast to be growing at approximately the same rate as total GDP, and the real contribution of net exports is predicted to be close to zero. Nominal GDP will be rising at a rate of approximately 5 percent per annum.

ANNEX I

NEW ZEALAND: OVERALL ECONOMIC PERFORMANCE

	1998	1999	2000	2001	2002	2003
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (level in billion NZ$)	101056	105686	112279	120509	126424	133068
Real GDP	-0.2	4	3.9	2.5	4.3	3.5
Consumption	1.2	4.8	1.1	2.7	3.8	4.6
Private Consumption	2.1	3.9	2	2.3	4.2	5.2
Government Consumption	-1.8	7.7	-1.9	4.2	2.6	2.6
Investment	-5.2	4.9	7.2	-0.3	9	13.7
Private Investment	-8.7	2.6	11.4	-3.3	11.2	17.1
Government Investment	12.2	14.1	-8.5	12.9	0.8	-0.4
Exports of Goods and Services	1.6	8.1	6.4	2.4	5.8	1.3
Imports of Goods and Services	1.4	12	0.1	1.8	8.6	10.2
Fiscal and External Balance (percent of GDP)						
Budget Balance	2.1	1.7	1.4	1.2	1.9	1.5
Merchandise Trade Balance	1.7	-0.7	1.3	2.9	0.9	-0.5
Current Account Balance	-4.1	-6.4	-4.9	-2.6	-3.7	-4.5
Capital and Financial Non-reserve Assets Balance	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	1.5	-0.1	2.4	4.6	0.6	2
CPI	0.4	0.5	4.0	1.8	2.7	1.6
M2	13.6	8.2	0.9	14.7	8.0	4.1
Short-term Interest Rate – 90-day bank bills (Dec qtr avg)	4.6	5.4	6.7	5.0	5.9	5.3
Real Effective Exchange Rate (IMF, CPI based, 1995=100, Dec month)	88.1	86.9	80.9	82.1	94.1	103.7
Unemployment Rate (Dec qtr, seasonally adjusted, percent)	7.7	6.3	5.6	5.4	4.9	4.6
Population (millions)	3.83	3.85	3.87	3.89	3.98	4.04

Note: Please specify what kind of short-term interest rate is used in the table.

ANNEX II

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

	2004						2005					
	Official	**IMF**	**ADB**	**OECD**	**PECC**	**Link**	**Official**	**IMF**	**ADB**	**OECD**	**PECC**	**Link**
Real GDP	3.2	3.0	N.A.	3.3	N.A.	N.A.	2.3	2.5	N.A.	2.5	N.A.	N.A.
Exports	5.5	3.6	N.A.	6.7	N.A.	N.A.	3.9	3.3	N.A.	8.6	N.A.	N.A.
Imports	12.1	9.9	N.A.	11.7	N.A.	N.A.	3.3	5.3	N.A.	6.6	N.A.	N.A.
CPI	2.1	2.4	N.A.	2.1	N.A.	N.A.	2.5	2.4	N.A.	2.4	N.A.	N.A.

ANNEX III

NEW ZEALAND: MEDIUM-TERM TREND FORECAST (percent)

	2004–2008
Real GDP	3.0
GDP Deflator	1.8

PAPUA NEW GUINEA

A. SUMMARY OF DEVELOPMENTS IN 2003

Papua New Guinea (PNG) is expected to see its first growth in real GDP since 1999, estimated at about 2 percent for 2003, due mainly to favourable external conditions. In US dollar terms, the prices of all major commodities have risen over the year. Copper, gold, palm oil, oil and log prices are now at, or close to, the highest levels seen over the past four years.

The continued stability of the kina, a big drop in headline inflation from 19.0 to 10.4 per cent, falling market interest rates and a favourable budget outcome are other important factors that have contributed to the improvement in the economy experienced during the year. New private sector investment is also being committed to, and new projects already in progress include the Napa Napa oil refinery and a tuna loining plant.

The Central Bank's business survey provided further evidence suggesting that the economy was reasonably strong during the year, with high private sector employment, strong signs of a more favourable trend emerging in profits, and potentially, also the extent to which investors are looking to build their business. The kina depreciated steadily against the Australian dollar during 2003, while it appreciated by 18 percent against the US dollar. The kina's strength against the US dollar was attributed to a better trade account outcome and the tight monetary policy stance of the Central Bank. These developments have allowed the Central Bank to rebuild gross international reserves to US$522.5 million at end 2003, equivalent to around 6 months of total import cover.

The lower Budget deficit for 2003 of 1.3 percent of GDP partly reflected the better than expected revenue and tighter controls on recurrent expenditures, mainly wages and salaries. The International Monetary Fund (IMF) mission in 2003 endorsed the government's expenditure control measures, and called for the Government to continue the reform programmes that have commenced, as it will send a strong signal of its determination to consolidate the gains made recently, and lay a foundation for sustainable economic growth.

The past concerns about the instability of the kina has lessen, while the poor state of private sector demand and the security situation have received more attention by the authorities. The Enhanced Cooperation Package (ECP) with Australia which aims to strengthen capacity building in policy planning and law enforcement areas over a 5-year period will provide support for this growth. It is clear the economy has consolidated over 2003 and is reasonably well placed to continue to grow during 2004.

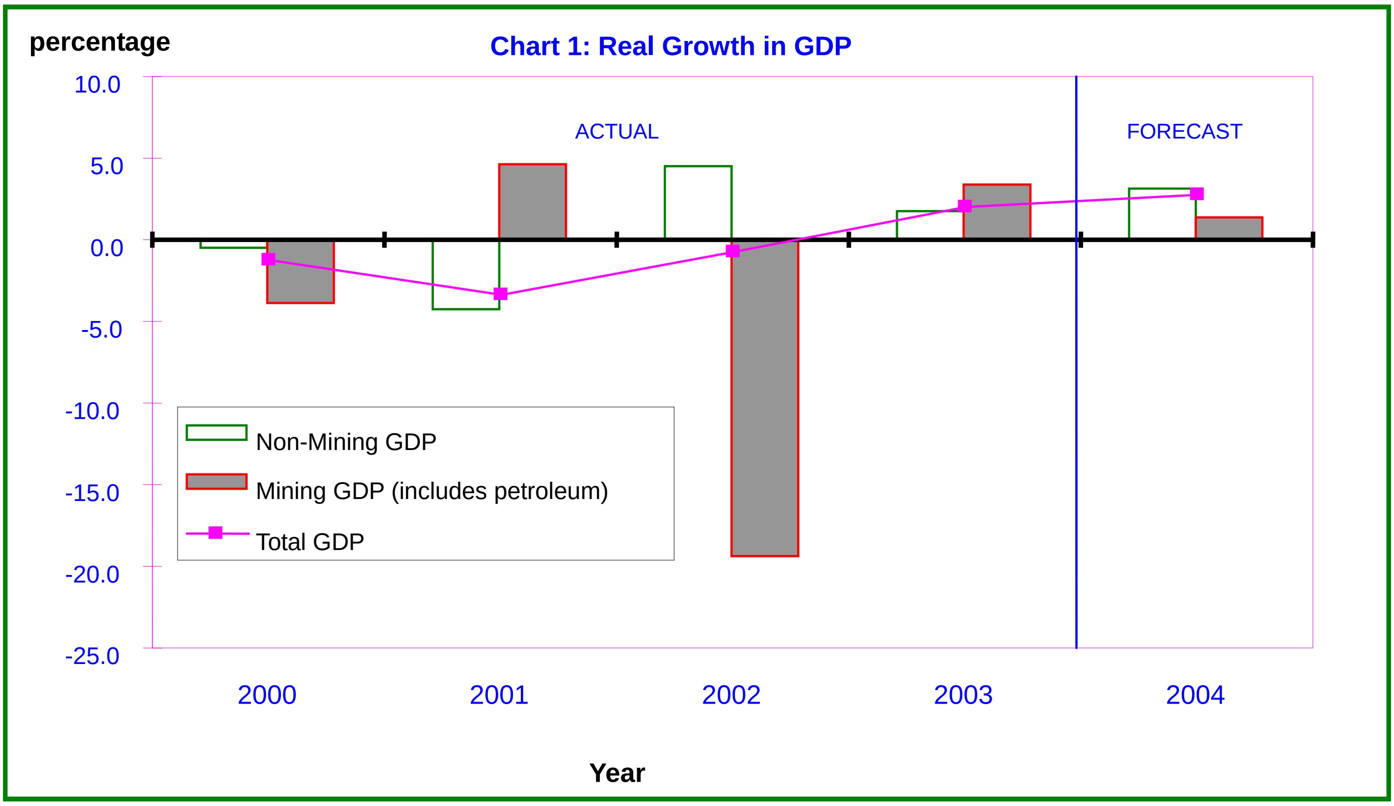
B. DEVELOPMENTS IN 2003 AND OUTLOOK FOR 2004

GROSS DOMESTIC PRODUCT

Preliminary assessment of economic activity indicates that real gross domestic product (GDP) is estimated to grow by 2.0 percent in 2003, compared to an earlier estimate by the Bank of Papua New Guinea (BPNG) of 2.4 percent. This outcome was attributed to improvements in both the mineral and non-mineral sectors. Real growth in the non-mineral sector is estimated to be around 1.7 percent in 2003, with the agriculture/forestry/fisheries sector growing by 1.6 percent. This was due to increased production of cocoa, coffee, palm oil, rubber, tea and copra oil. The mining and petroleum sector is estimated to grow by 3.3 percent, mainly reflecting higher production of oil from the Moran Petroleum Development License (PDL5) project and gold and copper from the Ok Tedi, Porgera and Tolukuma mines. The remaining sectors of the economy are all estimated to grow due to the spin-offs from the mineral and agriculture/forestry/fisheries sectors.

For 2004, real GDP is expected to grow by 2.8 percent with a projected real growth of 1.4 percent in the mineral sector. Oil production is expected to improve as production at the PDL5 project reaches its full production. Economic activity in the agriculture/forestry/fisheries sector is expected to contribute strongly with a forecast growth of 3.1 percent as prices for all agricultural commodities improve, due to the strengthening of the world economy. The government's Export-Driven Growth Strategy is likely to have a positive boost in these sectors, especially as a result of the tax incentives. Mineral exploration is also expected to recover due to the tax incentives and improved economic environment and confidence in government policies. The medium-term prospects for sustained recovery in the economy will be dependent on the following developments:

- Renewed political and financial stability;
- Continuation of structural reforms;
- Development of new mineral and non-mineral projects; and
- Increased expenditure on maintenance of existing infrastructure.



Source: Bank of Papua New Guinea

EMPLOYMENT

According to the employment index compiled by the Central Bank, the level of employment in the formal private sector, excluding mining and petroleum, increased during 2003 following lower growth in 2002. The growth provided further evidence of the underlying recovery in economic activity that was generated by the export sector and led to strong performance by the commerce sector. The strong increase in employment mainly reflected the higher demand for consumable items, which was also experienced in other sectors such as manufacturing, and indirectly benefited the transportations sector. In the building and construction sector, the increase was associated with the construction of a few large building projects, including a tuna loining factory, new buildings at a university campus, maintenance of buildings and roads, and reconstruction of the Rabaul-Kokopo road.

Employment levels in the agriculture/forestry sector increased due to growth in poultry and chicken processing, and the harvesting and processing of coffee, cocoa, copra and palm oil, and pickup in logging activities. In the mining/quarrying/petroleum sector, the increase in employment was associated with strong recovery in oil and mining exploration activities.

EXCHANGE RATE

The kina appreciated by 6.4 percent against the US dollar in the second half of 2003, following an appreciation of 13.3 percent over the six months to June 2003, while it depreciated against the Australian dollar. The favourable developments in 2003 were due to the following factors:

- The tightening of monetary policy in the first half of the year as a result of higher inflation outcome in 2002 and the first quarter of 2003;
- Supply response to improved prices of mineral and non-mineral exports, resulting in a net accumulation of gross international reserves by the Central Bank;
- Higher real domestic interest rates on Treasury bills, which provided incentives for residents to hold financial assets on-shore; and
- Controlled government expenditure.

INFLATION

The annual headline inflation rate was 8.4 percent in 2003, compared to 14.8 percent in 2002. The average inflation rate was 14.7 percent in 2003, compared to 11.8 percent in 2002. The major factors that contributed to higher inflation in 2002 and early 2003 included the depreciation of the kina over most months of 2002, high prices for fruits and vegetables, increased excise duty on cigarettes and tobacco and increased prices on items such as kerosene. Increased school fees reflecting the termination of the Government's 'free education' policy, were also a factor.

The annual underlying inflation in 2003 was 13.7 percent, compared to 15.9 percent in 2002. The underlying rate excludes prices of betelnut, fruits and vegetables, and the effects of government policy decisions, such as price controls.

The annual inflation projection for 2004 is largely dependent on the stability of the exchange rate, which is in turn influenced by the following factors:

- The expenditure control measures and budgeted financing of the Government; and
- Developments in world commodity prices for PNG's main exports and continued supply response by export producers.

The Central Bank expects the exchange rate to remain stable throughout 2004, as no significant price pressures are expected. Therefore, the headline annual inflation rate is expected to decline to 7.4 percent in 2004.

BALANCE OF PAYMENTS

The overall surplus in the balance of payments was K324 million in 2003, compared to a deficit of K239 million in 2002. This outcome was due to a surplus in the current account, which more than offset a deficit in the financial and capital accounts. The surplus in the current account was the result of an improvement in the trade account, lower net service payments and higher net transfer receipts, which more than offset higher net income payments. The deficit in the capital and financial accounts reflected increases in portfolio and other investment assets abroad, which more than offset a net inflow in equity capital flows reflecting the raising of capital through the placement of new shares, and increase in debt service payments. In 2003, the kina depreciated against the currencies of Papua New Guinea's major trading partners, with the exception of the US dollar, resulting in a decline in the kina value of some balance of payments transactions, as most transactions were made in US dollars (For more details see BPNG's website: www.bankpng.gov.pg)

Other main assumptions underlying the balance of payments projections for 2004 include:

- Stability in the exchange rate;
- No significant capital inflows for development of any new projects;
- The ECP from Australia is not included;
- The budgeted concessional project loans will be partially drawn down, due to capacity constraints by the implementing agencies; and
- The Asian Development Bank (ADB) loan for the Public Sector Reform Program (PSRP) is not included.

Accordingly, the balance of payments for 2004 is projected to show an overall deficit of K72 million, compared to an estimated surplus of K619 million in 2003. The deterioration reflects a projected deficit of K749 million in the capital and financial accounts, mainly attributed to an increase in government loan repayments and higher balances in offshore accounts by mineral companies. This is expected to more than offset the projected surplus of K677 million in the current account.

The level of gross foreign exchange reserves by end of 2004 is projected to reach US$502.4 (K1,794.3) million, sufficient for around 5.2 months of total and 8.1 months of non-mineral import cover.

STRUCTURE AND DIRECTION OF TRADE

The structure of exports has changed with an increase in the share of mineral exports and a decline in the contribution of the non-mineral sector between 1999 and 2003. The total value of merchandise exports was US$2,201 million in 2003, an increase of 12.1 percent from US$1963.0 million in 1999. There were increases in the values of gold, copper, cocoa, forestry and marine products. The value of agricultural, logs, marine and other non-mineral exports, was US$541.8 million and accounted for 24.6 percent of total merchandise exports in 2003, compared to 29.6 percent in 1999. Mineral export receipts were US$1659.2 million and accounted for 75.4 percent of total merchandise exports in 2003, an increase from 70.4 percent in 1999.

Papua New Guinea is highly dependent on Australia, and to a lesser extent, on Japan, for its export markets. Between 1999 and 2003 Papua New Guinea has increased its trade with China, while trade with the United States has declined during the same period. Kutubu crude oil is marketed internationally at a spread to Asia’s Tapis crude. Australia is a major buyer of Kutubu oil because of the short shipping distance. Gold is sold through refiners into the world market. The production of copper gold concentrate at Ok Tedi is marketed to a Japanese smelter pool, and other Asian and European customers. Agricultural exports are primarily sold into Europe.

Papua New Guinea imports comprise mainly capital goods, machinery and equipment for the development of new projects, food and consumables. Between 2002 and 2003, Australia’s share of total imports declined by 59.1 percent to 54.2 percent, due to the appreciation of the Australian dollar against the kina.

The volume of trade between PNG and the APEC member economies increased over the last two years. Terms of trade between APEC economies and PNG have been in PNG’s favour since 1995, with the exception of 1997 and 1998. Compared to PNG’s non-APEC trading partners, APEC has become an important trading block.

FOREIGN DIRECT INVESTMENT

There are significant foreign investments in the mineral sector in Papua New Guinea, resulting in an inflow of foreign exchange at the time of initial investment (project construction). In the last five years, there have not been any new major mineral projects, apart from the Moran and Gobe oil projects. However, these two projects had capital infrastructures already in place and resulted in less foreign direct investment inflows. In the non-mineral sector, there have been a few investments, however, these were not as large as in the mineral sector. Foreign investments in portfolio investments are minimal in PNG. Government securities have been sold to the domestic market only.

Renewed interest by foreign companies in investment in PNG has emerged and this was an encouraging sign for the economy. There is also increased mining and oil exploration, mainly in response to improved confidence and the tax incentives provided by the Government. PNG's aspirations for the development of its vast gas resources and construction of a US$3 billion pipeline to Australia and the nickel-cobalt mine are still being pursued by developers and government. They should provide the much needed impetus for further growth in the medium term. In addition, the Government has placed greater emphasis on the "Export-Driven Growth Strategy", with additional tax incentives provided to the agriculture sector. This is aimed at driving the economy into achieving a sustainable level of economic growth and development.

2003 BUDGET OUTCOME

Preliminary estimates of the fiscal operations of the Papua New Guinea government for 2003 showed an overall deficit of K152.6 million, compared to a deficit of K450.2 million in 2002, representing 1.3 percent of nominal GDP. The improvement was due to higher revenue combined with a decline in expenditure. Total expenditure during 2003 was K3,552.2 million, 3.5 percent higher than in 2002, representing 91.6 percent of the revised budgeted expenditure. The increase was due to higher recurrent expenditure which more than offset lower development expenditure.

The 2003 budget deficit combined with net external loan repayments of K306.3 million, were financed from domestic sources totalling K458.9 million. Domestic financing was sourced mainly from the non-banking sector of K565.5 million and proceeds from the sale of assets more than offset a repayment from the banking system. The increase financing by the non-banking system reflected higher holdings of government securities. The repayment by the banking system was due to the repayment of the temporary advance and lower holdings of government securities by the Bank of PNG, which more than offset increased holdings of Treasury bills by the commercial banks.

2004 BUDGET

The 2004 Budget passed by Parliament in December 2003, aims to consolidate the fiscal adjustments in the 2003 Budget. The Budget continues to focus on the Government's Export-Driven Growth Strategy with measures that would assist in achieving macroeconomic stability and provide the conditions necessary for promoting sustainable economic growth. The fiscal strategy for 2004 recognizes the difficult economic environment that PNG confronts and the need to adjust expenditure and introduce new revenue measures.

The Budget introduced several new revenue measures and a number of tax reforms in an effort to offset revenue decreases in the mineral sector. The two major tax measures include an import levy of 2.0 percent, and a reduction in rebates for dependents from four to three. Additional amendments have been made to the relevant tax Acts to prevent tax avoidance and protect the existing revenue base.

The new expenditure control measures planned for 2004 include:

- Improving expenditure controls;
- Termination of non-essential casual employees and a freeze on recruitment; and

- Tightening of controls to eliminate overruns on salaries and wage outlays, to remove 'ghost workers' on the payroll and eliminate other anomalies.

The projected Budget deficit of K195.6 million for 2004 is 1.5 percent of nominal GDP, compared to an estimated 1.7 percent of GDP for 2003. This deficit and the net external loan repayments to concessional and extraordinary sources are expected to be financed by net commercial loan of K176.4 million and domestic borrowing of K376.3 million. Domestic borrowing is increased from the budgeted amount as a result of the partial draw down of concessional project loans. If external borrowing does not eventuate, the Government may resort to further domestic borrowing. This would lead to a rise in domestic interest rates and debt service costs.

MONETARY AND FINANCIAL MARKET DEVELOPMENT

Following the better than expected inflation outcomes in the 2003 June and September quarters, the Central Bank eased monetary policy and reduced the kina fixed rate (KFR) by 200 basis points in aggregate to 14.0 percent by the end of December 2003. This was supported by a reduction in the cash reserve requirement (CRR) from 5.0 percent to 3.0 percent in October 2003. The reduction in the CRR of K57.0 million, combined with sales of kina in the foreign exchange market by the Central Bank, resulted in total liquidity increasing to high levels.

The weighted average total deposit rate declined from 4.60 percent in June to 2.95 percent in December 2003, while the weighted average lending rate on total loans increased. Consistent with the easing in liquidity conditions by the Central Bank, all the commercial banks reduced their indicator lending rates (ILRs) during the second half of the year to a spread of 12.75 to 14.50 percent by end December 2003. However, the spread between the weighted average lending and deposit rates remains wide. Other market interest rates also declined, including the 28-day Treasury bill rate, which decreased from 19.59 percent in June to 16.15 percent in December 2003.

Despite the decrease in the ILRs and the build up in liquidity levels, lending by the commercial banks to the private sector continued to remain depressed. This reflects the lack of demand for credit, partly attributed to low economic activity, and the crowding out of the private sector by the Government.

The level of broad money supply (M3*) increased by 1.4 percent between June and December 2003, as a result of an increase in net foreign assets. This more than offset a decline in net credit to the Government. The growth in reserve money of 17.7 percent in the second half of the year is mainly attributed to an increase in commercial bank deposits at the Central Bank and currency in circulation.

MONETARY POLICY STANCE

In the second half of 2003, lower inflation and improvement in macroeconomic indicators enabled the Central Bank to ease monetary policy. The Central Bank took a careful and cautious approach to easing of monetary conditions, in view of the potential for any fiscal slippages and increase in import demand during the Christmas period. However, the year ended firmer with no turnaround in the trend for the exchange rate, import demand, inflows of export receipts, Government expenditures and other price pressures.

The improvement in price stability during 2003 is expected to be consolidated in 2004. This provides the necessary foundation for further easing of monetary policy. While there is evidence of growth in economic activity, the economy remains fragile. The Central Bank expects that the declining inflation and interest rates should encourage the commercial banks to lend to the private sector. This includes the provision of credit to the agriculture sector to sustain the present economic recovery over the medium-term.

The monetary policy stance in the first half of 2004 will depend on the following factors:

- The inflation outcome for the December quarter of 2003 and the first half of 2004;

- Stability in the exchange rate, which in turn depends on the supply response to the favorable international commodity prices, the ability of the Government to restrain expenditure, the public's perception of the management of the economy and the maintenance of real interest rates to prevent any capital outflow; and

- Timely draw down of external loans by the Government.

Under these conditions the Central Bank expects to constrain the nominal growth in reserve money to 1.4 percent in broad money and 7.3 percent, which is around the projected level of inflation in 2004. This rate of growth is considered non-inflationary. Given the decline in net credit to the Government and high free liquidity reserves in the banking system, private sector credit is projected to grow by 9.0 percent. The level of net foreign assets is expected to increase by 27.7 percent, due to large reduction in the BPNG's foreign liabilities.

Accordingly, the Central Bank will continue to take a cautious approach to any further easing of monetary policy, in light of the significant increase in liquidity levels and its potential to adversely affect the exchange rate and other key macroeconomic indicators.

DEVELOPMENTS IN THE FINANCIAL SYSTEM

The financial system in PNG consists of four commercial banks, seven finance companies, 20 savings and loan societies (credit unions), 10 superannuation funds and four life insurance companies. There are also seven fund managers, three investment managers, one life insurance broker and one development bank. Of the four banks, three are foreign and hold 40 percent of the market share, whilst the other is a local bank that has 60 percent of the market. The financial sector is undergoing a major reform to provide a climate for effective financial intermediation. The essence of the financial sector reform begun in 2000 was to enhance the independence of the Central Bank with improved powers for regulation and supervision of the financial system. It commenced with a major amendment to the *Central Bank Act (CBA), the Banks and Financial Institutions Act (BFIA)*, and the introduction of the *Superannuation and Life Insurance Acts* for the first time in PNG. The superannuation and life insurance industries, which were largely unregulated previously, came under the ambit of the Central Bank. The Acts regulating these sectors became fully operational in November 2003, following the completion of the licensing process of companies, which existed when the Acts came into operations.

These Acts, together with the *Savings and Loans Society Act*, enable the Central Bank to undertake its role as the supervisor of the financial system and ensure its stability. They ensure that the Central Bank is not only independent, but performs its roles and functions in a transparent and diligent manner, and is accountable for its actions. The legislation also requires 'fit and proper persons' to be employed on the Boards and management of the financial institutions that the Central Bank supervises.

New prudential standards were introduced to the banks to comply with the Basle standards. There was a review of the prudential standard on Capital Adequacy in 2003, which resulted in the minimum capital adequacy requirement being raised from 10 percent to 12 percent overall, and with Tier 1 explicitly specified at 8 percent of Risk Weighted Assets (RWA).

Overall, an adequate level of capital was maintained by the banking sector. The financial system is generally stable and functioning reasonably well for a thin system comprising only a few large institutions. Capital strength is generally above the 11 percent minimum established by the Central Bank; asset quality has been declining somewhat with the corresponding difficulties in the economy, but is not a major concern in aggregate; liquidity is high due largely to low demand for credit and relatively high lending rates; and posted earnings continue to be favourable, especially for the major banks due to profitable foreign exchange operations.

Non-performing loans (NPLs) of commercial banks and finance companies have been around 3.0 percent of total assets, an improvement from 2002. This improvement followed the restructuring of bad loans acquired by another local bank, the Bank South Pacific from the former state-owned bank though the privatisation program. Provisioning for NPLs by both the banks and finance companies are low, but is considered appropriate and does not pose any risks for the financial system. On the other hand, the NPLs of Savings and Loan Societies has improved somewhat to 13 percent of total assets, with provisioning at 28 percent.

C. OUTLOOK

Continued stability in the exchange rate over the short to medium term would be dependent on several factors. This includes the fiscal operations of the government and the public's perception of, and confidence in the management of the economy. A continuation of prudent management of the budget by the government will sustain this stability and further enhance investor confidence.

The target budget deficit for 2004 is 1.5 per cent of GDP, and it is to be funded domestically given an ongoing negative external financing requirement. The target domestic financing requirement of K266 million may increase further if there is any shortfall in the draw down of external loans. This would pose a risk to macroeconomic stability.

The government's fiscal policy is framed on the Medium-Term Development Strategy (MTDS). Overall the budget made few changes to existing policy settings. The most significant changes have been made on the revenue side, such as the temporary import levy, the generous tax deduction for the provision of agricultural extension and other tax incentives offered to new primary sector projects. Even if these initiatives were considered relatively minor, a continuation of the favorable external conditions can be expected to help support the achievement of macroeconomic stability. The government's focus on a MTDS (2003–2007) aims to address the key constraints to development. The recent decisions to increase funding for infrastructure maintenance, strengthening governance and law and order problems offer some positive signs of addressing these problems.

The monetary policy stance in the first half of the 2004 will depend on the following factors:

- The inflation outcome for the first half of 2004;

- The stability in the exchange rate, dependent on the sustained improvement in the supply response to the high international commodity prices, the ability of the Government to restrain expenditure, the public's perception of the management of the economy and the maintenance of positive real interest rates to prevent any capital outflow; and

- Achieving the 2004 Budgetary financing target, including the draw down of external loans and reduced reliance on domestic borrowing.

The Short Term Outlook

The signs are for the economy to remain firm in the short term. Most world prices of PNG's exports are favourable, inflation is trending down, the kina is relatively stable and there are some indications of improved confidence in the business sector. The projected real GDP growth of 2.8 percent for 2004 will depend on the following influences:

- Timely disbursements of government and external loan funds for maintenance of the main infrastructures, such as the Highlands Highway and other development projects;

- Continued favourable news on new private sector investments projects, such as in mineral exploration and fisheries and agriculture;

- Continued high international prices for most commodities, notably oil, gold, and copper, because they are helping support government revenue;
- Continued privatisation of state assets;

- If the domestic financing of 2004 Budget deficit is not reduced, it will tend to put downward pressure on the kina because it may raise import demand;

- In net terms it seems a strengthening in the kina is more likely than a weakening, although this will be influenced by the developments in the Australian and US dollar rate and the Central Bank's monetary policy stance; and

- The declining trend in inflation, estimated at around 7.4 percent in 2004, as projected by the Central Bank, is likely to be supported by positive effects of the stability in the exchange rate.

Medium Term Outlook

Over the medium term, sustained economic growth can be realised if the following influences are appropriately managed:

- Improvement of economic management by the government and its capacity to address structural problems that constrain economic growth;

- The commencement of the development stage of the gas pipeline and other mineral and non-mineral projects, which would provide an important source of economic activity and boost investor confidence;

- Maintenance of the Central Bank’s independence in setting monetary policy;

- Provided economic management is sound and there are no major negative shocks, further improvement in economic conditions can be guaranteed; and

- The response of the private sector to increase investment spending.

D. STRUCTURAL REFORM

In 2004, the Government continued to implement a reform agenda based on four core principles: (a) promotion of good governance; (b) improving economic management; (c) improving public sector performance; and (d) removing barriers to investment and economic growth.

This is supplemented by a new focus on improving the management of public sector employment and the control of personnel expenditures; restoring the integrity of budget institutions and systems to improve budgetary discipline; and to review the role, functions, and outputs of each spending agency in order to identify ways of improving the allocative and technical efficiencies of public expenditure.

1. Public Sector Reform Program

A major part of the public sector reform program in 2004 is focused on improving the management of public employment and control of personnel expenditure. Public sector employment in Papua New Guinea is currently larger than the economy can afford. Major actions to be undertaken between 2004 and 2007 include removing ‘ghost’ names and unsettled payments from the payroll; reducing and eventually eliminating the unattached pool of officials; linking pay increases to affordability; enforcing budgetary control over payrolls; and the preparation of realistic budget estimates.

In 2004, proposed actions to strengthen institutional performance include improving support for the National Executive Council (NEC), Central Agencies Coordinating Committee (CACC) and Chief Secretary in coordination, policy advice, strategic planning, and monitoring the implementation of government decisions; and strengthening of corporate planning in departments, agencies and provincial administrations.

Strong emphasis is given to the following areas:

Reorienting Personnel Management Systems and Processes to Improve Delivery of Services

- Work done to date under the Public Sector Reform Program identified two of the key factors in declining service delivery to be (i) lack of funding by provinces for goods and services, and (ii) difficulties with the implementation of the Organic Law on Provincial and Local Level Government (OLPG and LLG).

- Other proposed actions in 2004 to improve systems and processes include implementation of reforms identified in recent reviews to reduce and control spending and improve the budget processes; financial management and procurement practices; extending the Service Improvement Program to cover additional provinces and departments; start up of capacity improvement training at District and LLG levels; and definition of a Program that would further rationalize and streamline the roles and structures of departments and agencies to improve the machinery of government, remove duplication, reduce overhead costs and improve service delivery.

Strengthening Provincial Reforms – Fiscal Decentralization

- On 24 September 2003, the PNG Parliament passed the amendments to the Organic Law on Provincial Governments and Local-level Governments (OLPG and LLG) to substitute new provincial and local government funding arrangements for 2004.

- The proposed changes to the OLPG and LLG have four key objectives. They are: to bring the grant formulas back within affordable limits; direct funding specifically to core priorities of health, education and road maintenance (through Function Grants) to lay the foundation for implementation of MTDS; to take into account all sources of provincial revenue including internal revenue; and to introduce a Less-Developed District Grant to make funding more equitable between provinces.

2. Promoting Good Governance

Strengthening Oversight Agencies

- The Government recognizes the need to continue with the efforts to reinstitute good governance in the public sector. In a concerted effort to minimize the impact of corruption on governance, the Government plans to strengthen state agencies (such as Ombudsman Commission, the Auditor-General, the Public Accounts Committee) responsible for detection and investigation of cases of corruption and will establish a National Anti-corruption Alliance to coordinate activities of the oversight agencies.

Strengthening Government Procurement

- Capacity building and streamlining of procedures and practices of the Central Supply and Tenders Board (CSTB) have been ongoing since 2001. The government procurement review undertaken in 2001 provides the basis for the current work program, which includes establishment of new arrangements, management information systems, and improved performance reporting and disclosure. These revised procedures will ensure that the CSTB is used for all government procurement.

3. Improving Economic Management

Strengthening Fiscal Discipline

- The fiscal year 2003 marked the beginning of the implementation of the Medium-term Fiscal Strategy (MTFS). The MTFS is an important part of a sound public expenditure management that accommodates both PNG's economic needs and its fiscal realities. It incorporates a declining budget deficit path resulting in deficits of around 1.0 percent of GDP on average over the period 2003 to 2007, and a balanced budget thereafter.

- Wages policy will continue to be based on a cautious and restrained approach given the current fragile fiscal situation. The Government intends to introduce new stringent controls on expenditures, especially in regard to public sector personnel emolument costs, as an important part of the expenditure policy proposals for 2004.

Improving Allocation of Resources

- The ongoing Public Expenditure Review (PER) noted that governance measures should be supplemented by a detailed exercise in adjustment and prioritization of expenditure.

- The Government intends to develop a medium-term budget framework by refining the MTDS to adequately reflect the trade-offs associated with the declining resource envelope and the Government's priorities and policies.

Financial Management Improvement Program

- As part of the Government's wider reform agenda, the Financial Management Improvement Program (FMIP) is an integrated reform program of financial management at all levels of government, and is the most significant single reform of financial management ever undertaken by the Government. The FMIP's mission statement is to implement best practice and transparency in Government financial management within and between national, provincial and local-level governments.

- The goals of the FMIP are: (i) improve the design, implementation and use of planning and budgeting systems in order to improve fiscal management, resource allocation, forecasting, efficiency, transparency and accountability; (ii) improve the design, implementation and use of accounting, resource management and fund control; (iii) implement sound information technology infrastructure as the delivery vehicle for FMIP (iv) support training for the new planning, budgeting, and accounting systems and to further enhance human resource development; and (v) coordinate and plan changes involving a wide range of agencies and donors that require systematic linkages between operating needs and systems development.

Improving Debt Management

- The importance of prudent debt management cannot be over-emphasized with total debt totalling K7,934.0 million by end September 2003. Weaknesses in the debt management framework means that key agencies find it increasingly difficult to coordinate and function, thereby worsening the environment within which debt is managed. The Government is currently investigating the possibility of establishing a semi-autonomous office to manage the portfolio of public debt.

Improving Expenditure Control

- Addressing expenditure control issues is critical to restoring the integrity of budget institutions and systems and returning Papua New Guinea to fiscal sustainability. The Government is committed to improving budget management and accountability at the provincial level, including reforming public expenditure systems and procedures at the provincial and district levels.

Monitoring of Revenue and Expenditure Performance

- Sound monitoring of annual revenue and expenditure flows is essential for ensuring that budget implementation is managed in accordance with appropriations. Adherence to appropriations, combined on occasion with necessary and transparent variations through virulent and supplementary approvals, underpins the legality of the budget process. Good financial information reporting systems are therefore the key to effective monitoring and control of the Government's fiscal operations.

Maintenance of Sound Financial Management Systems

In 2004, the Department of Finance is coordinating its activities under the Department's Corporate Plan 2004–2006. The pillars of the Corporate Plan are expenditure control (appointment of Financial Controllers); revenue maximization; enhanced financial systems; providing sound financial advice and information and increased staff financial management capacity.

- Expenditure Control – Appointment of Financial Controllers
- Non-Tax Revenue Maximization
- Enhancing Financial Systems
- Sound Financial Advice and Information
- Control on Claims and Arrears

4. Removing Barriers to Investment and Export Led Growth

In recent years, the Government has made steady progress towards the removal of structural barriers to investment, and therefore economic growth and development. The Government is committed to the promotion of growth and development through its Budgets, and to sector-wide policy reforms to ensure a more conducive investment environment. New and ongoing initiatives affect the following areas:

Facilitation of Business and Foreign Investment

A review of migration laws commenced in 2000, as part of the review of Papua New Guinea's foreign policy. The Government recognizes immigration laws as a useful tool to facilitate economic growth and development, especially through the support for tourism growth and facilitation of increased levels of inward investment.

Review of the Tariff Reduction Program

In the lead up to the 2003 Budget, the Manufacturers' Council of Papua New guinea sought a temporary suspension of the tariff reduction program (TRP). The Council argued that the TRP was entered into during a time of greater economic stability, and that the combined impact of tariff reductions and the economic downturn was causing an erosion of the manufacturing base and leading to increased imports and reduced exports. The Government did not suspend the TRP but appointed a taskforce to review the program.

Financial Sector Reform – Superannuation and Life Insurance

A number of important legislative amendments have been made to the *Superannuation (General Provisions) Act 2000* to incorporate the implementation of broader retirement income policy issues and other outstanding issues pertinent to the effective operation of the Superannuation Act.

Exemption of Agricultural Workers

Under the previous superannuation arrangement (pre-2002), six agricultural industries (cocoa, coffee, copra, oil palm, rubber and tea) were totally exempted from providing for superannuation, while all other industries in the rural sector have no exemption (through it is understood that some fail to provide for superannuation).

Periodic Payment of Superannuation Benefits (Payment of Entitlements)

The culture of long-term savings, and in particular, setting aside superannuation savings for retirement, is a relatively new concept in Papua New Guinea. Apart from the part-pensions paid by the Defense Force Retirement Benefit Fund, the practice in Papua New Guinea is that all superannuation entitlements are paid as lump sum at the time of retirement or other exit from workforce, resulting, in many instances, in the savings being quickly dissipated.

Transferred Arrangement for Up-front State Contributions to the Public Officers Superannuation Fund

The new Superannuation Act legally requires all employers, including the State, to promptly remit the employer's contribution on a fortnightly basis, or direct it towards a fully funded system. While this requirement is already practiced in the private sector, the State is the only employer whose contribution is not regularly funded, but is paid in upon full retirement, resignation or death of the contributor.

The new arrangement will have a significant budgetary impact on the Government's wage bill. This means that when a Government employee makes his/her contribution, the State will make its contribution at the same time, rather than wait until the person retires, as was the previous practice.

Mandatory Contributions for State Employees

It is a mandatory requirement under the new Superannuation Act for employees employed for three continuous months, whether on a casual, probation or permanent basis, to contribute to an ASF.

Insurance Complaints and Disputes Tribunal

The Office of the Commissioner of Insurance, in close consultation with the Papua New Guinea Insurance Council, is in the process of establishing an Insurance Complaints and Disputes Tribunal in accordance with the provisions of the *Insurance Act, 1995*.

Competition and Regulatory Policy

As part of the regulatory reform program, the Independent Consumer and Competition Commission (ICCC) replaced the Consumer Affairs Council and the Price Control Unit of the Department of Treasury in 2002. The ICCC continues to protect the interests of the people of Papua New Guinea with regard to the price, quality and reliability of basic and essential services and goods. It also administers regulatory contracts with major SOEs, which determine how prices are set, and specify minimum service standards.

In May 2003, the provisions of the ICCC Act governing anti-competitive behaviour came into force. These provisions prohibit anti-competitive behaviour such as price fixing and ensure competitive industries by preventing any industry structure that would substantially lessen competition in a market.

Privatizing Public Enterprises

The Review of Privatization in late 2002 drew a distinction between core and non-core assets. It concluded that the privatization of non-core assets should proceed, since these assets continue to be a drain on the PNG Budget. However, in the case of core assets, the Review recommended consideration of Public Private Partnerships (PPP). Such an approach is designed to introduce incentives to innovate in the design, construction, finance and operation of state-owned enterprises, as well as to manage risks in these critical investments.

In 2003, the National Executive Council has approved the sale of a controlling interest in Telikom PNG Ltd, as well as privatizations of PNG Harbours Ltd and Motor Vehicles Insurance Ltd (MVIL).

The sale of a controlling interest in Telikom is reaching the final stages, and it is expected that the sale will be completed during December 2003. The Independent Public Business Corporation will seek to sell MVIL and to enter into a PPP for PNG Harbours Ltd during the first half of 2004.

Improving Forestry Management

Despite the reforms following the 1990 National Forest Policy and the passing of the *1991 Forestry Act*, the management of forestry resources at the national level has remained generally poor. The requirements for sustainable management practices, reforestation and active community participation were not being applied in practice, either in project planning processes and project management in the field, and this led to further reforms and strengthening of governance (including oversight) of the forestry industry and its regulation in Papua New Guinea.

The Forestry and Conservation Project, which was agreed with the World Bank in 2001, and became operational in mid-2002, was designed to implement a broad range of participatory processes for landowners in forestry management and to strengthen the functions and processes of the PNG Forestry Authority, as well as other institutions with responsibilities over the sector, such as the Department of Environment and Conservation.

ANNEX I

PAPUA NEW GUINEA: OVERALL ECONOMIC PERFORMANCE

	1999	2000	2001	2002	2003
GDP and Major Components (percent change, year over year, except as noted)					
Nominal GDP (level in billion US$)	3.5	3.5	3.0	2.8	3.5
Real GDP					
Consumption					
Private Consumption	21.2	N.A	N.A	N.A	N.A
Government Consumption	0.9	N.A	N.A	N.A	N.A
Investment	-16.2	N.A	N.A	N.A	N.A
Private Investment	N.A	N.A	N.A	N.A	N.A
Government Investment	N.A	N.A	N.A	N.A	N.A
Exports of Goods and Services	-4.4	N.A	N.A	N.A	N.A
Imports of Goods and Services	1.5	N.A	N.A	N.A	N.A
Fiscal and External Balance (percent of GDP)					
Budget Balance	2.6	2.0	3.6	4.2	1.3
Merchandise Trade Balance	25.2	31.4	29.2	21.4	31.0
Current Account Balance	4.3	10.1	9.4	4.5	4.3
Capital and Financial Non-reserve Assets Balance	10.1	6.4	2.3	1.1	1.6
Economic Indicators (percent change, year over year, except as noted)					
GDP Deflator	-	-	-	-	-
CPI (Annual Headline)	13.2	8.9	10.5	14.8	8.4
M2	33.3	-12.5	4.2	9.7	-0.9
Short-term Interest Rate (percent) (28 Day T/bill rate)	22.68	15.67	10.15	15.48	16.13
Real Effective Exchange Rate (level, 1995=100)	N.A	N.A	N.A	N.A	N.A
Unemployment Rate (percent)	N.A	N.A	N.A	N.A	N.A
Population (millions) from 2000 National Population Census	N.A.	5.19	N.A	N.A	N.A

Note: n.a refers to data not available.

Published real GDP data is only up to 1999.
Additional Information can be obtained from the websites of Bank of PNG (www.bankpng.gov.pg) and Department of Treasury (www.treasury.gov.pg).

ANNEX II

PAPUA NEW GUINEA: FORECAST SUMMARY (percent change from previous year)

	2002						2003					
	Official	**IMF**	**ADB**	**OECD**	**PECC**	**Link**	**Official**	**IMF**	**ADB**	**OECD**	**PECC**	**Link**
Real GDP	-0.5	N.A.	N.A.	N.A.	N.A.	N.A.	2.0	N.A.	N.A.	N.A.	N.A.	N.A.
Exports	-0.3	-13.5	N.A.	N.A.	N.A.	N.A.	22.8	N.A.	N.A.	N.A.	N.A.	N.A.
Imports	1.2	-3.5	N.A.	N.A.	N.A.	N.A.	0.8	N.A.	N.A.	N.A.	N.A.	N.A.
CPI (annual headline)	14.8	N.A.	N.A.	N.A.	N.A.	N.A.	7.4	N.A.	N.A.	N.A.	N.A.	N.A.

ANNEX III

PAPUA NEW GUINEA: MEDIUM-TERM TREND FORECAST (percent)

	2004–2007
Real GDP of non-mineral sector	2.5
GDP Deflator	N.A.

PERU

REAL GROSS DOMESTIC PRODUCT

In 2003 the Peruvian economy grew by 4 percent achieving 30 months of consecutive growth, mainly associated with sound macroeconomic and growth-promoting policies and a positive international environment.

GDP growth was driven by the expansion of non-primary activities such as construction (4.0 percent) and services (4.4 percent). Primary activities grew by 2.5 percent due to the dynamism of metal mining (7.8 percent) which reflected to a great extent the increase of production in gold (an historical peak), iron, silver and zinc.

Domestic demand grew by 3.7 percent, explained by the expansion of investment followed by private consumption. The growth of investment (5.2 percent) was associated with the natural gas project of Camisea and the 4.0 percent increase in the construction sector. The increase in family incomes and a larger number of consumer credits granted by financial institutions in a context of falling interest rates in domestic currency contributed to expand private consumption (3.2 percent). On the other hand, exports of goods and services recorded a 5.0 percent growth, reflecting the important expansion of mining, agricultural and textile exports.

INFLATION

By December 2003, annual inflation, measured by the consumer price index (CPI) was 2.5 percent, meeting the target set by the Central Bank (2.5 percent +/- 1 percentage point).

Core inflation, an indicator of the actual trend of prices in the economy, calculated by excluding high price volatility items, was 0.77 percent in 2003. The rising prices of processed foodstuffs, such as rice and edible oil, accounted for most of the annual increase of this indicator.

EMPLOYMENT

Urban employment estimated by the Ministry of Labor through the National Survey on Monthly Variation of Employment in firms with 10 employees or more increased by 1.7 percent in 2003, mainly associated with the evolution of economic activity.

BALANCE OF PAYMENTS

In 2003, the current account deficit of the balance of payments dropped from 2.1 percent to 1.8 percent of GDP. The smaller deficit was attributable to the higher surplus in the trade balance, partially compensated for by the larger deficit in investment income.

The trade balance recorded a surplus of US$710 million, the second surplus after 11 years of deficit, reflecting the dynamism of exports by increasing 17 percent mainly associated to better terms of trade of mining exports, larger volumes of gold shipped and higher values of garments and farm products exports. Non-traditional exports, particularly textiles, increased by the Andean Trade Promotion and Drug Eradication Act (ATPDEA).

Imports grew by 11 percent, mainly due to higher oil prices as well as increased imports of intermediate and capital goods for industry and durable consumer goods.

The financial account of the balance of payments recorded a positive flow of US$931 million, down US$1,049 million from 2002 due to investments abroad by private pension funds and other financial institutions (US$1,186 million) which included the purchase of Peruvian Government bonds placed abroad. Also, 2002 includes the sale of Backus brewery shares valued at US$657 million. During 2003, three international government bond issuances took place with a total of value of US$1,250 million at maturities between 12 and 30 years.

Foreign direct investment amounted to US$1.322 million in 2003, mainly explained by Camisea, Banco Wiese-Sudameris and Tim Perú capital contributions. The fact that total long-term private borrowing and direct investment (US$1.960 million) is almost twice the current account deficit constitutes a strong indicator of the solvency of Peruvian external accounts. Furthermore, net international reserves increased US$596 million reaching a balance of US$10,194 million. This level is equivalent to 2.3 times external debt due in one year, 15 months of imports, 5 times the monetary base balance and 67 percent of banking system broad money. These indicators reflect the economy ability to face restrictive conditions in the international capital markets or an unexpected demand for foreign exchange.

EXTERNAL DEBT

Medium and long-term external debt, including bonds, totaled US$29,708 million or 48.7 percent of GDP, an increase of US$1,868 million over 2002. Public sector medium and long-term debt went up by US$2,053 million compared to 2002, of which US$927 million was due to a net increase of indebtedness and US$1,126 million to the depreciation of the dollar, mainly against the yen and the euro.

EXCHANGE RATE

In 2003, the free-floating exchange rate regime was maintained. As of December 2003, the exchange rate was S/. 3.472, down 1.2 percent from a year ago, in a context where most of Peru's main trade partners have consistently appreciated their currencies against the US dollar.

In real terms, the nuevo sol depreciated by 7.5 percent as the nominal exchange rate fell by 1.2 percent and domestic inflation and the external price index increased 2.5 percent and 11.6 percent, respectively.

FISCAL POLICY

The overall public sector deficit fell to 1.9 percent of GDP in 2003 from 2.3 percent in 2002. This reduction was mainly due to the increase in central government current revenue, from 14.3 to 14.8 percent of GDP that exceeded the expansion of non-financial expenditure of the central government from 14.6 to 14.7 percent of GDP.

The primary balance, which excludes interest payments from the overall balance, improved from a 0.3 percent of GDP deficit in 2002 to a 0.1 percent surplus in 2003.

The improvement of current revenues reflected the effect of administrative measures introduced during 2002 that were oriented to enhance tax collection. Income tax collection increased from 3 percent of GDP in 2002 to 3.8 percent in 2003, whereas IGV (value added tax) collection went from 6.4 to 6.7 percent of GDP in a similar period.

In May 2003 the new Fiscal Responsibility and Transparency Law was enacted, which states, among other rules, a 2004 fiscal deficit not higher than 1.5 percent of GDP. Since 2005, the fiscal deficit should be less than 1.0 percent of GDP.

MONETARY POLICY

Since 2002, the Central Bank's monetary policy has been conducted under an Explicit Inflation Targeting regime. The target is set for an annual rate of inflation of 2.5 percent, with a margin of 1.0 percent up or down.

During 2003, monetary policy went through two different stages. Over the first half of the year the Central Bank maintained its monetary policy stance in the context of a temporary acceleration of inflation, due to marked increases in international oil prices associated with the Iraq conflict. In the second half of the year, the Central Bank's inflation forecasts for 2003–2004 were around the lower limit of the target range. As a result, monetary policy was loosened and policy interest rates were reduced. The interbank interest rate came down from 3.8 percent in December 2002 to 2.5

percent in December 2003. This reduction has influenced short-term interest rates and low-risk loan rates, i.e., the 90-day prime interest rate came down from 5.1 percent at the end of 2002 to 3.3 percent at the end of 2003.

Lower interest rates had a positive impact on recovering economic activity and credit aggregates, particularly in domestic currency. Credit in soles expanded 11.7 percent in 2003, especially in the small business segment (24.4 percent) and institutional investors (32.6 percent). Credit dollarization coefficient decreased from 72.0 to 67.0 percent. In terms of broad money, the dollarization coefficient fell from 65.0 to 62.0 percent, due to the 11.8 percent increase for sol-denominated broad money.

2004 AND MEDIUM-TERM OUTLOOK

During 2004, real GDP is expected to grow 4.0 percent and domestic demand to expand 3.7 percent.

The balance of payment current account deficit is expected to fall to 1 percent of GDP, due to a trade surplus for a third consecutive year mainly associated with the expansion of exports (17,2 percent). Central Bank international reserves should remain over US$ 10 billion during 2004.

Fiscal deficit should continue decreasing to 1.5 percent of GDP in 2004 and to 1 percent from 2005, as stated in the new Fiscal Responsibility and Transparency Law.

Monetary policy will continue to be conducted under the Explicit Inflation Targeting regime with a target of 2.5 percent and a 1 percent margin up or down.

STRUCTURAL REFORMS

Efforts to encourage private sector investment have progressed in areas like hydroelectric power (Yuncan), mining (Las Bambas copper extraction), concession of a Trasandean tunnel and the sale of the 32 percent of the state share in the fuel firm (Relapasa).

Remaining projects cover areas such as road infrastructure (in the north and center regions), land transfer to the private sector, other mining projects (La Granja, Bayovar, Michiquillay, San Antonio de Poto, for copper, gold, etc.), concessions of water and telecomunications services, non-residential construction and tourism projects (Playa Hermosa). A Law was passed to improve the concession process of the seaports.

With regard to other structural reforms, the Multiannual Macroeconomic Framework for 2005–2007 includes progress in state reform and improvement in the quality of public spending (with an increased share of capital expenditure). Additionally, a legal and administrative frame was reinforced for better allocation of resources to subnational governments. A tax Reform to fight tax evasion and broaden the tax base is in progress. Also, progress has been made in the reform of the pension system.

The trade policy has been oriented to continue liberalization that helps diversification and expansion of trade. Peru is actively participating in bilateral and multilateral agreements and in the negotiations towards a Free Trade Agreement with the United States and other economies.

ANNEX I

PERU: OVERALL ECONOMIC PERFORMANCE

	1998	1999	2000	2001	2002	2003
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (level in billion US$)	56.7	51.4	53.1	53.6	56.4	61.0
Real GDP	-0.6	0.9	2.8	0.3	4.9	4.0
Consumption	-0.6	0.0	3.5	1.3	4.1	3.4
Private Consumption	-0.9	-0.4	3.5	1.4	4.5	3.2
Government Consumption	2.5	3.5	3.1	0.1	1.6	4.5
Investment	-2.1	-13.5	-2.9	-7.6	3.7	5.2
Private Investment	-2.4	-15.2	-2.0	-4.5	0.2	5.2
Government Investment	2.9	6.2	-14.9	-22.9	-5.0	3.4
Exports of Goods and Services	5.6	7.6	7.9	7.1	6.8	5.0
Imports of Goods and Services	2.3	-15.2	3.7	2.6	2.4	3.5
Fiscal and External Balance (percent of GDP)						
Budget Balance	-0.9	-3.2	-3.3	-2.6	-2.3	-1.9
Merchandise Trade Balance	-4.4	-1.4	-0.9	-0.5	0.4	1.2
Current Account Balance	-6.0	-3.0	-2.9	-2.2	-2.1	-1.8
Capital and Financial Non-reserve Assets Balance	3.3	1.1	1.9	2.9	3.5	1.5
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	6.2	3.9	3.6	1.3	0.6	2.8
CPI	6.0	3.7	3.7	-0.1	1.5	2.5
M2 [1]	15.4	1.7	6.0	6.9	17.0	10.7
Short-term Interest Rate [2]	19.0	14.9	12.7	8.6	3.2	3.4
Real Effective Exchange Rate (level, 1994=100)	12.6	4.5	-5.2	-4.3	-0.6	7.5
Unemployment Rate in the Urban Area (%) [3]	N.A.	N.A.	N.A.	N.A.	9.4	9.4
Population (millions)	25.1	25.5	25.9	26.3	26.7	27.1

[1] Average percentage change of banking sector's broad money in domestic currency
[2] Average interbank interest rate in domestic currency
[3] Data from Employment Permanent Survey, National Institute of Statistics (INEI)

ANNEX II

PERU: FORECAST SUMMARY (percent change from previous year)

	2003					2004				
	Official	**IMF**	**Link**	**ADB**	**OECD**	**Official**	**IMF**	**Link**	**ADB**	**OECD**
Real GDP	4.0	N.A.	N.A.	N.A.	N.A.	4.0	N.A.	N.A.	N.A.	N.A.
Exports [1]	17.1	N.A.	N.A.	N.A.	N.A.	17.2	N.A.	N.A.	N.A.	N.A.
Imports [1]	10.8	N.A.	N.A.	N.A.	N.A.	5.9	N.A.	N.A.	N.A.	N.A.
CPI	2.5	N.A.	N.A.	N.A.	N.A.	2.5	N.A.	N.A.	N.A.	N.A.

ANNEX III

PERU: MEDIUM-TERM TREND FORECAST (percent)

	2004
Real GDP	4.0
GDP Deflator	2.5

THE PHILIPPINES

REAL GROSS DOMESTIC PRODUCT GROWTH

The Philippine domestic economy remained resilient in 2003 despite numerous threats to growth. Real gross domestic product (GDP) grew by 4.7 percent, falling within the 2003 growth target of 4.2 to 5.2 percent. The GDP growth was also slightly higher than in 2002. Gross national product (GNP) grew by 5.6 percent spurred by a strong surge in the net factor income from abroad (NFIA) which was boosted in turn by a 6.6 percent increase in the incomes of overseas Filipino workers (OFW).

Growth was broad-based. Agriculture, industry (except public construction) and services all grew. The service sector still led the growth in GDP for 2003 with a 5.8 percent growth rate, higher than the 5.1 percent growth posted in 2002 and well within its growth target of 5.2 to 6.2 percent for the year. The finance sector and ownership of dwellings and real estate recovered while transportation, communications and storage and trade services grew steadily. The finance sector grew by 7.1 percent, while ownership of dwellings and real estate grew by 4.0 percent due to the increase in residential building construction The transportation, communications and storage sector grew by as much as 8.6 percent with the continued demand for Short Message Services (SMS) and the strong support for both road and railway transport services. Trade services grew by 5.7 percent in 2003 as both retail and wholesale trade reported brisk sales throughout the year. Private services, meanwhile, grew by 5.1 percent due to the strong demand for personal, recreational and educational services. Government services grew only by 2.9 percent as the government observed fiscal prudence.

Agriculture, fishery and forestry sector grew by 3.8 percent, despite the onset of a mild *El Nino* in the first half of 2003 and Typhoon Harurot in the third quarter. The sector's growth performance was also well within the 3 to 4 percent target for the year. The widespread use of hybrid and certified seeds and good varieties, access to credit, alternative farm activities and intense information drive on new methods of farming resulted in the modest production growth of palay (1.7 percent) and healthy production growth of corn (6.9 percent), sugarcane (13 percent) and fishery (7.4 percent). The forestry sector also grew significantly due to the increased production of the Paper Industries Corporation of the Philippines (PICOP) in the Caraga Region. Livestock and poultry production, however, was affected by higher prices of inputs, particularly feed and feed ingredients.

The industry sector grew by 3.8 percent in 2003, 0.2 percent higher than its 3.6 percent growth performance in 2002. Mining and quarrying, manufacturing and private construction mitigated the overall growth in the industry sector. Mining and quarrying grew by 16.8 percent, slower than in 2002 (51.0 percent) due to the termination of the test period for crude oil production in the Malampaya project. Manufacturing also expanded, by 4.2 percent, on account of gains in food production, basic metal industries, petroleum and coal products, chemical and chemical products. Tobacco products, electrical machinery, footwear and wearing apparel and transport equipment all posted declines. Private construction continued to recover as the monetary authorities eases off access to housing finance. Public construction, however, dropped due to the reduction in government outlays. Rising costs of oil as well as regulatory uncertainties caused a deceleration in growth of the utilities subsector, from 4.3 percent in 2002 to 3.2 percent in 2003.

On the demand side, strong private consumption expenditures (PCE) and investments underpinned growth. Greater per capita income and low inflation fuelled a strong growth in private consumption and at 5.3 percent, it was the highest growth recorded since 1990. Growth was driven by increased demand in transportation and telecommunication, utilities and food. Government consumption expenditure (GCE) registered a slight increase at 0.5 percent following the adoption of a tight fiscal policy.

Gross domestic investments turned around, from a 5.0 percent decline in 2002 to 0.1 percent increase in 2003. Real investments in durable equipment grew by 8.5 percent, almost twice the growth registered in 2002, following significant investments on machinery for agriculture, mining, and construction, as well as pulp and paper, and railway and water transport equipment. On the other hand, growth of public construction slackened to 2.9 percent in 2003

Merchandise exports grew by 5.4 percent propped up by increased exports of crude coconut oil, gold, prepared tuna, sugar and copra. Exports of semiconductors and microcircuits, however, decelerated to 3.7 percent. Exports of non-factor services declined by 2.2 percent as the substantial increase in receipts from miscellaneous services, particularly call centers and insurance companies, failed to offset the slowdown in travel and government services. Total imports continued to support growth, particularly investments in durable equipment such as electrical machinery and transport equipment.

The economy still managed to sustain its growth momentum in the first half of 2004, growing by an average of 6.3 percent despite a growing budget deficit, political anxiety and rising oil prices. Services continued to boost domestic growth during the first half of 2004 with a 6.9 percent increase. Industry also continued to gain strength, with 5.6 percent growth cushioning the deceleration in growth of agriculture in the second quarter where the rising cost of inputs slowed production in the livestock and poultry sectors. The modest increase in NFIA of 3.2 percent caused GNP to expand to 6.1 percent

Transportation, communication and storage, trade and private services spurred the growth of the services sector as election-related activities intensified during the period. The favorable performance of manufacturing and the recovery of construction contributed to sustained industrial growth. Increased fishery, palay, forestry, sugarcane, and corn production contributed to the 6.3 percent growth of the agriculture, fishery and forestry sectors in the first half of 2004.

Heightened consumer spending pushed PCE to grow by 5.9 percent during the first half year with election-related expenses and increased usage of mobile phone services largely contributing to the increase. As the government continued its efforts to ease the budget deficit, GCE posted a minimal 0.5 percent growth from –1.6 percent in the first half of 2003. Fixed capital investments increased by 7.2 percent, a marked improvement from the 2.4 percent growth in the previous year, due to hiked investments in construction.

Total exports grew by 13 percent in the first half year (from a modest 2.7 percent growth in 2003) due to the robust performances of both merchandise exports and non-factor services. Electronic products such as components/devices, electronic data processing, office equipment, consumer electronics; vegetables and fruits; bars and rods of copper; iron conglomerates; transmission apparatus; canned pineapple and copra oil, cake and meal contributed to export growth. Total imports, however, grew at a slower pace of 5.7 percent compared to 14.7 percent in the first half of 2003, as both merchandise and non-factor services imports slowed down.

INFLATION

For two consecutive years, the average inflation rate remained unchanged at 3.0 percent, lower than the target of 4.5 to 5.5 percent. The below target inflation rate for 2003 was attributed mainly to the absence of significant demand-driven upward pressures that could pull up consumer prices and the easing of cost-push inflationary risks. On the supply-side, inflation risks subsided with the mild *El Nino* phenomenon and the downward trend in international oil prices from their peak level in March (due to stock-piling).

On a commodity group basis, the inflation rate for food, beverage and tobacco inched up slightly to 2.0 percent in 2003 on account of the mild *El Nino* during the first part of the year, increased production costs and seasonal variations in food demand. From 2.4 percent and 4.9 in 2002, the inflation rates for fuel, electricity and water and services increased to 6.0 percent and 6.1 percent, respectively, in 2003. The higher inflation rate for fuel electricity and water was attributed to the increase in the world prices of crude oil, particularly in the last quarter, the weakening of the peso vis-à-vis the US dollar and higher electricity cost. Housing and repairs (2.9 percent), clothing (2.2 percent) and miscellaneous items (1.7 percent), meanwhile, registered a substantial reduction in inflation rates compared to 2002.

In the first three quarters of 2004, the inflation rate climbed to an average of 4.8 percent compared to 2.95 percent during the same period in 2003. The increases in basic electricity and fuel charges, high cost of basic raw materials such as flour, and lower production of vegetables as a result of the floods and typhoons which hit the economy contributed to the general uptrend in prices.

EMPLOYMENT

Employment was dragged down as bad weather struck during the third quarter claiming a large number of those employed in agriculture while the lingering effects of the SARS slowed down employment in services. Total employment grew by 1.9 percent to 30.63 million in 2003 from the level a year ago of 30.06 million. Agriculture employment (11.22 million) grew slightly by 0.9 percent and services employment growth slowed down 2.3 percent (from 4.8 percent a year ago) to 14.58 million. Employment in industry (4.84 million) grew by 3.1 percent, propped up by manufacturing employment (2.94 million), which expanded by 2.5 percent. This development in sectoral employment was corroborated by the decline in self-employed workers and unpaid family workers, which typically comprise the agriculture and service sectors. In terms of jobs generated, the service sector led with 331,000 new jobs created, followed by the industrial sector with 145,000 jobs and the agriculture sector with 98,000 jobs.

The average unemployment rate stood at 11.4 percent in 2003, the same as the 2002 rate. This brings the total number of unemployed to 3.93 million from 3.87 million in 2002. The average underemployment of 17 percent approximates the average underemployment rate in 2002.

Total employment from January to July 2004 grew by 4.1 percent to reach 31.56 million. The growth in employment was supported by the recovery in employment in the agriculture, fishery and forestry sector and the continued expansion in service sector employment. The unemployment rate, however, inched up to 12.1 percent from 11.8 percent a year ago despite some easing up in July. The incidence of underemployment also went up to 17.9 percent from 17.5 percent over the same period in 2003.

BALANCE OF PAYMENTS

The overall balance of payment (BOP) for 2003 ended with a surplus of US$111 million, lower than the 2002 BOP surplus of US$663 million. The BOP posted a surplus mainly because of the sustained current account surplus of US$3,347 million.

The sluggish performance of the export sector during the early part of 2003 caused the trade-in-goods balance to post a deficit of US$1,253 million, a reversal from its surplus of US$407 million in 2002. Specifically, exports of electronic products contracted to US$18,255 million last year from US$18,583 million in 2002. Similarly, exports of garments declined by 5.1 percent to US$2,269 million from US$2,391 million in 2002. On the other hand, exports of machinery and transport equipment expanded by 1.7 percent last year.

Meanwhile, total imports reached $36,095 million, up by 6.3 percent. Imports of capital goods (41.6 percent) as well as raw materials and intermediate goods (40.4 percent) accounted for the bulk of imports and signified a resurgence of economic activities. Likewise, imports of capital goods primarily by the telecommunication sector, rose by 15.9 percent in 2003.

The cumulative income account balance for 2003 amounted to US$5,215 million, 16.1 percent higher than the previous year. The surplus in the income account was attributed to the higher overseas Filipino workers (OFW) remittances and the lower payment of dividends and profits. Net current transfers increased to US$612 million or 21.7 percent from 2002 due to higher transfers from migrant workers and the Government.

Weaker direct and portfolio investments caused a higher net outflow of US$5,319 million in the capital and financial account. The combined effects of the net investment withdrawals by non-residents from the equities market and the increase in equity participation by residents in foreign firms, especially during the fourth quarter accounted for the decrease in net direct investments from US$1,733 million in 2002 to US$161 million in 2003. Similarly, the purchase by residents of foreign-issued local debt papers in the secondary market, bond repayment and higher subscriptions by local companies for foreign debt securities, especially during the fourth quarter, resulted in a net outflow of portfolio investments amounting to US$706 million, a reversal from the net inflow of US$1,122 million in 2002. The net outflows in other investments account amounting to US$4,795 million, was likewise larger than the net outflow of US$4,480 million in 2002.

The level of gross international reserves (GIR) for 2003 was equivalent to 4.7 months worth of payment of services, income and imports of goods. Moreover, the level of US dollar reserves can cover 2.9 times the amount of the economy's short-term foreign liabilities based on original maturity and 1.5 times based on residual maturity. A large part of reserves was in the form of foreign investments (75.8 percent), gold, (20.2 percent), foreign exchange (3.2 percent), and combined SDRs as well as reserve position in the Fund (0.8 percent).

The overall BOP position for the first half of 2004 stood at US$68 million, a reversal from a deficit of US$609 million a year ago. The current and capital and financial accounts performed strongly following steady signs of recovery of the world economy and the continued strength in global IT-related demand. The current account posted a significantly higher surplus of US$1,926 million compared to US$782 million last year as a result of the narrowing of the deficit in both the trade-in-goods and services accounts, which more than offset the weakening of the net receipts from the income and current transfer accounts. Merchandise exports rose by 9.7 percent outpacing the rise in imports of 5.6 percent during the first half of 2004. Key export earners were electronics, machinery and equipment, copper metal and coconut oil, among others. The deficit in the trade-in-services balance narrowed to US$330 million for the first half of 2004 (compared to a deficit of US$812 million a year ago) on account of the rise in receipts from travel, construction and financial services.

The net outflow in the capital and financial account was significantly reduced to only US$256 million from a high of US$2,479 million. Significant improvements in the other investment accounts more than compensated for the deterioration in both direct and portfolio investments.

As of end September 2004, the GIR stood at US$15.908 billion. The level of reserves was equivalent to 4.3 months' worth of imports of goods and payment of services and income. The reserves level was 2.4 times the amount of the economy's short-term foreign liabilities based on original maturity and 1.4 times based on residual maturity.

GROSS EXTERNAL DEBT

As of the end of December 2003, the Philippines' total outstanding external debt stood at US$57,395 million, a 7.0 percent increase from the 2002 total of US$53,645 million.

The long-term public sector debt accounted for almost half (US$ 26,094 million) of the economy's external debt. The average maturity date for these loans was extended from 17.0 years in September 2003 to about 19.4 years in December 2003. Public sector borrowings were intended for budgetary requirements, various infrastructure projects, international reserve management and re-lending to bank clients. Credits from both the United States and Japan remained as the bulk of the economy's external debt.

As for the private sector loans, the average maturity date for these also improved from 17.0 years in September to about 17.2 years last December 2003. On the other hand, loans of private non-banks were used to finance power, telecommunications and transportation projects, which will help boost the service sector in the near future.

As of 30 June 2004, the Philippines' outstanding external debt stood at US$56.3 billion, 0.7 percent lower than the US$56.7 billion recorded at the end of the first quarter. Medium to long-term debt still accounted for the bulk (88.2 percent) of the country's debt stock. These loans have average maturity of 17 years with public sector accounts having a longer average maturity of 19.3 years compared to the private sector accounts with an average maturity of 11.1 years.

EXCHANGE RATE

The average peso-dollar exchange rate for 2003 stood at P54.20/USD, higher than the 2002 average of P51.60/USD, or a depreciation of 4.8 percent. Both domestic and external factors, including increased demand for dollars, political uncertainties and the Iraq war, among others, caused the volatility in the movement of the peso against the US dollar. The peso, however, was less volatile despite its depreciation. The annual standard deviation stood at P0.98, lower than 2002 level of P1.13. The continued inflow of remittances from OFWs helped ease dollar liquidity in the foreign exchange market and allowed the peso to broadly stabilize towards the end of the year.

The average peso-dollar exchange rate stood at P55.95/US$, a 3.86 percent depreciation from the nine-month average in 2003. The depreciation of the peso was mainly on account of seasonal factors, including higher dollar demand by corporates to cover import requirements (including oil and other requirements for the holiday season) and to service month-end and quarter-end foreign exchange obligations. Concerns over the economy's fiscal situation, and general weakness in regional currencies against the US dollar also contributed to the downward pressure on the peso.

FISCAL POLICY

The enforcement of revenue reform measures and the prudent spending management policies of the government contained the budget deficit in 2003 to P199.9 billion, which was below the target of P202 billion for the year. The deficit accounted for about 4.6 percent of GDP.

In 2003, the total revenue collection rose to P626.63 billion, a 10.49 percent increase from its 2002 level. Around P537.36 billion of the revenues collected came from tax sources, while P89.27 billion came from non-tax revenues such as income from the Bureau of Treasury, sale of assets, other fees and charges. Both the Bureau of Internal Revenue (BIR) and the Bureau of Customs (BOC) registered increased revenue collections. The BIR collected P425.35 billion, 7.8 percent higher than its 2002 collection while the BOC collected P106.09 billion, a 10.2 percent increase from its 2002 level. Both administrative and structural reforms that were implemented throughout the year improved revenue collection for these two agencies.

Total government expenditure for 2003 amounted to P826.50 billion, a 6.25 percent increase from 2002 spending. Expenditure allocation for economic, social, defense and general public services decreased last year as part of the government's action plan in reducing the budget gap. On the other hand, the total expenditure allotment for interest payments increased by 22 percent from 2002.

The government's first half year 2004 deficit reached P80.1 billion, slightly exceeding the target for the period by 0.6 percent. Total revenue collections for January to June reached P343.3 billion, 12.4 percent higher from a year ago as marked improvements in revenue collections were registered by the BIR and the BOC. BIR's revenue collections rose by 9.6 percent while tax collections by the BOC increased by 14.2 percent. Meanwhile, total expenditures for the first half of the year rose to P423.4 billion, 10.0 percent higher than 2003 first half level, and 2.7 percent over program level. The larger spending was accounted for by among others, the larger settlement of accounts payable, higher allocation for landowner's compensation; a higher requirements; for the conduct of elections; larger payments for pensions and retirement benefits of policemen; and the early release of funds for road maintenance.

MONETARY POLICY

The Bangko Sentral ng Pilipinas (BSP) provided the conditions to set the economy afloat in the face of economic uncertainties. The inflation-targeting framework guided the monetary policy. Policy rates were tightened to dampen exchange rate volatility and stem the risks of potential higher inflation. Because of the uncertainties brought about by the Iraq conflict, the BSP absorbed liquidity by increasing the liquidity reserve ratio from 7 to 8 percent in the first quarter of 2003 and then abolished the tiering system. When market pressure subsided in June 2003, the tiering system was reintroduced and the policy rate was lowered by 25 basis points. In response to peso instability during the third quarter of 2003, the BSP again abolished the tiering system and strengthened restrictions on foreign exchange purchases by residents.

Due to a lower interest rate of 8.9 percent in 2002, the BSP increased the average bank lending rates to 9.5 percent in 2003. Similarly, average 91-day T-bill rates rose in 2003 to 6.0 percent from 5.4 percent in 2002. Meanwhile, the average savings deposit rate for 2003 remained at 4.2 percent, the same as in 2002.

For the rest of the year, the monetary authorities will ensure that the marcroeconomic environment will remain favorable to credit demand and investment activities while guarding against potential risks of inflation. The BSP will continue to recognize liquidity needs for economic growth and emphasize the need for caution against possible vulnerabilities in the system that could arise from the volatility in the foreign exchange market, excess accumulation by both private and public sector, as well as any possible price instability. Key interest rates were kept steady at 6.75 percent for the overnight borrowing or reverse repurchase (RRP) rate and 9.0 percent for the overnight lending or repurchase (RP) rate since July 2003.

MEDIUM-TERM OUTLOOK

Real GDP growth is expected to move to the range of 4.9 to 5.8 percent in 2004 while real GNP is expected to expand by 5.2 to 6.0 percent due largely to the continued increase in foreign remittances. Support to the economy-wide growth will come from agriculture, fishery and forestry, which is expected to grow by 4.0 to 5.0 percent. The agriculture sector will gain from the continuing programs to modernize agriculture and fisheries including the use of hybrid and certified seeds, rehabilitation of irrigation facilities and use of roll-on-roll-off vessels. The industry sector is estimated to grow by 4.4 to 5.2 percent following the favorable demand for the economy’s exports and continued support for small and medium enterprises. The growth of mining and quarrying estimated at 10.0 to 10.9 percent for the year is expected to emanate among others, from the indicated interests by interested investors. Services will remain as the anchor of the economy, growing by 5.7 to 6.6 percent as demand for telecommunications, trade, and private services remain buoyant. Merchandise exports (in dollar terms) are projected to increase by 10 percent in line with the projected growth of partner economies as well as continued global demand for electronics. Imports of goods (in dollar terms) are anticipated to increase by 13 percent due to higher international crude oil prices and increased imports of raw materials and capital goods to support the requirements of exports and recovery of the manufacturing sector.

Inflation is expected to be within the 4 to 5 percent target range for 2004 with the possibility of a temporary overshooting of the target for 2005. .

The Medium-Term Philippine Development Plan (MTPDP) will spell out the economic blueprint for 2005–2010. The Plan has five major components covering economic growth and job creation, energy development, the promotion of social justice and basic needs, the enhancement of education and youth opportunity, and anticorruption and good governance. The plan envisions exports exceeding US$50 billion by 2006, reducing poverty incidence to below 20 percent by 2009, a annual job creation exceeding 1.7 million by 2009, GDP growth accelerating to 7 percent to 8 percent by years 2009 and 2010, an investment to GDP ratio nearing 28 percent by 2010, and a balanced budget by 2010.

STRUCTURAL REFORMS

While the Philippine economy has attained a respectable growth in the last one and a half years, it is cognizant of the need to continue to work on structural reforms that would promote macroeconomic stability, accelerate regional development and agricultural modernization, achieve comprehensive human development and improve good governance.

The government's tariff program remained on-track despite a slight increase in the average nominal tariff (from 6.02 percent in 2002 to 6.49 percent in 2003) as a result of the increase in tariff on certain products to provide temporary relief to local manufacturers and allow them to further enhance their competitiveness. The Philippines continued to participate in liberalization initiatives in ASEAN by reducing the CEPT rates to zero for around 60 percent of products in the CEPT Inclusion List, granting zero duty on information and communications technology products to accelerate technology transfer, and providing tariff preferences on certain products of less developed members of the ASEAN to assist in their economic development.

To allow the farmers and fisherfolk access to low cost raw material inputs and equipment, the duty-free privilege granted under the Agricultural and Fisheries Modernization Act of 1997, which expired on 8 February 2003, has been reinstated under Republic Act 9281.

Cognizant of the mining industry's huge potential to contribute to economic growth, a Mineral Action Plan has been formulated to provide strategic directions, rules and regulations for exploration, development and utilization of the Philippines' mineral resources. To address ICT concerns, the Commission on Information and Communication Technology was created to take charge of, among other things, formulating and recommending national policies to promote ICT and wider use of the Internet and other cyberspace infrastructure, and establishing and administering comprehensive and integrated programs for ICT at the national, regional and local levels.

Efforts have been geared towards improving revenue effort and maintaining prudent expenditure, the government continued to push for the legislation that will correct the structural defects in the system that have eroded tax collection even as they improve tax administration. These include among others, the restructuring of the excise tax on automobiles, which has been enacted into law, and the indexation of a specific tax on 'sin' products. The computerization program and the continuous systems improvement at the BIR and the BOC raised tax and duty collections.

To enable the government to implement a more effective tax collection program, a new law was passed expanding the jurisdiction of the Tax Appeals Court to include criminal and civil jurisdiction over tax and customs cases. This is expected to speed up the prosecution and judicial adjudication of criminal tax and customs cases. The Revenue Integrity Protection Services was also created within the Department of Finance (DOF) with the task of investigating allegations of corruption within the DOF and its attached agencies.

The drive against smuggling has been further strengthened with the reconstitution of the membership of the Anti-Smuggling Intelligence and Investigation Center to include the Armed Forces of the Philippines, the Bureau of Customs, the Philippines National Police, the Philippine Coast Guard and the Department of Justice.

The Securitization Act of 2004, meanwhile, establishes the legal, tax and regulatory framework for asset securitization. The enactment of the law is hoped to lead to a stronger capital market that would provide for a stable source of long-term funds to support broader business undertakings, increase foreign and domestic investments, generate more job opportunities and increase substantially the incomes of households. The BSP also issued rules and regulations to enhance the transparency of securities transactions of banks and non-bank financial institutions under BSP supervision in line with its policy of promoting the protection of investors and encouraging them to participate in the domestic capital market.

ANNEX I

THE PHILIPPINES: OVERALL ECONOMIC PERFORMANCE

	1996	1997	1998	1999	2000	2001	2002	2003	1st Half 2004
GDP AND MAJOR COMPONENTS (% change, year over year, except as noted)									
Nominal GDP (million US$)	82724	82221	65074	76043	74725	70914	76731	79330	40268
Real GDP	5.8	5.2	-0.6	3.4	4.4	3.0	4.3	4.7	6.3
Total Consumption									
Private Consumption	4.6	5.0	3.4	2.6	3.5	3.6	4.1	5.3	5.9
Government Consumption	4.1	4.6	-1.9	6.7	6.1	-5.3	-3.7	0.5	0.5
Total Investment	12.5	11.7	-16.3	-2.0	5.5	13.6	-5.0	0.1	9.4
Exports of Goods and Services	15.4	17.2	-21.0	3.6	17.7	-3.4	3.6	4.4	13.0
Imports of Goods and Services	16.7	13.5	-14.7	-2.8	4.0	3.5	4.7	10.2	5.7
FISCAL AND EXTERNAL BALANCES (% of GDP)									
Budget Balance	0.3	0.1	-1.9	-3.8	-4.1	-4.1	-5.3	-4.6	-3.6
Merchandise Trade Balance	-13.7	-13.5	-0.04	6.5	5.1	-1.0	0.5	-1.6	-0.03
Current Account Balance	-4.8	-5.3	2.4	9.5	8.4	1.9	5.7	4.2	2.8
Capital Account Balance[/a]	13.4	8.0	0.7	-3.1	-5.5	-1.8	-2.1	-6.7	0.60
ECONOMIC INDICATORS (% change year over year earlier period, except as noted)									
GDP Deflator (% change)	7.7	6.0	10.7	8.0	6.3	6.4	4.5	3.7	5.0
CPI (% change) 1994=100	9.1	5.9	9.7	6.7	4.4	6.1	3.0	3.0	4.1
M2 (% change)	15.8	20.5	8.0	19.3	4.8	6.9	9.5	3.1	5.7
Short-term Interest Rate (%)	12.4	13.1	15.3	10.2	9.9	9.9	5.4	6.0	7.0
Exchange Rate (P/US$)	26.2	29.5	40.9	39.1	44.2	51.0	51.6	54.2	55.94
Real Effective Exchange Rate Index	90.5	88.1	69.0	74.0	68.8	64.1	63.4	56.94	53.88
Unemployment Rate (%)	8.6	8.7	10.1	9.8	11.2	11.1	11.4	11.4	13.7
Population (millions)	70.0	71.7	75.2	76.8	76.8	78.4	80.2	82.1	83.8

- Revised as of 17 October 2004.

/a - the modification in data on capital account balance from 1999 reflects the adoption of the Bangko Sentral ng Pilipinas of the new framework for BOP compilation and reporting in accordance with the IMF's balance of Payment Manual, 5th Edition.

Sources: National Statistical Coordination Board
Bangko Sentral ng Pilipinas

ANNEX II

THE PHILIPPINES: FORECAST SUMMARY

	2004					2005				
	Official	**IMF**	**Link**	**ADB**	**OECD**	**Official**	**IMF**	**Link**	**ADB**	**OECD**
Real GDP	4.9–5.8	4.5	N.A.	4.5	N.A.	5.3–6.3	N.A.	N.A.	N.A.	N.A.
Exports [/a]	3.4–4.4	N.A.	N.A.	7.0	N.A.	8.2–9.2	N.A.	N.A.	N.A.	N.A.
Imports [/b]	7.0–8.0	N.A.	N.A.	5.8	N.A.	11.7–12.7	N.A.	N.A.	N.A.	N.A.
CPI	4.0–5.0	3.9	N.A.	4.5	N.A.	4.0–5.0	N.A.	N.A.	N.A.	N.A.

/a - Forecast based on real exports of goods and services
/b - forecast based on real imports of goods and services

ANNEX III

THE PHILPPINES: MEDIUM TERM FORECAST

	2004	2005	2006	2007
Real GDP	4.9–5.8	5.3–6.3	6.3–7.3	6.5–7.5
GDP Deflator	N.A.	N.A.	N.A.	N.A.

Preliminary Forecasts

RUSSIA

The positive dynamics of the most important macroeconomic indicators of the development of Russian economy were good in 2003. The output of goods and services expanded, fixed capital investment grew and real household incomes rose. The consumer price index was 112.0 in 2003 as against 115.1 in 2002. Financial stability, which was ensured by a budget surplus of expanded government and balance of payments, was maintained. Inflation rates decreased.

The fact that in 2003 Russia continued to enjoy a current account surplus shows there was a balance between domestic demand and supply, which contained price increases and created the favorable macroeconomic expectations considered to be a major factor of moderate price growth. High world prices for major Russian export commodities led to a rise in incomes of legal entities and considerable overall investment growth (12.5 percent increase in 2003 compared to only 2.6 percent in 2002).

The share of foreign investment in the Russian Federation's (RF) gross fixed investment was 5.7 percent in 2003 compared to 4.9 percent in 2002.

External debt was repaid in accordance with the adopted schedule, with rather limited external borrowings.

REAL GROSS DOMESTIC PRODUCT

The gross domestic product (GDP) growth in 2003 was 7.3 percent as compared with 4.7 percent in 2002. Q12003 growth amounted to 6.6 percent year on year and Q2 growth stood at 7.7 percent. There was a minor slowdown in Q3 (to 5.9 percent), but in Q4 the index gained 8.2 percent.

The GDP amounted to RUR13,285.2 billion (US$434.0 billion[1]) in current prices compared to RUR10,834.2 billion (US$345.9 billion) in 2002. The GDP deflator index amounted to 14.2 percent in 2003 as compared with 15.2 percent in 2002.

The output index of five basic economic sectors (industry, construction, agriculture, transport, retail trade) was 107.1 in 2003 as compared with 103.8 in 2002. The industrial output index was 107.0 in 2003 (103.7 in 2002).

Freight turnover of transport companies rose by 7.4 percent in 2003 as compared with 5.9 percent in 2002. The communication sector expanded by an impressive 27.5 percent in 2003 (9.8 percent in 2002). The number of people using mobile telephones reached 35.5 million by 1 January 2004 as compared with 17.7 million a year before. The number of mobile telephone users indicates, to a certain extent, the number of top and middle income earners in the RF.

Retail turnover rose in 2003 by 8.0 percent as against 9.2 percent in 2002, while the growth of real disposable incomes and real wages was 14.5 percent and 10.4 percent, respectively. In 2003 Russian consumers, mostly from the top and middle income levels, preferred saving money to spending it on buying goods.

The volume of services rendered to natural entities went up by 5.1 percent in 2003 compared to 3.7 percent in 2002.

PRODUCTION

Industrial output expanded by 7 percent in 2003 year-on-year. The analysis of industrial production dynamics, made without taking into account seasonal and random factors, shows that the base conditions for industrial growth in 2003 were far better than in 2002. In 2003, industrial output grew 0.6 percent a month that is 0.3 percent faster than in 2002.

[1] The official average annual RUR/US$ rate in Russia was 30.61 in 2003.

The structure of industrial production in 2003 was as follows: fuel 18.5 percent, ferrous metals 9.8 percent, non-ferrous metals 7.4 percent, electrical power 12.0 percent, chemical 5.5 percent, machinery and metal working 19.9 percent, wood, wood pulp and paper 4.2 percent, construction materials 3.1 percent, light industry 1.4 percent, food 15.4 percent, and other industries 2.8 percent.

The output index for the key branches of the economy (industry, agriculture, construction, transport and retail trade) gained 7.1 percent in 2003 year-on-year.

According to estimates, the average monthly rate of growth (calculated without taking into account seasonal and random factors) increased by 0.2 percent year-on-year to 0.5 percent in export-oriented industries in 2003, 0.6 percent to 0.8 percent in industries oriented to the domestic market and 0.2 percent to 1.2 percent in industries manufacturing goods both for export and the domestic market.

Estimates indicate that the biggest contribution to industrial production growth was made by the fuel, machine-building and food industry sectors (in 2002, it was the fuel, non-ferrous metallurgy sector and food industry sectors).

Output rose 9.3 percent in the fuel sector in 2003 year on year, 8.9 percent in the ferrous metallurgy sector, 6.2 percent in the non-ferrous metallurgy sector, 6.4 percent in the building materials industry and 5.1 percent in food industry. In the electric-power industry full-year growth amounted to 1.0 percent. The light industry registered a 2.3 percent drop in production.

Industrial output of key enterprises grew as the average production capacity utilization ratio increased from 54 percent in January to 56 percent in December 2003, reaching its highest level since May 1995.

There was a 7.4 percent rise in the freight turnover of transport companies in 2003. Freight turnover grew 10.2 percent in railway transport, 1.4 percent in air transport, 3.5 percent in automobile transport and 8.1 percent in pipeline transport. There was a contraction in freight turnovers in inland waterway and marine transport. The intra-year dynamics of freight turnover in transport in 2003 differed from those monitored in 2002 when the most rapid rates of growth were registered in Q3. In Q12003, freight turnover expanded 7.1 percent year on year and in Q2 and Q4 growth stood at 7.5 percent. Unlike Q3 2002, Q3 2003 saw a slight slowdown in the rate of growth (7.3 percent).

Agricultural output rose 1.5 percent in 2003. In 2003 agricultural output expanded in Q1 and Q4 (by 1.1 percent and 7.8 percent, respectively), but contracted in Q2 and Q3 (by 1.2 percent and 0.1 percent, respectively). Gross grain production by all categories of farms fell 22.6 percent year-on-year to 67.2 million tonnes against 86.6 million tonnes in 2002. Meat production rose 4.7 percent and the production of eggs increased 0.4 percent. Milk production fell 0.6 percent (in 2002, the production of meat, eggs and milk expanded 4.5 percent, 3.1 percent and 1.8 percent, respectively).

FOREIGN TRADE

In 2003, Russia's exports of goods increased to US$31.1 billion Q1, US$31.7 billion in Q2, US$34.9 billion in Q3 and to US$38.2 billion in Q4 according to the latest estimate (April 2004) of the Russian Federal Statistics Service (Goskomstat of Russia).

Russia’s total merchandise exports increased by 26.7 percent and amounted to US$135.9 billion in 2003, as against their growth at 5.3 percent in 2002. Exports’ share in total sales of industrial goods (at current prices) in 2003 was 25.1 percent (29.6 percent in 2002 prices) compared to 25.0 percent a year before.

The situation in the world’s commodity markets in 2003 was considerably better for Russian exports than in 2002. World prices of major Russian exports rose 16.3 percent on average. The price of Urals crude grew 15.5 percent to US$27.3 per barrel and Brent was up 15.4 percent to

US$28.8 billion per barrel. The price of petrol rose 23.4 percent, diesel fuel 24.8 percent and fuel oil 12.8 percent. Natural gas prices in Europe jumped 28.0 percent and non-ferrous metal prices rose 15.5 percent on average (aluminum was up 6.0 percent, copper 14.1 percent and nickel 42.1 percent).

Growth in exports was due to a significant rise in the contract prices of major export commodities and the expansion of export volumes. At the same time, most of the expansion in exports resulted from an increase in energy export prices.

There was also a rise in the value of exports of ferrous metals, chemicals, timber products and machinery, equipment and transport vehicles. The export volumes of oil, petroleum products, natural gas, aluminum, timber and synthetic rubber expanded, while those of nitrogen fertilizer, copper, nickel and lorries contracted. Looking at exports as a whole, the share of energy products, especially oil, expanded and there was a slight expansion in the share of ferrous metals.

In accordance with the official revised estimate, imports' share in saleable resources of retail turnover was 38 percent in 2002 and went up to 46 percent in Q12003, 43 percent in Q2 and Q3 and 44 percent in Q4. Imports' share in total resources for sale in the domestic market went down to 23.2 percent in 2003 compared to 23.6 percent (at current prices) a year before, but it went up in constant prices, to 27.4 percent.

According to Goskomstat of Russia, Russia's total merchandise imports amounted to US$75.4 billion in 2003, an increase of 23.7 percent compared to 13.3 percent in 2002 (US$61.0 billion).

Growth in imports was largely due to the expansion of import volumes. At the same time, there was a rise in the contract prices of some imported products, particularly food, light industry goods and fuel and energy products. The increase in the value of imports mainly resulted from growth in the purchases of machinery, equipment and transport vehicles. There was also a rise in the imports of ferrous metals, chemical products, some light industry goods and foodstuffs. The imports of investment goods rose faster than the imports of consumer goods. Overall, the value of imports surpassed the pre-crisis level.

In 2003, Russia's trade surplus amounted to US$60.5 billion, approaching the 2000 level, the highest level since 1994. (In 2002, it stood at US$46.3 billion).

Thanks to considerable growth in the prices of major Russian exports, the terms of Russia's trade with other economies in 2003 were better than in 2002.

Exports to non-CIS economies expanded 25.3 percent (year-on-year) in 2003 to US$114.0 billion and imports from non-CIS economies rose 23.0 percent to US$60.0 billion. Russia's trade surplus with non-CIS economies increased by US$11.8 billion to US$53.9 billion.

Exports to CIS economies rose 30.9 percent in 2003 (year-on-year) to US$21.4 billion and imports from CIS economies grew 26.7 percent to US$15.4 billion. Russia's trade surplus with the CIS economies stood at US$6.0 billion against US$4.2 billion in 2002. The CIS share in Russian exports expanded from 15.3 percent in 2002 to 15.8 percent in 2003 and the CIS share in Russian imports widened from 19.9 percent to 20.4 percent.

INFLATION

According to Russia's Goskomstat, in 2003 the consumer price index (year-on-year) reached 112.0 percent, lower than in 2002 (115.1 percent) and was in line with the schedule stipulated by the budget guidelines for 2003 (110 percent to 112 percent). Prices of non-food goods (109.2 percent) and foodstuffs (110.2 percent) increased far less than those of services (122.3 percent) in 2003. Increased prices of petrol, natural gas and electricity, as well as transport and communal services, caused a further increase in the prices of nearly all other goods.

The producer price index was 113.1 percent in 2003 (117.1 percent in 2002) and is higher than the consumer price index by 1.1 percent.

The exchange rate policy pursued by the Bank of Russia continued to play a favorable role in curbing core inflation. The nominal rise of the ruble against the US dollar restrained growth in the prices of imported goods and, consequently, their domestically produced analogues.

Consumer price inflation was affected by the dynamics of prices in cost-creating industries. Producer prices in the electric-power industry continued to rise at a fast rate, far surpassing the industrial average. At the same time, producer price growth in the fuel sector was considerably slower than in 2002.

Since the beginning of the year, the industrial producer price index (IPPI) registered 113.1 percent against 117.1 percent in 2002.

In 2003 producer price dynamics by industry were not as they were in 2002. The most significant increase in producer prices in 2002 was registered in the non-ferrous metallurgy sector (30.1 percent). There was also considerable growth in producer prices in the electric-power industry (27.3 percent), fuel sector (24.3 percent) and ferrous metallurgy sector (23.3 percent) that year, whereas in 2003 the most significant increases in producer prices were registered in the ferrous metallurgy sector (28.8 percent), non-ferrous metallurgy sector (27.2 percent) and building materials industry (17.0 percent).

Producer price growth in the electric-power industry slowed down from 27.3 percent in 2002 to 13.9 percent in 2003. Producer prices in the fuel sector rose 1.4 percent in 2003; in the oil-extracting industry they went up 1.6 percent against 25.6 percent a year earlier, and in the oil-refining industry increased14.8 percent against 19.9 percent in 2002. Producer prices in the gas industry declined 22.9 percent, whereas in 2002 they rose 30.2 percent.

Producer prices rose significantly in light industry and the food industry in 2003 (by 15.2 percent and 14.8 percent, respectively). One of the reasons for the acceleration of price rises in the food industry is the rising prices of raw materials, especially the selling prices of farm produce. Feedstock prices, for example, rose 46.2 percent in 2003 and livestock farmers raised their prices 12.4 percent. (In 2002, feedstock prices fell 4.9 percent and livestock farmer prices remained unchanged from 2001).

Producer prices growth in other industries ranged from 7.9 percent in the timber, woodworking and pulp-and-paper industry to 15.1 percent in the chemical industry.

Consumer price dynamics were also affected by increases in freight transportation charges, which in 2003 rose faster than in 2002.

According to tentative data, the volume of grain sales by agricultural organizations in 2003 accounted for 77.4 percent of the 2002 volume. The output of bread and bakery products by food industry enterprises fell 4.7 percent in 2003 year-on-year.

Food price dynamics were largely affected by producer price growth in industry, which stood at 14.8 percent in 2003 against 5.8 percent in 2002, and in agriculture the prices of farm produce rose 24.7 percent in 2003, whereas in 2002 they fell 1.9 percent.

EMPLOYMENT

As regards employment, the main trend was an increase in the number of those employed in the economy in 2003. The total number of economically active persons in Russia increased from 65.1 million in 2002 to 72.3 million in 2003 (over 50 percent of the Russian population). The number of employed Russians decreased in 2003 by 0.3 million (from 66 million in 2002 to 65.7 million at the end of 2003).

In 2003 the number of unemployed, calculated according to International Labour Organization (ILO) methodology, was 8.1 percent of the economically active population (8.8 percent in 2002).

Meanwhile the main stable internal source of expanding final consumption and consequently production was growing real incomes of population. Real disposable incomes of the population increased by 13.6 percent in 2003 compared to 10.3 percent a year before. This growth is not based entirely on increasing wages and salaries, since real wages increased by only 10.4 percent in 2003 compared to 16.2 percent in 2002. An increase of real disposable incomes still stimulates expanding imports of competing consumer goods because of an insufficient supply of Russian non-food goods of high quality against a background of recent real effective ruble appreciation.

INVESTMENT

The favorable general economic situation in 2003 encouraged Russian companies to actively invest.

There was a significant rise in fixed capital investment in 2003. Compared to 2002, it expanded 12.5 percent to RUR2,183.3 billion. Investment growth stood at 10.2 percent in Q1, 13.2 percent in Q2, 12.3 percent in Q3 and 13.4 percent in Q4, the most rapid rate of the year.

Monitored without taking into account seasonal and random factors, the dynamics of the fixed capital investment show that its tendency towards growth, which emerged in April 2002, gained ground in 2003.

Positive fixed capital investment dynamics were accompanied by a rise in business activity in the construction sector. Construction work done by contract in 2003 was valued at RUR1,164.8 billion, an increase of 14.4 percent on 2002.

Growth in fixed capital investment and the high activity of construction companies led to the expansion of new production capacity in various sectors of the economy.

Table 1: Gross Fixed Investment, by Economic Sector: 1996–2003

	1996	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**
Total, billion rubles in current prices, of which (percent):	375958	408797	407.1	670.4	1165.2	1504.5	1360.3[2]	1774.9[2]
Industry	34.8	36.4	33.3	37.3	38.3	38.7	42.7	42.4
Agriculture	2.9	2.5	3.0	2.9	2.7	3.9	3.1	29
Construction	4.0	4.2	4.1	3.9	3.9	3.8	2.7	3.2
Transport	13.5	15.2	14.1	18.5	21.1	20.7	19.1	179
Communications	1.8	2.8	3.5	3.2	2.6	2.9	4.0	5.4
Trade and catering	2.2	2.3	2.5	2.4	2.8	3.0	2.4	2.8
Housing	20.3	16.7	16.1	14.0	11.6	11.1	9.4	14.3
Other economic branches	20.5	19.9	23.4	17.8	16.8	15.9	16.6	11.1

(1) Denominated rubles. In 2002 and HY1 of 2003 large and medium-size enterprises only.
(2) Less VAT.
Source: Goskomstat of Russia.

Investment activity accelerated considerably in 2003, showing 12.5 percent growth (2.6 percent increase in 2002). The total size of gross fixed investment (less VAT), including small business and households, amounted to RUR2 186.2 billion in 2003 (US$71.2 billion). The share of foreign investment in the RF's gross fixed investment is 5.7 percent in 2003 compared to 4.9 percent in 2002.

Gross Fixed Investment, by Source of Financing: 1996-2003 (percent distribution)

	1996	1997	1998[1]	1999[1]	2000[1]	2001[1]	2002[1]	2003[1]
Total investments of which from:	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Budget sources	20.1	20.7	19.1	17.0	22.0	20.4	19.6	18.7
Non-budget sources	79.9	79.3	80.9	83.0	78.0	79.6	80.4	81.3
Enterprises' own funds	52.3	60.8	53.2	52.4	47.5	49.4	48.0	45.6[2]

(1) Large and medium-size enterprises only.
(2) Of which disposable income accounts for 18.0 percent, amortization - 23.8 percent.
Source: Goskomstat of Russia.

Housing construction continued to expand at a rapid rate in December 2003. Housing with a total floor space of 36.3 million square meters was commissioned in 2003, an increase of 7.2 percent on 2002. Housing with a total floor space of 15.2 million square meters, or almost 42 percent of total housing erected in 2003, was built by individuals at their own expense and on credit.

As for the construction projects built in the social and cultural spheres, the number of institutions of higher education built in 2003 rose 64.5 percent year-on-year, children's pre-school institutions 1.8 percent, and old people's homes 4.5 percent. At the same time, the rate of construction of schools declined 2.1 percent, specialized secondary schools fell 61.9 percent and outpatient clinics also fell, by 14.2 percent.

The total sum of attracted foreign capital in Russia's economy amounted to US$29.7 billion in 2003, an increase of 50.1 percent in comparison with 2002. This level may be considered the highest for the whole of the period of market reforms in the RF. About 76 percent (US$22.5 billion) of foreign capital inflow relates to the category of "other investment", this is 47.1 percent higher than in 2002. FDI increased by 69.4 percent to US$6.8 billion. Foreign investments in shares and other securities, i.e., portfolio investments, were estimated at US$401 million,15.1 percent lower than in 2002.

Table 3: Inflow of foreign investment in the RF

	1998	1999	2000	2001	2002	2003	2003/2002
US$ million							
Total	*11,773*	*9,560*	*10,958*	*14,258*	*19,780*	*29,699*	
Direct	3,361	4,260	4,429	3,980	4,002	6,781	
Portfolio	191	31	145	451	472	401	
Other	8,221	5,269	6,384	9,827	15,306	22,517	
percent							
Total	*100*	*100*	*100*	*100*	*100*	*100*	*150.1*
Direct	28.6	44.6	40.4	27.9	20.2	22.8	169.4
Portfolio	1.6	0.3	1.3	3.2	2.4	1.4	84.9
Other	69.8	55.1	58.3	68.9	77.4	75.8	147.1
Accumulated foreign investments, US$ million (percent)							
Total		**29,253 (100)**	**32,005 (100)**	**35,624 (100)**	**42,928 (100)**	**57,014 (100)**	
Direct		12,757 (43.6)	16,125 (50.4)	18,169 (51.0)	20,351 (47.4)	26,131 (45.8)	
Portfolio		309 (1.1)	507 (1.6)	1 230 (3.5)	1 473 (3.4)	1 429 (2.5)	
Other		16,187 (55.3)	15,373 (48.0)	16,225 (45.5)	21,104 (49.2)	29,454 (51.7)	

Source: Goskomstat of Russia.

By the start of 2004 the total amount of accumulated foreign investments in the RF reached US$57 billion or 32.8 percent more than a year before. FDIs constituted 45.8 percent (47.4 percent a year before), other investment 51.7 percent (49.2 percent), portfolio investment 2.5 percent (3.4 percent).

Foreign capital came from 117 economies in 2003. Germany, USA, Cyprus, the UK, France, the Netherlands, and Italy were the principal debtors, constantly making large investments they accounted for 68.7 percent of total accumulated foreign investment and 68.2 percent of total accumulated FDIs in 2003.

Thus, foreign capital has been strengthening its position in Russia's economy. The permanent and rapid development of the leading sectors of the RF economy was considered the main cause of growing investment.

In 2003, 28.3 percent of total FDIs were made in the fuel industry (99 percent of total FDIs in the fuel industry was made in oil production and processing), 22 percent in trade and public catering, and about 5 percent in each of the following: the food industry; machine building and metal working; forest industry and timber manufacturing; and transport and communications. 6.5 percent of FDIs were directed for commercial activity of servicing market functioning. The aggregate size of FDIs in the above mentioned industries amounted to US$5.1 billion or 75 percent of total FDIs in 2003.

Legal regulation of foreign capital activities has remained rather stable and predictable despite some corrections and amendments[2]. Plans to modernize the legal regulations have become more transparent. The laws on foreign investment and investment activity, as well as some other legal acts, were to be re-considered to stimulate the investment process further.

Besides, the RF Government has worked out a plan for setting up Free Economic Zones (FEZs); this plan implies organization of economic territorial zones, customs-free zones and technological parks. The draft bills on free economic zones and on concession agreements and amendments to the previously mentioned investment laws are to be submitted to the State Duma (Russian Parliament) soon.

HOUSEHOLD INCOME AND SAVINGS

The continued economic growth and relatively low inflation in 2003 led to an increase in real household disposable income, which grew 14.5 percent year-on-year against 9.9 percent in 2002. Real incomes in 2003 rose 15.6 percent in Q1, 14.0 percent in Q2, 11.4 percent in Q3 and 17 percent in Q4.

Wages and salaries, including undisclosed earnings, remained a major source of household income. In 2003, the share of wages and salaries expanded by 0.2 percent (year-on-year) to 66.7 percent, while the share of incomes from entrepreneurial activities contracted.

The average monthly nominal imputed wage rose 25.5 percent in 2003 year- on-year to 5,512 rubles. The real imputed wage increased 10.4 percent year-on-year against 16.2 percent in 2002. Wage growth slowed down each quarter year-on-year from January through September 2003 (in Q1 growth stood at 9.7 percent, in Q2 9.4 percent, and in Q3 8.4 percent), but in Q4 wages rose 13.8 percent. (In 2002, the most significant growth in wages was registered in Q2; in Q1 wages rose 17.2 percent, in Q2 19.5 percent, in Q3 17 percent and in Q4 12.9 percent.)

Overall wage arrears amounted to 24.4 billion rubles as of 1 January 2004, contracting by 20.1 percent compared to 2003.

[2] On 10 December 2003 the RF authorities passed a new version of the Federal Law "On Foreign Exchange Regulation and Foreign Exchange Control" No. 173-FZ. The new law is to replace the former version of the Federal Law "On Foreign Exchange Regulation and Foreign Exchange Control" passed on 9 October 1992 with its numerous further alterations and amendments. Law No. 173-FZ will come into force beginning 17 June 2004, except for some provisions. So, the RF new law on foreign exchange regulation replaces a system of giving individual permits on many operations, mainly in the sphere of transferring capital, by the possible procedure of introducing special accounts and several types of reservation. Moreover, all restrictions, excluding obligatory repatriation of resident's foreign currency earnings due to exports of goods, services etc., will be removed by 2007.

The average monthly imputed pension in 2003 rose 4.5 percent in real terms (against 16.3 percent in 2002), to 1,637 rubles.

Growth in household money income brought about a rise in consumer spending in 2003, an increase of 7.7 percent in real terms. The share of household expenses on goods and services in the household budget in 2003 contracted by 3.7 percent year-on-year to 69.5 percent.

The share of household expenses on the purchase of foreign exchange expanded to 7.4 percent in 2003 from 5.5 percent in 2002.

Public propensity for organized savings, evaluated at 12.1 percent in 2003, was 1.7 percent higher than in 2002.

The value of individual deposits at all commercial banks of Russia as of 1 December 2003, rose 43.1 percent year-on-year.

FINANCIAL MARKETS

The favorable price situation in the world's oil market amid the prevalent expectations of the ruble's appreciation predetermined the continuing and persistent excess of the supply of foreign exchange over demand in the domestic foreign exchange market.

The price trends registered in most segments of the Russian financial market in the Q4 of 2003 continued as a result, while the raising of Russia's credit rating by Standard and Poor's[3] was an additional factor that stimulated investor interest in Russian financial instruments.

A steady inflow of export earnings to the Russian market and persistent investor interest in Russian assets caused the nominal rate of the US dollar to fall against the ruble for most of the time and on 29 January 2003 the dollar sank to 28.49 rubles, its lowest level since February 2001.

As the Bank of Russia bought large amounts of US dollars from market operators, the ruble liquidity in commercial banks continued to grow.

In January 2004 the balances of commercial banks' correspondent accounts in the Bank of Russia ranged from RUR177 billion to RUR282 billion and the average monthly balance grew to RUR230.3 billion from RUR204.2 billion in December 2003.

This factor and the continued lack of interest in short-term foreign currency assets caused inter-banking interest rates to fall further. The average weighted overnight Moscow Interbank Actual Credit Rate (MIACR) slipped to 1.1 percent in January from 1.4 percent in December.

The financial securities market remained stable in 2003.

[3] In October 2003 the Moody's Investor Service has increased a credit rating of Russia to the investment grade. The agency has lifted also ratings on euro bonds and ruble bonds from Ba2 up to Baa3. The rating of Russia assigned by the other international rating services in 2003, remained below of the investment level: Fitch Ratings - BB+, Standard and Poor's - BB.
January 27, 2004 S&P's Rating Services raised its long-term foreign currency sovereign credit rating on the Russian Federation to "BB+" from "BB", and its local currency sovereign credit ratings to "BBB-/A-3" from "BB+/B". At the same time, S&P's affirmed its "B" short-term foreign currency sovereign credit rating and "ruAA+" 's Russia National Scale rating on Russia. The outlook was stable. The upgrade reflected continued rapid improvement in external liquidity and government debt levels, general government surpluses since 2000 which helped to reduce the general government debt to 38 percent of GDP at year-end 2003 (down from more than 110 percent at year-end 1999). Foreign exchange reserves were almost double short-term external debt and almost 4x more than Russia's 2004 gross external financing requirement. The upgrades also reflected prudent financial management–in particular, the Russian Government's recent establishment of a stabilization fund–and a number of structural reforms that have fostered a strong macroeconomic performance spurred by very high oil prices.

BALANCE OF PAYMENTS (CURRENT AND CAPITAL AND FINANCIAL ACCOUNTS)
The development of overseas economic activities in 2003 occurred in conditions of increased business activity in Russia, an increase of domestic demand and a favourable world situation as a whole.

Over 2003 the favourable trade balance, according to the assessment for 2003, amounted to US$60.5 billion, approaching the 2000 level and the highest level since 1994. (In 2002, it stood at US$46.3 billion.)

However capital inflow was neither large nor stable enough.

Table 5: Balance of Payments of Russia for 2003
(neutral presentation from Russia's CB, US$ million)

Current account	**35,905**
Goods and Services	**49,401**
Export	151,959
Import	- 102 558
Goods	60,493
Export	135,929
Import	-75,436
Investment income and compensation of employees	**- 13,132**
Receivable	5,487
Payable	- 18,620
Investment income	- 12,988
Receivable	4,674
Payable	- 17,662
Current transfers	**- 363**
Receivable	2,537
Payable	- 2,900
Capital and financial account	**- 28,706**
Capital account	**- 993**
Capital transfers	**- 993**
Receivable	616
Paid	- 1,609
Financial account	**- 27,713**
Direct investment	**- 2,989**
Overseas	- 4,133
Domestic	1,144
Portfolio investment	**- 4,880**
Assets	- 2,543
Liabilities	- 2,338
Financial derivatives	**640**
Assets	1,017
Liabilities	- 377
Other investment	**5,882**
Assets	- 16,770
Cash: foreign currency	5,911
Current accounts and deposits extended	1,567
Trade credits and advances extended	- 3,926
Loans extended (excluding arrears)	- 256
Liabilities	22,652
Cash : domestic currency	97
Current accounts and deposits received	3,767
Loans received (excluding arrears)	18,550
Reserve assets	**- 26,365**

Source: Russia's CB, updated March 31, 2004

According to the Russian balance of payments in 2003 the official foreign exchange reserves have increased on US$26.2 billion (in 2002 they increased by US$11.4 billion). By the start of 2004 the Russia's gold and foreign exchange reserves amounted to US$76.9 billion and would suffice for the financing of imported goods and services for more than nine months of 2003.

Moreover, there was net capital outflow from the RF private sector, though it fell from US$8.1 billion in 2002 to US$2.9 billion in 2003.

GROSS EXTERNAL DEBT

In 2003, the main developments in Russia’s finances were caused by an increasing surplus of supply over demand for foreign exchange in the foreign currency market as a result of growing exports of Russian raw materials, though demand for foreign exchange is also increasing due to rising imports of goods (up by 23.7 percent in 2003 compared to 2002) and repayment of more external debt (about US$12.55 billion due to the RF public external debt in 2003 Q1 to Q3 compared to actual repayment of this debt at US$9.44 billion in January to September 2002 or 33 percent more).

At the start of 2003 the total amount of the financial reserve in the RF federal budget was RUR209 billion (US$6.6 billion) and it increased to RUR255 billion (US$8.66 billion) by 1 January 2004. According to RF federal budget law/regulations, RUR103.5 billion from the financial reserves were directed to the stabilization fund to be used should world oil prices fall and RUR120 billion will be used for repayment of the RF’s public external and internal debt.

Debt servicing payments exerted less pressure upon the federal budget expenses in 2003 than in 2002. The overall interest payments due to the public debt reached RUR220.9 billion (US$7.2 billion) or 9.4 percent of total federal budget expenses as compared with 11.2 percent in 2002.

The RF Government fulfilled the revised plan for servicing 88.4 percent of public debt in 2003. Debt servicing payments in 2003 were planned to be RUR250.0 billion in the revised federal budget.

According to the data of the Central Bank of Russia, by the end of 2003 the gross external debt of Russia amounted to US$182.1 billion (the similar indicator for 2002 was US$153.2 billion), an increase of 18.8 percent).

The external indebtedness of Russia's private sector rose by US$27.1 billion. In particular, foreign debts of the Russia's non-financial companies increased by US$16.5 billion up to US$ 50.5 billion in 2003 (27 percent of the Russian total foreign debt), while those of Russian banks went up by US$10.6 billion to US$24.8 billion (13.6 percent of Russia's total foreign debt). In 2003 the Russia’s total public foreign debt went up by US$ 1.6 billion from US$105.2 billion to US$106.8 billion. It included the federal government liabilities at US$97.8 billion, the regional authorities' debt at US$1.2 billion and the foreign indebtedness of Russia's monetary authorities (the Central Bank of Russia’s foreign liabilities and Russia's public management sector debt to the IMF) at US$7.8 billion. By 1 January 2004 the RF public management sector was responsible for 58.8 percent of Russia's total foreign indebtedness.

Inherited ex-USSR debt made up 32 percent of the Russia's overall foreign indebtedness, 54 percent of the RF total public debt, and 59 percent of the RF Federal government’s foreign liabilities. 43.7 percent of Russia's Federal government liabilities are owed to the Paris Club of creditors.

Credits from international financial organizations to the state management sector were equal to 11.0 percent of Russia's total public foreign debt. At the end of December 2003 the mature external debt of the Russian Federation to IMF and other monetary authorities amounted to USUS$7.8 billion (US$7.5 billion at the end of December 2002)[4].

External debt with a repayment period of one year or less amounted to US$37.1 billion.

EXCHANGE RATE

In 2003, Russia continued to pursue a policy of a floating exchange rate of the ruble.

Table 6: Analytical ruble exchange rate indicators in January-December 2003

	Jan	Feb	Mar	Q1	Apr	May	Jun	Q2	1st half year	July	Aug	Sep	Q3	Jan-Sep	Oct.	Nov	Dec	Q4	Average annual exchange rate
USD/RUR																			
Official exchange rate of US dollar against ruble, end of period	31.82	31.58	31.38	31.38	31.10	30.71	30.35	30.35	30.35	30.26	30.50	30.61	30.61	30.61	29.86	29.74	29.45	29.45	30.61
EUR/RUR																			
Official exchange rate of EUR against ruble, end of period	34.44	34.04	33.59	33.59	34.14	36.47	34.71	34.71	34.71	34.63	33.20	35.08	35.08	35.08	34.87	35.50	36.82	36.82	34.79

Source: The Central Bank of Russia

Over the year the exchange rate of the ruble remained relatively stable. On the whole, the supply of foreign exchange on the market prevailed over the demand. For most of the year movements of the ruble exchange rate were characterized by growth trend.

There was a ruble revaluation against the US dollar in 2003, while the ruble devalued againstthe euro. During 2003 the official RUR/USD exchange rate fixed by the RF Central Bank went down by 7.3 percent (or from RUR31.78 per USD as on 31 December 2002 down to RUR29.45 by 31 December 2003). In 2003, the official RUR/EUR exchange rate went up by 11.2 percent (from RUR33.11 per EUR on 31 December 2002 to RUR36.82 per EUR on 31 December 2003).

The ruble’s real appreciation in comparison with the US dollar reached 13.6 percent in 2003 as a whole compared with 2002, and 9.8 percent compared to December 2002, while the ruble depreciated in real terms compared to the euro by 4.7 percent in 2003 as a whole against 2002, and by 0.5 percent compared to December 2002.

As a result, the real ruble effective exchange rate (as compared with the basket of foreign currencies used in Russia's foreign trade) rose by 0.8 percent in 2003 as against 2002, and by 2.6 percent compared to December 2002 (it had gone up in 2002 by 1.6 percent compared to 2001 as a whole but fell by 0.7 percent as against December 2001).

The real effective rate of the ruble against the currencies of Russia’s leading trading partners rose 4.1 percent year-on-year.

The continued pursuance of a floating exchange rate policy for the ruble in 2003, confirmed its efficiency in present-day conditions.

[4] http://www.cbr.ru/eng/statistics/credit_statistics/print.asp?file=debt_maturity_e.htm

MONETARY POLICY

The dynamics of the macroeconomic indicators in 2003 reaffirmed that Russia's monetary policy is adequate to the objectives of economic growth. Over 2003, gold and foreign exchange reserves increased, capital outflow was reduced, stability of the exchange rate of the ruble was ensured, and real interest rates were reduced.

The supply of money in 2003 was considerably influenced by the high surplus of Russia's foreign trade balance.

An important factor in forming the demand for money was the substantial growth of the extent of settlements monetization that was, in turn, determined by the expansion of production volumes, improvement of financial position of enterprises, and stabilization of the budgetary situation.

During 2003, the Central Bank of Russia twice (on 17 February and 21 June) took the decision to reduce the refinancing rate. Over the said period the refinancing rate fell from 21 percent to 16 percent.

Growth in the formal indicator of money supply (M2) increased in 2003 by 50.5 percent (up to RUR3 212.7 billion as on 1 January 2004).

As a result of a high positive trade balance Russia's gold and foreign exchange reserves rose considerably. The gold and foreign exchange reserves of the Central Bank of the Russian Federation reached US$76.9 billion by 1 January 2004, an increased of 1.6 times as compared with 1 January 2003 (US$47.8 billion).

Total surplus of the federal budget was estimated at 1.7 percent of GDP in 2003 as against 1.4 percent in 2002. It reached RUR228.2 billion (US$7.7 billion) by 1 January 2004 compared to RUR150.5 billion a year ago, and much more than the RUR148.3 billion stipulated by the revised plan for 2003.

The overall federal budget revenue in 2003 amounted to RUR2,583.1 billion (US$84.2 billion). Execution of the federal budget can be declared 'good', as the 2003 plan for collecting revenues was fully accomplished at 100.8 percent.

Collection of export and import duties, dues and excises, as well as VAT on imports amounted to RUR757.6 billion (US$24.7 billion) in 2003 compared to RUR590 billion (US$18.8 billion) in 2002. The share of customs payments in the federal budget's total tax revenues comprises 37.6 percent in 2003 against 35 percent in 2002.

In this period, collection of corporation income tax and customs duties and dues exceeded the average level of fulfillment of the 2003 plan for Russia's federal budget incomes.

Improving basic macroeconomic indicators proved the further financial and economic stabilization of the Russian Federation. To a certain extent, stabilization was a result of implementing the Russian authorities' anti-crisis measures aimed at economic recovery.

The monetary, credit and foreign exchange policy pursued in 2003 by the Central Bank of Russia was in accordance with the conceptual document "Basic Directions of General State Monetary and Credit Policy for 2003" announced at the end of 2002.

Thus, the RF Central Bank has continued implementing its policy of a controlled floating ruble exchange rate without fixing limits for rate fluctuations.

Priority in the RF's financial policy was given to slowing down inflation. The large amounts of foreign exchange received from sales of Russian raw materials at recent high world prices were leading to increasing rates of internal inflation. To reduce this negative effect, the rate of obligatory sales of export foreign currency earnings has been fixed at the level of 25 percent since 9 July 2003. However, lowering of the mandatory rate of sales of foreign exchange earnings received due to exports of goods and services has not, so far, brought considerable results.

In this connection the Central Bank of Russia decided in February 2003 to restrict ruble emission by cutting down its net purchase of foreign exchange. This restricts increases in the official reserves and has brought a gradual fall in the USD/RUS exchange rate.

To ensure continuous development of positive trends in Russia's economy, the Central Bank of Russia has been also trying to apply adequate instruments of monetary, credit and foreign exchange policy to eliminate sharp USD/RUS exchange rate fluctuations not caused by real economic changes.
To neutralize excessive ruble amounts held by commercial banks, Russia's Central Bank, together with the Ministry of Finance, was continued to borrow their funds by holding auctions for the sale of state short-term obligations (GKO) and federal official bonds (OFZ) in 2003. The total size of the initial sale of federal securities by the Ministry of Finance amounted to RUR135.9 billion, while the total cost of repaying these securities from the federal budget reached RUR134.6 billion. The Central Bank of Russia was also selling state securities from its own reserve, on condition they were redeemed on definite dates.

However, despite different auctions for the sale of state securities and the Central Bank’s regular operations to attract deposits, ruble amounts in the commercial banks’ RF Central Bank accounts remained at the relatively high level of RUR288.3 billion as on 31 December 2003 as against RUR110 billion on 8 January 2003. This may threaten the stability of the ruble and promote growing rates of inflation. The main reason for the high ruble amounts was weak demand from commercial banks for the ruble-denominated financial instruments issued and used by the Central Bank and the Ministry of Finance because of their low interest rates in 2003. (In December 2003 the interest rate of state securities newly sold was 8.179 percent per annum and those of two weeks’ deposits in the Central Bank was 1.5 percent per annum). The Russian financial authorities deliberately fix the rates lower than current rates of inflation to urge Russian commercial banks to direct their funds to credit enterprises in the real sector.

On the one hand, these measures seem to be insufficient to have any considerable success in the sphere of providing credit to Russia's real sector. On the other hand, the monetary and credit policy has not succeeded in sterilizing the above mentioned excessive ruble amounts to any great extent. Nevertheless it has brought about the anticipated result: inflation (12.0 percent in 2003).

Another reason for fixing reduced interest rates of state securities and other ruble instruments used by the Russian authorities is to avert any large inflow of short-term foreign capital.

In November 2003, the Central Bank of Russia passed another planning document called "Basic Directions of General State Monetary and Credit Policy for 2004". In accordance with this document the Russian Central Bank will keep implementing its policy of a controlled floating ruble exchange rate without fixing limits to its fluctuations, its priority being keeping inflation to within of 8 to 10 percent in 2004. The Central Bank will make efforts to prevent ruble real effective exchange rate appreciation (in comparison with the basket of foreign currencies) by more than 7 percent during 2004. It will be a rather difficult task, because the official forecasts show ruble real effective appreciation will be 3 to 5 percent in 2004 when the Urals oil blend average yearly price is between US$18.5 and US$22 per barrel.

FISCAL POLICY

Federal budget receipts for 2003, disregarding the single social tax, amounted to 16.7 percent of GDP.

The main factors in the growth of federal budget receipts were: growth of the economy; a favourable foreign economic situation; implementation of tax reform that allowed the expansion of the tax base with a reduction of the tax burden; reform of customs tariffs; administrative measures to increase the collection of taxes thereby increasing the average level of the collection of main tax revenues to the federal budget in 2003 by 15.5 percent (as compared with 2000). More than three fourths of the growth in the collection of taxes results from the decrease in tax rates and the improvement of tax administration.

Federal budget expenses in 2003 (without the single social tax) amounted to 15.0 percent of GDP.

Federal budget surplus amounted to 1.7 percent, primary surplus – 3.4 percent of GDP.

STRUCTURAL REFORM

Reforming Natural Monopolies

In January and February 2003, the set of Federal Acts on the reform of railway transport was accepted enabling execution of measures for the realization of the Program of Structural Reform on Railway Transport in 2003–2005 as affirmed by the government in May 2003.

In March—April 2003 a number of the Federal Acts on Reform of the Electric Power Industry were signed to realize the measures for reforming the electric power industry in 2003—2005.

In July 2003, the Federal Law "About Communication" (new edition) was accepted. The new law sets standards of direct operation providing transparency and openness of issue, annulling of licenses for activity in the field of communication, and annexation of operators of communication to a transmission network of common use and their interaction.

One of the major directions of activity was to *remove administrative barriers*. In December 2003 the Federal Law "About Modification and Supplements in the Legislative Acts of Russian Federation in a part of Perfecting of Procedures of State Registration and Settings on the Record-Keeping of the Legal Persons and Individual Businessmen" was signed. Are these two paras referring to the same legislation? Or is the second para talking about a new, different law.

Signed in October 2003, the federal law introduces a moratorium on programmed checks within the first three years of existence of a small enterprise. This law will promote the development of *small businesses*. The draft of the program of crediting small business was developed to accomplish finance and credit support by Russian banks.

Development of Corporate Legislation

On 5 July 2003, the new edition of the Federal Law "About Capital Market" came into effect. The document significantly strengthened the demand for disclosure of information and summary accounts of the lenders?. The new demands concern the volume of financial information disclosed: practically all of the information accountable quarterly is now transferred under the Federal Act, whereas it was earlier regulated by a decree of Russia's Federal Securities Commission.

One of the major aims is to develop a *financial infrastructure* and it intermediary system. In December 2003, the Federal Law "About Insurance of the Contributions of the Natural Persons in Banks of Russian Federation" was signed to ensure protection of the rights and interests of investors in banks, to strengthen confidence in the banking system, and to stimulate the level of savings by citizens in the banking system.

On 10 July 2003 the Central Bank has finalized the normative documents concerning the issue of financial credit instruments by the banks, in correspondence with the existing legislation. The new regulation of the Central Bank was essentially a strengthened demand to the commercial banks regarding disclosure of information about the issuing of shares and bonds.

In 2003 great attention was given to *development of real estate crediting*. In November 2003, the Federal Law about real estate loan instruments was signed.

Administrative Reform

In July 2003, the new decree was signed, in which the main directives, including limitations on state intervention in the economic activity of businesses were defined. Within the framework of reforming public services in May 2003 the Federal Law "About the System of Public Services in the Russian Federation" was signed, wherein the legal and organizational bases of the system of public service in the Russian Federation were defined.

MEDIUM-TERM OUTLOOK

The main priorities of economic policy for 2004 are to increase the income level of the population, work out and realize measures to support economic growth, and shape the potential of the economy's stable development.

According to the last government assessment (in April 2004), in 2004 the growth rate of GDP will amount to 6.4 percent, of industrial production 5.9 percent, of agriculture 3.0 percent, of investments in fixed capital 11.5 percent, and of inflation (in terms of the CPI) 10 percent.

ANNEX I

RUSSIAN FEDERATION: OVERALL ECONOMIC PERFORMANCE

	1998	1999	2000	2001	2002	2003
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (level in billion US$)	271.0	195.9	259.8	306.7	345.9	434.0
Real GDP	-5.3	6.4	10.0	5.0	4.3	7.3
Consumption	-1.5	-2.4	7.4	7.3	7.3	6.1
Private Consumption	- 2.4	-4.4	9.3	10.1	8.8	7.3
Government Consumption	0.6	3.0	1.4	-0.8	2.6	2.2
Investment	-28.7	8.5	31.9	16.7	-2.2	13.4
Private Investment	-29.6	9.6	36.8	19.1	0.5	12.6
Government Investment	-20.6	-1.1	-2.4	21.0	11.9	11.9
Exports of Goods and Services	1.9	9.5	9.8	2.7	9.9	25.7
Import of Goods and Services	-13.6	-9.6	20.2	19.8	14.5	21.4
Fiscal and External Balance (percent of GDP)						
Budget Balance	-5.9	-0.9	1.1	2.7	1.3	1.7
Merchandise Trade Balance	6.1	18.4	23.1	15.5	13.3	13.9
Current Account Balance	0.1	12.6	18.0	11.3	8.5	8.3
Capital and Financial Non–Reserve Assets Balance	1.6	-7.3	-8.4	-5.3	-4.0	-6.6
Economic Indicators (percent change, year over year, except as noted)						
GDP deflator	18.1	73.9	38.9	17.8	15.2	14.2
CPI	84.4	36.5	20.2	18.6	15.1	12.0
M2	19.8	57.2	62.4	40.1	32.3	50.5
Short-Term interbank rate*	41.8	39.7	24.4	17.9	15.7	3.8
Exchange Rate (Rubles/USD)	9.71	24.62	28.13	29.17	31.35	30.61
Unemployment Rate	11.9	12.9	10.5	9.0	8.8	8.1
Population (millions)	146.7	146.3	145.2	144.4	143.5	142.8

Note:
* Interbank rate is an average-weighted rate on overnight interbank credits (MIACR) in the Moscow market.

Sources: Ministry of Finance of Russia, the Central Bank of Russia, Goskomstat of Russia

ANNEX II

RUSSIA FEDERATION: FORECAST SUMMARY (percent change from previous year)

	2003			2004		
	Official	IMF	OECD	Official	IMF	OECD
Real GDP	7.3	7.6	7.3	6.4	6.0	7.0
Exports	26.7	-	-	7.9	-	-
Imports	23.7	-	-	19.1	-	-
CPI	12	12.1	12.0	10.0	10.3	-

ANNEX III

RUSSIA FEDERATION: MEDIUM-TERM FORECAST (percent)

	2004	2005	2006	2007
Real GDP	6.4	6.2	6.1	6.2
GDP Deflator	10.1	9.1	8.0	7.4

SINGAPORE

REAL GROSS DOMESTIC PRODUCT GROWTH
The Singapore economy expanded by 1.1 percent in 2003, half the pace in 2002. This was mainly due to the global economic uncertainties in the first half of 2003, as well as the impact of SARS on Singapore's tourism industry. All major sectors, except wholesale and retail trade and financial services, deteriorated from 2002.

EMPLOYMENT
After a weak first half, the labour market showed signs of turning around in the second half of 2003. For the whole of 2003, employment contracted by 12,900. Retrenchments also came in lower 16,400 in 2003, compared to 19,100 in 2002. The strong cyclical recovery towards the end of the year, coupled with the post-SARS rehiring, led to a moderation in the seasonally adjusted unemployment rate from 5.5 percent in September to 4.5 percent in December. For the whole of 2003, unemployment averaged 4.7 percent, compared to 4.4 percent in the previous year.

INFLATION
Inflation remained benign in 2003. The recovery of economic activity during the later half of 2003, both in Singapore and elsewhere, did not strain productive capacity to generate significant inflationary pressures.

The CPI rose by 0.5 percent in 2003, compared with a 0.4 percent decline a year ago. External factors provided the main impetus. More expensive imported goods, especially oil-related products, drove consumer price inflation during the year. A significant proportion of the hike in consumer prices could be attributed to higher prices for cigarettes and tuition fees paid to foreign universities. Smaller gains were recorded for the cost of food, clothing and transport and communications, which mainly reflected the 1.0 percent increase in the goods and services tax implemented at the beginning of the year.

TRADE
Singapore's total trade rose by 9.6 percent in 2003 to hit S$474 billion, following a 1.5 percent increase in 2002. The second half of the year saw a quick recovery with especially robust growth in the fourth quarter, due to improvements in the external environment and the pickup in global electronics demand.

BALANCE OF PAYMENTS
Singapore's overall balance of payments rose to S$12 billion in 2003, up significantly from S$2.3 billion in 2002. The increase in the surplus could be attributed to the larger current account surplus, which more than offset the rise in outflows from the capital and financial accounts. In line with these developments, Singapore's official foreign reserves rose by S$20 billion to reach S$163 billion as at end-2003 (or 8.8 months of current imports).

GROSS EXTERNAL DEBT
Singapore has no official foreign debt.

FISCAL POLICY
An expansionary fiscal policy stance was maintained in 2003. The Government introduced two off-budget fiscal packages to support the economy, helping households and businesses tide through the difficult period. The SARS relief package announced in April 2003 was followed by another package to accompany the Central Provident Fund (CPF) changes in September. These prompt measures helped to maintain confidence, buffer the shocks, and boost economic activity.

MONETARY POLICY

Although monetary policy was maintained at a neutral stance during the first half of 2003, the Singapore dollar nominal effective exchange rate (S$NEER) showed a marginal decline as it eased into the lower half of the policy band. In July 2003, responding to the uncertainties in the economic outlook, the Monetary Authority of Singapore (MAS) re-centred the exchange rate policy band at the level prevailing at that time. The S$NEER was allowed to follow a zero percent appreciation policy path within the new band. However, with clearer signs of more favourable growth outlook for the Singapore economy, and the risk of rising inflationary pressures in early 2004, the MAS shifted from a zero percent appreciation path to a policy of modest and gradual appreciation of the S$NEER, starting from the mid-point of the current policy band.

EXCHANGE RATE

While the S$NEER remained broadly stable in 2003, there were significant changes in the bilateral exchange rates between the Singapore dollar and currencies of its major trading partners. The Singapore dollar closed 2003 at a level 2.1 percent higher against the US dollar and Malaysian ringgit compared to levels at the end of 2002. During the year, the Singapore dollar also rose 2.7 percent against the Korean won.

The Singapore dollar weakened against most other major currencies in the year. It fell by 0.2 percent against the new Taiwan dollar, 8.0 percent against the Japanese yen, 8.1 percent against the pound sterling and 14.9 percent against the euro.

MEDIUM-TERM OUTLOOK

The economy showed clear signs of turning around in the second half of 2003. In the third and fourth quarters, GDP expanded by 1.7 percent and 4.9 percent respectively compared to the previous year. On an annualised quarter-on-quarter basis, GDP grew by 16.1 percent and 11.0 percent respectively. The recovery was reflected in increased exports, investments, and employment.

This recovery is gathering momentum. For 2004, Singaporeans and businesses alike have expressed greater optimism. Accordingly, the growth forecast for 2004 has been revised upwards to 8.0 to 9.0 percent. However, beyond the cyclical pickup in the growth rate, the foundations for achieving sustained long-term growth lie with Singapore's ability to restructure its economy. This should sustain medium term growth at 3.0 to 5.0 percent per annum.

STRUCTURAL REFORMS

Singapore's structural reform agenda is aimed at developing a globalised, diversified and entrepreneurial economy. Broadly, the key Economic Review Committee's strategic thrusts include:

a. Expanding external ties – embracing globalisation through the multilateral trading framework of the WTO, regional co-operation as well as bilateral Free Trade Agreements (FTAs).

b. Maintaining competitiveness and flexibility – keeping the burden of taxes and the Central Provident Fund on the economy as low as possible, reviewing the labour market and wage system to make them more flexible, and pricing factors of production competitively.

c. Promoting entrepreneurship and Singapore companies – encouraging people to be innovative and improving the ability of firms to develop new ideas and businesses, tap new export markets and broaden the economic base.

d. Growing manufacturing and services – upgrading these sectors by improving cost competitiveness, equipping the labour force with relevant skills, and developing new capabilities and industries.

e. Developing human capital – investing in education, helping workers train and upgrade, and welcoming global talent to augment the indigenous talent pool.

ANNEX I

SINGAPORE: OVERALL ECONOMIC PERFORMANCE

	1998	1999	2000	2001	2002	2003
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (billion US$)	81.9	82.4	92.6	86.0	88.3	91.3
Real GDP*	-0.9	6.9	9.7	-1.9	2.2	1.1
Consumption*	-1.6	8.2	15.4	3.5	2.5	-0.4
Private Consumption	-3.9	8.6	14.5	3.3	2.4	-0.5
Government Consumption	8.3	6.5	18.5	4.1	3.0	-0.2
Investment	-6.0	-4.9	8.7	-4.5	-9.9	-3.8
Private Investment	-9.2	-7.5	10.9	-7.4	-7.9	-3.3
Government Investment	8.3	4.4	1.2	5.9	-16.2	-5.6
Exports of Goods and Services	-3.8	7.9	14.7	-6.4	3.6	9.5
Fiscal and External Balance (percent of GDP)						
Merchandise Trade Balance	16.4	15.1	13.7	18.3	22.5	32.1
Current Account Balance	22.7	18.6	14.3	18.7	21.4	30.9
Capital and Financial Non-reserve Assets Balance	-21.9	-17.4	-6.4	-16.8	-15.4	-27.7
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	-2.3	-4.7	4.3	-1.6	0.4	-0.4
CPI	-0.3	0.0	1.3	1.0	-0.4	0.5
M2	9.7	8.5	-2.0	5.9	-0.3	8.1
Short-term Interest Rate (%, p.a.) 3-month interbank Offer Rate)	1.88	2.75	2.81	1.25	0.81	0.75
Unemployment Rate	3.2	3.5	3.1	3.3	4.4	4.7
Population (millions)	3.9	4.0	4.0	4.1	4.2	4.2

ANNEX II

SINGAPORE: FORECAST SUMMARY (percent change from previous year)

	2004			2005		
	Official *	**IMF**	**Asia Pacific Consensus Forecast**	**Official**	**IMF**	**Asia Pacific Consensus Forecast**
Real GDP	8-9	8.8	8.3	3.5	4.4	4.5
CPI	1.5-2	1.8	1.6	N.A.	1.6	1.7

* Based on the September 2004 forecast.
# Based on the *October 2004 Asia Pacific Consensus Forecasts* report.

CHINESE TAIPEI

REAL GROSS DOMESTIC PRODUCT GROWTH

The Chinese Taipei economy improved steadily in the early months of 2003, but the SARS outbreak caused it to dip sharply in the second quarter. With a pick-up in export growth and the successful containment of the SARS epidemic, economic growth rebounded to a positive growth rate of 4.87 percent in the latter half of 2003. However, because of the second-quarter contraction, the real GDP growth rate for the whole of 2003 slipped to 3.31 percent from 3.59 percent the previous year. Per capita GDP increased to US$13,156. Foreign demand contributed three-fourths of economic growth. The recovery was spurred by global as well as short-term and long-term domestic forces.

In the international sphere, the steady recovery of the global economy and the pepping up of information and communication industries worldwide had a significant impact on Chinese Taipei's export-led production. Merchandise exports grew 10.40 percent, with shipment of information and communication products expanding by 7.98 percent. The rise in export sales helped lift the industrial production index 5.48 percent.

In the domestic sphere, the growth rates of private consumption and investment both weakened, though the lowering of the unemployment rate and improvement in the stock market lifted business and consumer confidence. After the stock market index had dropped to just 4,044 points in April, a sustained rally took it back up to 5,891 points at the end of the year. Vigorous efforts by the Government to promote the soundness of the banking sector helped achieve a dramatic reduction in the non-performing loan (NPL) ratio of domestic banks from 8.04 percent in March 2002 to 4.33 percent in December 2003, its lowest level since 1998.

In its mid- to long-term industrial development policy, Chinese Taipei has been vigorously promoting the expansion of knowledge-intensive industries, the upgrading of traditional industries, and the adjustment of certain IT industries, with a view to achieving the optimum blend of competitive advantages in the industrial sector. The bolstering of domestic innovation and the establishment of sunrise industries has largely offset the exodus of less-competitive industries to offshore locations, enabling industrial production to grow at a sound pace and promising a fall in unemployment in the near future.

In 2003, domestic demand increased 0.40 percent, contributing 0.36 percent to the overall economic growth rate of 3.31 percent. Private consumption grew 0.69 percent and private investment declined 1.47 percent, contributing 0.42 and -0.17 percent, respectively, to overall growth. The implementation of the Program to Expand Employment in Public Service and spending on anti-SARS measures increased government consumption by 1.06 percent, for a contribution of 0.12 percent, while government investment shrank 1.92 percent, contributing -0.08 percent. Exports of goods and services climbed 10.89 percent, largely due to surging demand for electrical machinery and precision instruments. Imports grew 6.85 percent on the back of rising export-induced and domestic demand. Exports and imports translated into a 2.95 percent contribution by net foreign demand.

Both industry and services were in better shape in 2003. Industrial output rose 4.67 percent and accounted for 30.39 percent of GDP, with a surge in the manufacture of information and electronic products. Information and high-tech industries dominated the manufacturing sector, accounting for 35.8 percent of total manufacturing value added (at 1996 prices), far above the next-largest share of 8.2 percent for the chemical industry. The service sector grew 2.71 percent to generate 67.81 percent of GDP. The communications industry posted an expansion of 7.38 percent, due largely to the opening of the domestic fixed-network telecommunications market, while financial, insurance and securities services grew a robust 5.19 percent. Agricultural production increased 0.15 percent and accounted for 1.80 percent of GDP.

INFLATION

Intensifying competition in the domestic market, the effect of bumper production on fruit and vegetable prices, and the falling prices of imported consumer goods and residential rents caused Chinese Taipei's consumer price index (CPI) to fall slightly for the third year in a row, at -0.28 percent in 2003. The core CPI, excluding fresh food and energy prices, dropped by 0.61 percent, but the wholesale price index rose by 2.48 percent, owing to the rising international prices of oil, raw materials, and steel products.

EMPLOYMENT

In 2003, with the steady recovery of the global economy, employment rebounded to a growth of 1.26 percent. The unemployment rate fell back to 4.99 percent from the previous year's historic high of 5.17 percent.

The main reason for the surge in unemployment in recent years is that the labor market has lacked sufficient flexibility to keep up with changes in the industrial structure, resulting in increased structural unemployment as traditional labor-intensive industries have struggled in the harsh economic climate.

In 2003, the average monthly earnings of labor in industry increased 2.4 percent. Among the unemployed, 45.4 percent had lost their jobs due to business closures or downsizing. Most were family breadwinners in the 25 to 44 age group.

In Chinese Taipei, knowledge-based employment has been growing in line with the development of the knowledge-based economy, with its ratio of total employment rising from 28.9 percent in 2002 to 29.5 percent in 2003. Between 1992 and 1997, such employment increased at an average annual rate of 4.4 percent. Although it slowed to 2.7 percent between 1998 and 2003, that was still above the economy-wide average.

EXTERNAL TRADE ACCOUNT [BALANCE OF PAYMENTS]

Chinese Taipei's merchandise exports and imports both registered double-digit growth rates in 2003. The value of merchandise exports grew by 10.5 percent to US$143.5 billion, mainly driven by steady growth in the global economy and the vigorous rebound in the information and communication technology (ICT) industry worldwide. The value of merchandise imports rose by 12.2 percent to US$118.6 billion, primarily led by stronger derived demand arising from the expansion in exports and the gradual recovery in domestic demand, while also being pushed upward by surging international commodity prices. The balance of trade for the year showed a surplus of US$24.9 billion in Chinese Taipei's favor, its highest such surplus on record.

In 2003, Chinese Taipei's services-trade deficit widened slightly to US$3.2 billion from the previous year's US$3.1 billion. Much of this gap resulted from the sharp decrease in travel receipts caused by the SARS outbreak. Even so, services exports increased by 6.8 percent over the year to US$23.1 billion, due to an increase in receipts from merchanting and other trade-related services. Trade-related services have become the key component of services exports since 1997 as global logistics activities undertaken by domestic industries have gained increasing importance. Services imports increased by 6.4 percent to US$26.3 billion, due to increased transportation services expenditures, and insurance and financial expenditures.

The current account balance reached a surplus of US$28.6 billion in 2003, which was equivalent to 10.0 percent of GDP.

A huge inflow of US$6.3 billion was recorded on the financial account, following two previous years of inflows, mainly owing to increased liabilities in the banking and private sectors. Direct overseas investment by residents rose by 16.2 percent from US$4.9 billion in 2002 to US$5.7 billion in 2003. Direct investment in Chinese Taipei by non-residents posted a net inflow of US$0.5 billion, a sharp reduction of 68.7 percent from the previous year. Portfolio investment exhibited a net outflow of US$5.3 billion in 2003. This net outflow was mainly attributable to the increase in the investment of insurance companies in foreign securities with the aim of improving earnings. Other investment exhibited a net inflow of US$16.8 billion in 2003. This increase can be mainly attributed to the inflow of funds from overseas branches to local banks in expectation of the NT dollar's appreciation against the US dollar, together with increased borrowings from abroad by the local nonbank private sector.

The overall balance of payments posted a surplus of US$37.1 billion in 2003, due to a sizable current account surplus and a huge financial account inflow.

GROSS EXTERNAL DEBT

External debt covers both public and private debt, broken down into long-term and short-term debt. Total external debt substantially increased by 40.0 percent from US$45.0 billion in 2002 to US$63.0 billion in 2003. Most of the increase was in private debt, and was mainly attributable to an increase in euro-convertible bonds (ECBs) issued by local firms to raise funds from the international market. External public debt has remained consistently low since 1998, with less than US$200 million outstanding at the end of 2003. Long-term and short-term external private debt grew by 39.2 percent and 40.3 percent, respectively, in 2003.

EXCHANGE RATE

From January to mid-April of 2003, alternating bullish and bearish influences, such as the US-Iraq war, the weakening of the US dollar, and inflows of foreign funds to the Chinese Taipei stock market, resulted in the NT$/US$ exchange rate fluctuating between 34.4 and 34.8. In late April, due to the outbreak of the SARS epidemic in Chinese Taipei coupled with a weak Japanese yen, the NT dollar declined to 34.944 against the US dollar on 25 April, the lowest level of the year. However, the NT dollar started to appreciate in May as market participants suspected the US government's departure from the "strong US dollar policy". Inward remittance of foreign funds and the Japanese yen's strengthening from 120 to 110 against the US dollar between August and October pushed the NT dollar up further until it reached 33.71 on 13 October, the highest level of the year. From mid-October onwards, the NT$/US$ exchange rate became relatively stable and fluctuated around the 34 mark. At the end of 2003, the NT dollar closed at 33.978 against the US dollar. Compared with the rate of 34.753 registered at the end of 2002, the NT dollar appreciated slightly, by 2.28 percent, in 2003.

FISCAL POLICY

In recent years, the sluggishness of the economy and various tax-cutting measures have squeezed government revenue, and the growth of social expenditure and massive funding required for reconstruction after the devastating earthquake of 21 September 1999 have greatly increased the burden of government expenditure, resulting in a substantial widening of the fiscal deficit. In 2003, the ratio of the public deficit to annual expenditure stood at 20.2 percent, or 3.6 percent of GDP. And with the government depending increasingly on raising public debt to cover expenditure, outstanding debt climbed to 31.2 percent of GDP. To improve this situation, the Government has been actively seeking out means to augment its sources of revenue while scaling back on expenditures. Toward this end, in September 2001 the government set up a Fiscal Reform Committee, which presented recommendations that were incorporated into a Fiscal Reform Plan launched by the Government on 22 April 2003. All government authorities are required to take appropriate measures to put the plan into effect with the aim of achieving a balanced budget within five to ten years.

MONETARY POLICY

With inflationary pressures subdued, Chinese Taipei's Central Bank has maintained an accommodative monetary stance to shore up domestic demand. In late June 2003, the Central Bank lowered the discount rate from 1.625 percent to 1.375 percent, the fifteenth consecutive rate cut since December 2000. As a result, market interest rates have remained low.

To strengthen the effect of interest rate cuts and to enhance the transparency of the banks' pricing process, the Central Bank has urged banks to promote adjustable rate mortgages (ARMs) and the base rate system. At the end of 2003, 43 domestic banks had adopted ARMs and 47 domestic banks had changed their pricing policies to the base rate system. These institutional changes are aimed at making banks' lending rates more flexible, thereby lowering the cost of funds for the general public.

Owing to the robust economic recovery and huge foreign capital inflows in the second half of 2003, the broad monetary aggregates, M2 and M2 plus bond funds, expanded at year-on-year rates of 3.77 percent and 5.25 percent, respectively, in 2003, both within their target ranges.

Under the guidance of Chinese Taipei's Central Bank, its central clearing house launched Asia's first e-check system in September 2003 to enhance the efficiency of the payment system and to facilitate payment flows arising from e-commerce. Moreover, the Central Bank presided over the reopening of government bond issues, aimed at increasing liquidity and building a complete yield curve on benchmark government debt issues.

MEDIUM-TERM OUTLOOK

The global economic recovery and trade expansion are expected to remain strong enough to sustain the gathering momentum of Chinese Taipei's export growth in 2004. On the home front, the launch of the *Ten New Major Construction Projects* to complement and speed up the implementation of the *Challenge 2008* six-year national development plan, should deliver a powerful stimulus effect. As the upswing in domestic and foreign demand gains strength, Chinese Taipei's GDP growth rate is projected to rise to 5.87 percent in 2004, accompanied by continued price stability.

Driven by the expansion of global trade, Chinese Taipei's foreign trade is expected to increase substantially in 2004. Merchandise exports and imports are forecast to grow 21.31 percent and 29.37 percent respectively, generating a trade surplus of US$10.3 billion. Trade in goods and services is projected to register real growth of 17.05 percent in exports and 20.13 percent in imports.

The positive wealth effect from the warming-up of the stock and real-estate markets, together with the lowering of the unemployment rate, will give a boost to business and consumer confidence, and is likely to result in a strong rebound in consumer spending in the near future. Therefore, private consumption is projected to show a real growth rate of 2.70 percent for the year.

Chinese Taipei is doing its utmost to improve its domestic investment environment for both local and foreign investors. Rising investor confidence, combined with a wave of expansion in the opto-electronic and semiconductor industries and the implementation of large-scale projects such as the high-speed railway and the sixth naphtha-cracker plant, will push up private investment sharply. As a result, the real growth rate of private investment is projected to reach 24.02 percent for the year.

With the implementation of public service job-creation programs, government consumption will expand by 0.17 percent. Due to delays of the public works, government investment will reduce 2.19 percent. Fixed investment by public enterprises will decrease 9.64 percent as major privatizations slow down the speed of investment expansion.

Under the impact of the rising trend in international crude-oil and raw-material prices, the growth rate of Chinese Taipei's wholesale price index is projected to climb to 6.99 percent in 2004. However, domestic market opening and tariff reduction as part of Chinese Taipei's WTO commitments will underpin the stability of consumer prices, which are forecast to show a yearly increase of 1.49 percent.

STRUCTURAL REFORMS

To prepare Chinese Taipei to meet the needs of economic development in the new century, in 2002 the Government unveiled the *Challenge 2008* six-year national development plan. To speed the implementation of *Challenge 2008*, in 2003 the government designated key related projects as the

Ten New Major Construction Projects. These projects are designed to enhance Chinese Taipei's competitive strength, maintain its number-one competitiveness ranking in Asia, and make Chinese Taipei one of the world's three strongest economies.

As part of its efforts to reform and strengthen its banking system, Chinese Taipei has introduced asset management companies and the Financial Restructuring Fund to help banks and financial institutions sell assets held as collateral for bad loans and clear non-performing loans from their books. As a result, the average NPL ratio has declined sharply from its peak of 8.04 percent in March 2002 to 4.33 percent in December 2003.

Moreover, the soundness of Chinese Taipei's financial system will be enhanced by the Agricultural Finance Act and the Financial Supervision Agency Act, which were passed into law in 2003. The former will help improve the operations of community financial institutions while the latter will establish a new agency to bring the supervision of banks, securities and futures houses, and insurance companies under one roof, starting on 1 July 2004. Nevertheless, the Central Bank will retain the power to carry out targeted examinations to monitor activities that may hamper the effectiveness of monetary policy or jeopardize financial stability.

Meanwhile, Chinese Taipei has continued to relax controls on capital movement and enlarge the scope of portfolio investment for foreign investors. In October 2003, it took the significant step of formally scrapping its qualified foreign institutional investor (QFII) system, abandoning restrictions that had governed overseas participation in the stock marked for more than a decade and replacing them with a much simpler registration system.

ANNEX I

CHINESE TAIPEI: OVERALL ECONOMIC PERFORMANCE

	1998	**1999**	**2000**	**2001**	**2002**	**2003**
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GNP (billion US$)	269.2	290.5	313.9	286.8	289.3	295.9
Real GDP*	4.57	5.42	5.86	-2.18	3.59	3.31
Consumption*	6.06	3.13	4.18	0.70	1.63	0.75
Private Consumption	6.52	5.37	4.93	1.04	1.99	0.69
Government Consumption	4.12	-6.49	0.55	-1.02	-0.20	1.06
Investment	8.01	1.78	8.61	-20.61	-2.13	-2.01
Private Investment	11.80	-0.68	15.74	-29.17	2.50	-1.47
Government Investment	0.09	3.64	-4.66	-4.77	-13.14	-1.92
Exports of Goods and Services	2.41	11.9	17.55	-7.77	9.98	10.89
Imports of Goods and Services	6.34	4.41	14.53	-13.87	5.84	6.85
Fiscal and External Balance (percent of GDP)						
Budget Balance of General Government	0.7	-0.5	-2.4	-3.9	-3.6	-3.5
Merchandise Trade Balance (BOP basis)	3.86	5.11	4.40	7.06	8.58	8.71
Current Account Balance	1.29	2.78	2.86	6.36	9.09	9.98
Capital and Financial Non-reserve Assets Balance	0.87	3.14	-2.68	0.06	3.05	2.17
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	2.64	-1.42	-1.73	0.57	-1.01	-2.13
CPI	1.69	0.17	1.26	-0.01	-0.20	-0.28
M2	8.76	8.33	7.04	5.79	3.55	3.77
Short-term Interest Rate (%)**	6.56	4.77	4.73	3.69	2.03	1.04
Real Effective Exchange Rate (level, 1994=100)	92.43	87.95	90.94	86.70	85.80	82.56
Unemployment Rate (%)	2.69	2.92	2.99	4.57	5.17	4.99
Population (millions)	21.78	21.95	22.13	22.28	22.39	22.49

**: O/N Call-Loan Rate

ANNEX II

CHINESE TAIPEI: FORECAST SUMMARY (percentage change from previous year)

	2003						2004					
	Official	**IMF**	**ADB**	**OECD**	**PECC**	**Link**	**Official**	**IMF**	**ADB**	**OECD**	**PECC**	**Link**
Real GDP	5.87	4.9	N.A.	N.A.	N.A.	4.7	4.49	4.9	N.A.	N.A.	N.A.	4.6
Exports	17.05	N.A.	N.A.	N.A.	N.A.	N.A.	5.88	N.A.	N.A.	N.A.	N.A.	N.A.
Imports	20.13	N.A.	N.A.	N.A.	N.A.	N.A.	4.35	N.A.	N.A.	N.A.	N.A.	N.A.
CPI	1.49	N.A.	N.A.	N.A.	N.A.	N.A.	1.58	N.A.	N.A.	N.A.	N.A.	N.A.

ANNEX III

CHINESE TAIPEI: MEDIUM-TERM TREND FORECAST (percent)

	Period
Real GDP	N.A.
GDP Deflator	N.A.

THAILAND

ECONOMIC OUTLOOK IN 2004

In 2004, the Thai economy is expected to grow by 7.1 percent. The continued expansion in private consumption and investment remains the key economic driver. In addition, the 2004 GDP growth will benefit from the improved economies of Thailand's major trading partners, the supplementary budget of Bt135.5 billion and further expansion of domestic credits. However, the growth will be dampened by the negative impact of the avian influenza, a rise in the world oil price, the Chinese economy's soft landing and an increase in the US interest rate.

REAL GROSS DOMESTIC PRODUCT

In 2003, The Thai economy continued to expand well despite the negative effect of the severe acute respiratory syndrome (SARS) epidemic. GDP growth in 2003 reached 6.7 percent, marked one of the best economic performances in Asia. The main economic drivers included strong domestic demand, both private consumption and investment, as well as robust export growth.

The Thai economy in 2004 is expected to continue with its strong growth momentum. Following the Finance Ministry's projection in May 2004, the Thai economy is projected to grow by 7.1 percent from well-balanced sources of growth in private consumption, private investment, and net exports.

Private consumption is projected to grow by 6.7 percent in 2004. The robust growth is supported by the continued low interest rate and low inflation, an increase in both farm and non-farm incomes, as well as the indirect effect of the supplementary budget.

Private investment in 2004 is projected to increase favorably. Particularly, investment in machinery and equipment is anticipated to pick up strongly as a result of replacement and new investment in manufacturing sectors. Thus, private investment is expected to grow at a rate of 23.1 percent in 2004, compared to 17.9 percent in 2003. The factors contributing to this expansion are low interest rates and a continued rise in the capacity utilization rate, especially in the automobile, petrochemical and electronics industries. Moreover, state-owned enterprises' investment is expected to increase.

Real public consumption and investment in 2004 are expected to rebound, with growth rates of 12.9 percent and 10.3 percent respectively, compared to 1.2 percent and -2.3 percent in 2003. As strong revenue performance has continued in FY2004, it has enabled the government to introduce the mid-year supplementary budget of Bt135.5 billion in order to sustain the strong growth momentum.

On the external front, international trade is expected to increase in line with world trade expansion. Exports in 2004 are projected to reach US$89.9 billion, an increase of 15.3 percent, following the improvement in trading partners' economies and an increase in export prices. The growth in the volume of goods and services exports is, however, expected to slow down to 4.2 percent in 2004, compared with 6.5 percent in 2003.

Imports are expected to record US$90.0 billion, up 21.8 percent, following strong expansion of domestic consumption and investment. The import volume of goods and services in 2004 is expected to increase at the rate of 9.9 percent (compared with 7.3 percent in 2003) due mainly to high demand in private consumption and private investment.

INFLATION
Headline inflation in 2004 is projected to be 3.1 percent, up from 2.0 percent in 2003, due mainly to a rise in oil prices. On the other hand, core inflation is expected to remain subdued at 1.4 percent.

EMPLOYMENT
In 2003, the number of persons employed increased by 2.5 percent, reflecting the strong economic growth. Consequently, the unemployment rate dropped to 1.5 percent in 2003. As the Thai economy continues to grow in 2004, the unemployment rate is expected to remain at this low level.

EXTERNAL TRADE ACCOUNT
Although the avian influenza slightly dampened Thai export performance in the first quarter of 2004, for the whole year the value of exports of goods and services is expected to grow robustly by 15.3 percent to US$ 89.9 billion, owing to the trading partners' improved economies. At the same time, the value of import of goods and services in 2004 is projected to increase strongly by 21.8 percent to US$ 90.0 billion. Major supporting factors included a continued appreciation of the baht as well as increasing imports after the subsequent high level of economic expansion.

Following import growth that was stronger than export growth, the trade balance in 2004 is forecast to register a slight deficit of US$0.1 billion. Nevertheless, the current account balance is expected to show a surplus of US$5.3 billion, or 3.1 percent of GDP. International reserves are projected to remain at the high level of US$42.4 billion (or 5.7 months of imports and 4.6 times short-term external debt).

GROSS EXTERNAL DEBT
As of February 2004, external debt registered US$51.1 billion, down from the peak of US$102.2 billion in 1999. The drastic decline mainly resulted from the acceleration in private external repayments. The external debt comprised US$16.7 billion of public external debt and US$34.5 billion of private external debt, which US$10.8 billion were short-term external debt and US$40.3 billion were long-term external debt. The short term external debt was equivalent to four times the international reserves, representing a well-maintained external stability.

EXCHANGE RATE
The baht is expected to continue with its appreciation trend. The baht appreciated from 39.71 baht per US dollar at the end of 2003 to 39.44 baht per US dollar at the end of April 2004. In 2004, the baht is projected to be around 39.80 baht per US dollar.

MONETARY SECTOR DEVELOPMENT
In the first quarter of 2004, the monetary base rose by 8.0 percent, down from 10.6 percent in 2003. Meanwhile, broad money (M2a) was up by 7.1 percent, owing to an increase in commercial bank deposits of 4.9 percent. Commercial bank credits, adding back debt write-offs and net transfers to AMCs but excluding commercial bank credits to AMCs, rose by 6.2 percent following the improved economic condition, up from 4.8 percent in 2003.

The interest rate remains low, following the excess liquidity of the commercial banks together with the low interest rate environment in the world economy. The 14-day repurchase rate, the policy rate, has been kept at 1.25 percent since June 2003. As of May 2004, the 1-year fixed deposit rates were at 1 percent, while the minimum lending rate (MLR) was in the range of 5.5 to 5.75 percent.

FINANCIAL AND CORPORATE RESTRUCTURING

The non-performing loans (NPLs) resolution has been expedited. Outstanding NPLs of all financial institutions was down from Bt770.3 billion or 15.65 percent of outstanding loan at end-2002 to Bt617.6 billion or 12.1 percent of outstanding loan in the first quarter of 2004. Meanwhile, the Thai Asset Management Corporation (TAMC) has also relieved some of the debt burden. The TAMC has already resolved NPLs of Bt732 billion in book value or almost 94 percent of total NPLs transferred from financial institutions as of December 2003.

The Bank of Thailand (BOT) also sets a goal to reduce NPLs to less than 5 percent of outstanding loan by 2006. To do so, first, the BOT proposes to amend the Asset Management Corporation law so that the entity can purchase distressed assets and real property pledged as loan collateral from banks and financial companies. Secondly, the BOT is currently revising the guidelines on loan loss provisions to punish financial institutions that make no progress in resolving NPLs.

CAPITAL MARKET DEVELOPMENTS

Despite strong economic fundamentals, the southern violence together with external risk factors dragged the index down to around 650 points in the first four months of 2004, from its peak of around 790 points at end-2003. The market, however, still exhibits a strong performance by its listed companies. In particular, the net profit of listed companies was up 42 percent in the first quarter of 2004.

FISCAL POLICY

FY2003 marked the first year after the crisis that Thailand registered a budget surplus and a public sector surplus on a GFS basis, largely due to buoyant revenue and lower-than-targeted budget disbursement. The budget surplus and public sector surplus were at 0.4 percent and 0.8 percent of GDP respectively. Strong revenue performance has continued in FY2004. Revenue collection for the first six months of FY2004 (Oct 03–March 04) surged by 15.7 percent to Bt504,419 million. Over-performance of revenues has led the government to introduce the mid-year supplementary budget of Bt135.5 billion. The overall budget balance is expected to be in a slight deficit in FY2004. The government has realized the importance of fiscal sustainability, therefore for FY2005 the Cabinet has passed a balanced budget of Bt1.2 trillion as publicly committed by the fiscal sustainability framework. The government is also committed to keep public debt to GDP ratio below 55 percent while debt service in the budget would not be higher than 16 percent. As of January 2004, public debts amounted to Bt2,897 million or 44.73 percent of GDP.

MONETARY POLICY

In 2003, as inflation remained low, there was no negative effect to further easing monetary policy to safeguard against uncertainties in economic conditions and support the growth process. Also, a wider differential between domestic and foreign interest rates can cause the volatility in short-term capital movements that may exert an adverse effect to the economic recovery. The Bank of Thailand, therefore, decided to lower the 14-day repurchase rate by 0.50 percent per annum from the level of 1.75 percent per annum to 1.25 percent per annum, effective on June 27, 2003. As of May 2004, the policy rate remains at 1.25 percent per annum as inflation remains within in the target range.

MEDIUM TERM ECONOMIC OUTLOOK

In the medium term (2005–2008), the government has set its macroeconomic framework, including an economy growth rate of 6 to 7 percent, with the inflation rate of around 3 percent.

Economic growth in 2004 to 2006 is expected to be supported by strong domestic and external demand. Private investment should pick up more firmly once problems in financial sectors are resolved. In 2004, the United Nations Conference on trade and Development (UNCTAD) ranked Thailand the fourth most attractive place for investment in the world, a ranking which should also enhance the investors' confidence. One crucial factor supporting growth will be an improving productivity, which will enhance the economy’s competitiveness and increase investment efficiency. Meanwhile, private consumption is expected to expand in line with improved incomes and better consumer confidence in economic prospect. Inflation is expected to be low around 3 percent in 2004–2006. As the economy is projected to grow at faster rate, the current account surplus is expected to be smaller, mainly due to a greater demand for imported capital goods.

Medium-Term Trend

	2000	2001	2002	2003	2004	2005-2008
Real GDP growth (%)	4.6	1.9	5.4	6.7	7.1	6.0–7.0
- Private investment (%)	16.8	4.9	13.2	17.9	23.1	19.1–20.0
- Export value (% $US)	19.5	-6.9	5.7	16.7	15.3	4.4–7.8
Gross Domestic Product						
- Billion Baht	4,916.5	5,123.4	5,430.5	5,939.1	6,814.0	7,322–9,719
- Billion $US	122.4	115.2	126.3	131.9	171.6	186.3–247.3
Current account (% to GDP)	7.6	5.4	6.0	5.6	3.1	-0.6–2.5
Per capita income						
- Baht per year	78,891.2	81,407	86,969	95,151	108,257	115,992–152,582
- US$ per year	1,964.3	1,829.4	2,022	2,290.0	2,729	2,955–3,887
Inflation (%)	1.5	1.6	0.7	1.8	3.1	3.0

Source: National Economic and Social Development Board (NESDB)
: Ministry of Finance

STRUCTURAL REFORMS

A. Financial Sector

The Financial Sector Master Plan was approved by the Cabinet in January 2004. The Plan aims to improve efficiency, stability and competition within the financial institutions system, and to broaden accessibility to financial services for all potential users. Therefore, there will be two types of Thai financial institutions:

1. Commercial banks will offer a full range of financial services to all groups of customers, except insurance underwriting and brokering, trading and underwriting of equity securities.

2. Retail banks will provide financial services for SMEs and low-income customers, subject to a lending limit per customer. Retail banks may provide virtually all types of financial transactions with the same exceptions as commercial banks, and are not permitted to conduct business related to foreign exchange and derivatives products.

In the initial phase of implementation, only currently-operating and qualified finance companies and credit fonciers are able to apply for commercial banking or retail banking licenses. These institutions must pass all the criteria of strength measurement both in quality (e.g. behavior and role of committees and executives, risk management, as well as internal audit and control) and quantity terms (comprising various financial ratios such as capital to risk weighted assets, non-performing assets to total assets, and reserves for doubtful assets which may be worthless or irrecoverable). Capital requirements and further conditions for each license are as follows:

- Commercial banks with branch permits: Tier-1 capital must be maintained at the minimum of Bt5 billion, and the applicant must be the core institution for any merger with, or acquisition of, other financial institutions.

- Commercial banks without branch permits: Must comply with minimum capital requirement of Tier-1 capital (to be determined).

- Retail banks: Tier-1 capital must be maintained at the minimum of Bt250 million. They are allowed to open branches with no limit on the number or location.

The aforementioned measures for restructuring the financial landscape will extend the scope of business for commercial banks, as well as remove regulatory distinction in the scope of business amongst different types of deposit-taking institutions. It thereby renders the very reason for each financial conglomerate to be comprised of more than one deposit-taking institution futile. Indeed, to reap full benefits from economies of scale and elimination of duplicate functions, each financial conglomerate is encouraged to have only one deposit-taking institution within its group (one presence).

On top of the retail banking license to be granted to improve financial services to SMEs and retail customers, an appropriate agency will be designated to assume a developmental role and provide support for community financial organizations. Further increases in accessibility of financial services to the public particularly at the grass-root level will result accordingly. The committee for Grass-Root Financial Services, chaired by the Finance Minister, will determine the final details.

Adjustments to rules and regulations in order to strengthen the efficiency of the Thai financial institutions system include changes to develop the framework for consolidated supervision, encourage the development of risk management capability, and relax lending-related rules imposed upon financial institutions, as well as promote efficient market mechanism and alternatives financial-service provisions to customers.

Consumer protection, both in terms of information disclosure and complaint-handling procedures, will be encouraged. However, the effectiveness of such protection will be greatly increased if the new Financial Institutions Business Act is enacted and competition within the financial institutions systems increases as a result of the restructuring of financial institutions.

Regarding the implementation of the Plan, the MOF will in due course issue the notification detailing terms and conditions, as well as procedures, for the application for a new bank license. Financial institutions wishing to apply for an upgrade must submit their application within six months of the date of the notification. Any financial conglomerates comprising with than one type of deposit-taking institution within the same group, on the other hand, must submit a plan to comply with the one-presence policy to BOT. The implementation process with regards to the restructuring of financial institutions will be achieved within two years, although it is anticipated most of it will be completed within one year.

B. Asset Capitalization

While the poor do have assets, there are currently limited operational channels for the poor to access capital. Creating access to capital can unleash their productive capacity, thereby helping them escape the poverty trap. The objectives and the mandate of assets capitalization can be defined in four broader areas: to formalize and legitimize various types of asset as a step towards creating access to the capital markets; to create value from the registered assets; to develop a database that will be instrumental in ensuring a transparent framework for transactions; and to make the necessary preparations for long-term measures for assets capitalization. It is important to note that the policy intent of the capital creation initiative is to help the capital-deficient, underprivileged groups to create legally pledgible assets which in turn, can be used to fund existing or new business ventures. The government launched this program in 2003, and the program is expected to continue in 2004.

C. Public Sector Reform

Public sector reform, commended in October 2002 with the promulgation of the Ministerial Restructuring Act and the Public Administration Act, was introduced to improve the working environment and procedures in the public sector. It can be broadly divided into public administration reform and public financial management reform.

Public administration reform aims to achieve the greatest effectiveness in policymaking. Reorganization of ministries and agencies, therefore, was launched in 2002, to streamline the role and task of each agency. Moreover, to reduce bureaucratic processes and decentralize functions and resources, the government proposed with the CEO Governor Program in 2003. The CEO

Governor is given more decision making power within the province and in turn is accountable for his/her actions. This holistic management style allows provinces to be run more efficiently and strategically.

On the public financial management side, budget procedure has been improved from the traditional line-item budgeting to performance-based and forward looking budgeting. Public debt management law, aiming to give more flexibility in public debt management, is in the pipeline. Moreover, development of accounting and procurement systems is ongoing.

D. Privatization and SOE Development

The Ministry of Finance has prepared a plan in accordance with the cabinet resolution on 29 November 2003 regarding state enterprises. State Enterprise Policy Office (SEPO) will determine the proper management policy for state enterprises and has classified them into four groups:

1. Profitable state enterprises
2. Net losses state enterprises
3. Loss-making state enterprises
4. Remained as State-owned enterprises

Moreover, at the beginning of 2004, the SEPO announced a plan for the corporatization of state enterprises into public companies with registration in the Stock Exchange of Thailand.

ANNEX I

THAILAND: OVERALL ECONOMIC PERFORMANCE

	1997	1998	1999	2000	2001	2002	2003	2004f
GDP and Major Components (percent change, year over year, except as noted)								
Nominal GDP (level in billion US$)	150.8	111.8	122.5	122.4	115.2	126.3	143.9	171.6
Real GDP	-1.3	-10.5	4.4	4.6	1.9	5.3	6.7	7.1
Consumption								
Private Consumption	-1.4	-11.5	4.3	4.9	3.7	4.7	6.3	6.7
Government Consumption	-2.8	3.9	3.1	2.6	2.9	0.5	1.2	12.9
Investment								
Private Investment	-30.4	-52.3	-3.3	16.8	4.7	13.3	17.9	23.1
Government Investment	10.2	-28.7	-3.1	-9.7	-5.5	-6.8	-2.3	10.3
Exports of Goods and Services	7.2	8.2	9	17.5	-4.1	10.9	6.5	4.2
Imports of Goods and Services	-11.3	-21.6	10.5	27.3	-5.5	11.3	7.3	9.9
Fiscal and External Balance (percent of GDP)								
Budget Balance (Cash basis)	-1.3	-2.5	-2.8	-2.3	-2.6	-2.9	-0.7	0.0
Merchandise Trade Balance (Billion US$)	-4.6	12.2	9.3	5.5	2.5	3.5	4.2	-0.1
Current Account Balance	-3.1	14.4	12.4	9.3	6.2	6.1	5.6	3.1
Economic Indicators (percent change, year over year, except as noted)								
GDP Deflator	4.3	9.2	-4.0	1.3	2.2	0.8	2.1	3.7
CPI	5.6	8.1	0.3	1.5	1.6	0.6	1.8	3.1
M2	4.3	4.7	4.8	5	5.2	5.3	4.9	n.a.
Interbank Overnight Lending Rate (averaged, % pa)	15.69	13.02	1.77	1.95	2.00	1.76	1.31	n.a.
Exchange Rate (Baht/US$)	31.37	41.37	37.84	40.16	44.48	43.00	41.53	39.7
Unemployment Rate (percent)	2.2	4.4	4.2	3.6	3.3	2.4	2.2	n.a.
Population (millions)	60.35	61.17	61.78	62.40	62.94	63.46	64.01	n.a.

ANNEX II

THAILAND: FORECAST SUMMARY (Percent Change From Previous Year)

	2003	2004					
	Official	Official	IMF	ADB	OECD	PECC	Link
Real GDP growth (%)	6.7	7.1	7.0	7.2	N.A.	N.A.	N.A.
Export (% US$)	16.9	15.3	N.A.	14.0	N.A.	N.A.	N.A.
Import (% US$)	16.7	21.8	N.A.	17.8	N.A.	N.A.	N.A.
CPI	1.8	3.1	2.2	2.4	N.A.	N.A.	N.A.

ANNEX III

THAILAND: MEDIUM-TERM TREND FORECAST

	2003	2004f	2005–2008f
Real GDP growth (%)	6.7	7.1	6.0-7.0
GDP Deflator (%)	2.1	3.7	3.0

UNITED STATES

CURRENT CONDITIONS AND THE ECONOMIC PROJECTIONS FOR THE UNITED STATES (PREPARED FOR THE MID-SESSION REVIEW OF THE BUDGET AND UPDATED FOR THE US PRESENTATION TO APEC).

The growth-enhancing policies pursued by the Administration and the Federal Reserve during the past three years are now paying off handsomely. The expansion is strong, industrial production is rising, employment is increasing, after-tax incomes are growing, and Federal receipts are returning to normal levels.

Forward-looking indicators suggest that these trends will continue, although the growth rate will, as always, vary from quarter to quarter. Absent any significant unexpected events, the coming years are likely to be characterized by solid growth, expanding job opportunities, increasing wages, and relatively low inflation and interest rates. The Administration’s strong economic forecast is shared by the consensus of private sector forecasters.

A year ago, most forecasters, including the Administration, anticipated that the economy was about to strengthen noticeably in response to the expansionary fiscal and monetary policies then in place. That prediction has proven to be correct: over the past four quarters, the economy has grown at one of the fastest paces in the past two decades. Recent GDP revisions showed brisk growth in the first quarter and solid growth in the second.

Robust growth has meant more jobs for American workers. Since last August, the economy’s payrolls have increased by 1.7 million new jobs. The unemployment rate has fallen from 6.3 percent in June 2003 to 5.4 percent in August 2004. That level is lower than the decade averages for the 1970s, 1980s, and 1990s. Almost all major demographic groups and 45 states have seen a decline in their unemployment rate during the past year.

Since the Administration took office, fiscal and monetary policies have focused primarily on overcoming the powerful forces that brought growth to a near standstill in the second half of 2000, pulled the economy into recession in 2001, and then impeded the recovery that began in November of that year. These forces included: the sharp fall in the stock market that began in August 2000; the decline in business fixed investment beginning in early 2001; the terrorist attacks of September 11th; the ensuing “War on Terror” and concerns about further attacks; the slow growth, and even recession, in many industrialized economies that curtailed US exports; and the revelation of corporate accounting scandals, years in the making, that depressed the stock market. Thanks to the policies that were put in place and the inherent resilience of US workers and businesses, the economy has overcome these obstacles and is again on a solid expansionary path.

At this juncture, fiscal policy can shift from providing short-term demand stimulus to promoting long-term economic growth by fostering work, saving, and investment. To achieve these goals, and as part of the President’s Six-Point Plan for Economic Growth, the FY2005 Budget proposed making permanent many of the recently enacted tax relief provisions.

The monetary policy stance is also changing as the economy improves. The Federal Reserve decided in its last three meetings to raise the target Federal funds rate by 0.25 percent each, for a cumulative gain of 0.75 percent. The target Federal Funds rate now stands at 1.75 percent, reflecting the belief that the economy has made the transition from recovery to self-sustaining growth.

POLICY ACTIONS

Fiscal Policy: In each of the past three years, the Administration proposed, and Congress enacted, significant tax relief measures designed to overcome the obstacles to job growth and push the economy onto a positive, self-sustaining trajectory.

- In June 2001, the President signed the Economic Growth and Tax Relief and Reconciliation Act. It lowered marginal income tax rates; reduced the marriage tax penalty; and created a new, lower, 10 percent tax bracket, among other changes. The demand-side stimulus in this bill came just in time to help the economy resist the recessionary forces at work as well as to help offset the negative impacts from the September 11th attacks. By the fourth quarter of 2001, the economy was growing again, but at a pace that was not sufficient to restore job growth.

- In March 2002, the President signed the Job Creation and Worker Assistance Act to reverse the weakness in business capital spending and to aid the unemployed. For businesses, among other changes, the Act permitted a bonus depreciation of 30 percent of the value of qualified new capital assets put in place during the three years ended September 11, 2004, which lowered the cost of capital by allowing firms to write-off for tax purposes more of the cost sooner than normally allowed. For workers, the Act provided additional unemployment benefits to those who exhausted their normal unemployment insurance benefits.

- In May 2003, the President signed another extension of unemployment insurance benefits and the Jobs and Growth Tax Relief and Reconciliation Act. The Act provided significant additional stimulus to consumer and business spending. For households, it lowered income tax rates, raised the child tax credit, reduced the marriage penalty, and raised the exemption amount for the individual Alternative Minimum Tax. In addition, the Act reduced individual income tax rates on dividend income and capital gains, thereby improving business investment incentives by reducing the distortions in the tax code that result from the double taxation of corporate earnings. For businesses, the Act expanded and lengthened the bonus depreciation provision enacted in March, 2002 by raising the limit to 50 percent and including eligible capital put in service by the end of 2004. For small businesses, the Act lowered tax rates and raised the maximum amount that could be expensed from US$25,000 to US$100,000.

The substantial stimulus to consumer and business spending provided by the three bills helped return the economy to a solid growth path. Tax relief, which totaled US$69 billion in fiscal year 2001, increased in the following three years to reach US$272 billion in 2004—nearly 2.5 percent of gross domestic product—and, including the President's proposed tax relief extensions, is slated to ease back to US$170 billion in 2005.

*Monetary Polic*y: Like fiscal policy, monetary policy also focused on restoring strong, sustained growth. The Federal Reserve reduced the target Federal funds rate 13 times from the start of 2001, when the rate was 6.5 percent, to June 2003, when it was set at 1 percent. The Federal Reserve held the funds rate at that level until late June 2004 when it raised the rate 0.25 percent to 1.25 percent. The statement accompanying the increase indicated "…that policy accommodation can be removed at a pace that is likely to be measured." Since then, the FOMC has raised rates two more times, and the current target rate stands at 1.75 percent.

In response to the sub-par growth that began in mid-2000, very low inflation, and the successive easing of monetary policy, short- and long-term interest rates plummeted from mid-2000 through mid-2003. The rate on 91-day Treasury bills touched 0.8 percent in June 2003, 5 percent below its level in June 2000. At its low point in June 2003, the yield on the 10-year Treasury note was 3.2 percent, the lowest level since the late 1950s and 3 percent below its level in mid-June 2000. During the past year, rates on Treasuries have fluctuated but have moved up modestly on net.

Rates on private sector financial instruments followed a similar pattern. The rate on 30-year fixed rate mortgages, for example, fell to 5.2 percent in June 2003, the lowest level since the early

1960s. The rate increased subsequently to 6.0 percent by mid-July 2004. Even with this increase, mortgage rates were still historically low: 6.0 percent was lower than the rate in any month from the mid-1960s to mid-2002. Rates have since dipped back down to 5.7 percent in early October.

Interest-sensitive spending, especially for motor vehicles and housing, benefited enormously from the availability of low-interest loans in 2001–2004. Automakers were able to offer zero-percent financing deals because of their own low cost of borrowing. Homebuyers were able to obtain mortgages at rates not seen in four decades, and millions of homeowners refinanced their mortgages at lower rates, permanently lowering their housing costs while increasing their liquidity

During the past year, interest rates have risen as economic activity has surged, and, recently, as the monetary authorities have begun to signal that they intend gradually to shift away from a highly accommodative stance. Nonetheless, from their mid-2003 lows, short-term Treasury rates have risen only slightly, and the yield on long-term private sector bonds and mortgages has increased by only about 1.0 percent. In September, the 91-day Treasury bill rate was 1.7 percent and the 10-year Treasury yield was 4.1 percent. Historically, these are still very low rates.

RECENT DEVELOPMENTS

Real gross domestic product (GDP) surged at an average annual rate of 5.8 percent during the second half of 2003, and at a 4.5 percent annual rate in the first quarter and a 3.3 percent annual rate in the second quarter of 2004. Though growth has moderated in the most recent quarter, growth over the last four quarters remains among the fastest in the last twenty years.

Forward-looking indicators suggest that future growth is likely to continue at a solid pace. So far this year, the Index of Leading Indicators has risen at a 1.6 percent annual rate. The Conference Board Index of Consumer Confidence is well above its year-earlier level.

The improving economy is also evident in the *business sector*. In the second quarter, manufacturing production increased at a 7.2 percent annual rate, the fastest advance since the end of 1999, and grew further in July and August. Surveys of purchasing managers indicate strong growth. As of September, the purchasing managers' index was above the 50 percent mark for the sixteenth consecutive months. A reading above 50 percent indicates an expanding manufacturing sector.

Business investment in plant and equipment is increasing strongly again and the outlook is bright. The fundamentals underlying capital spending are favorable: sales have accelerated, corporate cash flow is strong, interest rates are low, and the expiration of the bonus depreciation provision provides further incentive for firms to take advantage of the temporary lowering in the after-tax cost of new equipment investment.

Consumer spending, which accounts for 70 percent of GDP, remains a mainstay of the expansion, though it slowed a bit in the second quarter as the economy hit a soft patch. In the first quarter of 2004, personal consumption, adjusted for inflation, increased at a 4.1 percent annual rate; spending growth moderated to 1.6 percent in the second quarter. Home sales have been very strong. In September, combined new and existing home sales are near record levels. Relatively low interest rates, the improving labor market, confidence in the future, and the recovery of household wealth has made consumers willing and able to make big-ticket purchases, such as cars, homes, and major home improvement projects. During the year ended in June 2004, household wealth rose by $4.6 trillion, an 11 percent gain, because of large increases in equity and home prices.

In the *labor market*, payrolls have increased by 1.7 million since last August, with over 1.4 million new jobs being added this year alone. Since June 2003, the number of unemployed persons has fallen by over 1 million. Attitudes about job market conditions have improved somewhat, with the purchasing manager’s employment index above 50 (implying further manufacturing job growth) for the eleventh consecutive month.

In contrast to the early years of the recovery when productivity growth entirely accounted for the increase in GDP, more recently both productivity growth *and* increased labor hours have contributed to the increased output. Over the year ending in 2004:Q2, productivity grew at a 4.6 percent rate in the non-farm business sector at the same time that labor hours increased at a 1.1 percent rate.

The remarkable *productivity* performance since the end of 2000 may be in part a temporary development that reflects intense cost-cutting by businesses. However, productivity growth has been quite strong since the mid-1990s suggesting that an upward structural shift has taken place. A permanent improvement in productivity growth would be a welcome development: strong productivity growth would eventually translate into strong growth in real wages and our standard of living.

Inflation has picked up this year, largely because of a surge in energy prices caused by a spike in oil prices, but remains contained. So far this year, the consumer price index (CPI) has increased at a 3.7 percent annual rate, up from 2.3 percent during 2003. Energy prices increased at a 22 percent annual rate from December to August. Excluding volatile food and energy prices, the core CPI rose at a 2.2 percent annual rate from December to August, which is a step up from the 1.5 percent advance during 2003. The modest uptick in core inflation so far this year may include a transitory component from the passthrough of the recent jump in energy prices and may also provide further evidence that labor and product markets are firming.

REVISED ECONOMIC ASSUMPTIONS

The economic assumptions for the Mid-Session Review (MSR), which were finalized in early June, have been revised very little from the 2005 Budget assumptions (after adjusting the assumptions for the comprehensive revisions to GDP and incomes released by the Department of Commerce in late December). The MSR assumptions through 2005 for these key economic variables are quite close to the latest forecasts of the Federal Reserve Governors, Reserve Bank Presidents and the Blue Chip consensus, an average of about 50 private-sector forecasts. From 2006 to 2009, the MSR assumptions are very close to the long-term Blue Chip forecast published in March (see Table 3).

Real GDP, Potential GDP, and Unemployment: Real GDP growth in the fourth quarter of 2003 and the first quarter of this year was close to the Budget assumptions. In light of the growing evidence that the expansion is now on a solid foundation, real GDP growth this year and next has been revised up slightly from the Budget forecast. On a year-over-year basis, real GDP is expected to grow 4.7 percent this year, moderating to 3.7 percent next year. Growth is projected to slow gradually to 3.1 percent in 2009, the Administration's estimate of the economy's long-run potential growth rate. The growth projection beginning with 2006 is the same as in the Budget. During the six years 2004–2009, growth is expected to average 3.6 percent, nearly the same as the Blue Chip consensus. The 3.1 percent estimate of the potential long-run growth rate is unchanged from that in the Budget.

The unemployment rate, currently at a level that is low in historical terms, is projected to continue to decline through 2007 when it is expected to level off at 5.1 percent. That is the center of the range that is thought to be consistent with stable inflation. The MSR unemployment rate projection is very close to those of the Budget and the Blue Chip consensus.

Inflation: The faster-than-expected inflation so far this year has resulted in an upward revision to the near-term inflation forecast. On a year-over-year basis, the CPI is projected to increase 2.5 percent this year and close to that rate during the subsequent years of the forecast period. The CPI projection is close to that of the Blue Chip consensus. An upward revision also has been made to the projection of the GDP chain-weighted price index.

Interest rates: Interest rates are projected to rise slowly, with short-term rates increasing more than long-term rates, the usual pattern at this stage of the business cycle. The decision of the Federal Reserve to raise the Federal funds rate 0.75 percent over the past three meetings is consistent with the gradual increase in short-term rates projected in the MSR. By 2009, the 91-day Treasury bill rate is projected to be 4.4 percent; the yield on the 10-year Treasury note is assumed to be 5.8 percent. The interest rate projections are nearly identical to those in the Budget and the Blue Chip consensus forecasts.

Income Shares: New information contained in the December national income accounts revision and first quarter income data, as well as new forecasts for health insurance costs and employer contributions to defined benefit pension plans, have resulted in significant revisions to the Budget assumptions' projection of income shares. The share of wages and salaries is projected to rise, although not quite as quickly as in the Budget assumptions. New forecasts for health insurance costs and employer contributions to defined benefit pension plans show that these fringe benefit costs are likely to rise more rapidly than expected in the 2005 Budget economic assumptions. Higher fringe benefits tend to moderate the rise in wages and salaries. Because fringe benefits are not taxed, an increase in their share at the expense of the shares of wages and profits tends to reduce the projection of budget revenues.

Corporate profits before tax will also be affected by the temporary bonus depreciation provision, which expires at the end of this year. The provision lowers profits before tax this year compared to what they otherwise would have been. After 2004, corporate taxable profits will increase because the provision expires, and because less capital will remain on the books to depreciate. Taking all these factors into account, the share of corporate profits before tax in GDP is expected to increase sharply in 2005 and then edge down gradually through 2009.

Summary: The economic news during the last half year is highly favorable: growth is strong, more new jobs are being created, and, even following their recent increases, inflation and interest rates remain quite low. For the most part, the 2005 Budget assumptions anticipated these developments. The MSR assumptions, like those of the Budget and the consensus of private-sector forecasts, anticipate solid growth, falling unemployment, low inflation, and historically low but moderately rising interest rates.

ANNEX I

UNITED STATES: OVERALL ECONOMIC PERFORMANCE

	1998	1999	2000	2001	2002	2003
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (billion US$)	8747.0	9268.4	9817.0	10128.0	10487.0	11004.0
Real GDP	4.2	4.4	3.7	0.8	1.9	3.0
Consumption	4.4	4.7	4.1	2.6	3.2	3.2
Private Consumption	5.0	5.1	4.7	2.5	3.1	3.3
Government Consumption	1.6	3.1	1.7	3.1	4.0	2.9
Investment	8.8	7.7	5.3	-6.0	-1.0	4.0
Private Investment	9.8	7.8	5.7	-7.9	-2.4	4.4
Government Investment	3.4	7.5	3.6	4.9	6.1	2.2
Exports of Goods and Services	2.4	4.3	8.7	-5.4	-2.4	1.9
Imports of Goods and Services	11.6	11.5	13.1	-2.7	3.4	4.4
Fiscal and External Balance (percent of GDP)						
Budget Balance	54388	158616	254848	94263	-230671	-396191
Merchandise Trade Balance	-2.8	-3.7	-4.6	-4.2	-4.6	-5.0
Current Account Balance	-2.4	-3.2	-4.2	-3.8	-4.5	-4.8
Capital and Financial Non-reserve Assets Balance						
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	1.1	1.4	2.2	2.4	1.7	1.8
CPI	1.6	2.2	3.4	2.8	1.6	2.3
M2	7.3	7.5	6.1	8.7	7.6	6.8
Short-term Interest Rate	5.35	4.97	6.24	3.89	1.67	1.13
Real Effective Exchange Rate	99.0	98.9	100.0	106.2	106.2	98.1
Unemployment Rate	4.5	4.2	4.0	4.8	5.8	6.0
Population (millions)	275.8	278.9	282.1	285.0	287.9	290.7

ANNEX II

UNITED STATES: FORECAST SUMMARY (percent change from previous year)

	2003						2004					
	Official	**IMF**	**ADB**	**OECD**	**PECC**	**Link**	**Official**	**IMF**	**ADB**	**OECD**	**PECC**	**Link**
Real GDP	3.0	N.A.	N.A.	3.0	N.A.	N.A.	4.2	N.A.	N.A.	4.7	N.A.	N.A.
Exports	1.9	N.A.	N.A.	1.9	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Imports	4.4	N.A.	N.A.	4.4	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
CPI	2.3	N.A.	N.A.	2.3	N.A.	N.A.	2.8	N.A.	N.A.	2.3	N.A.	N.A.

ANNEX III

UNITED STATES: MEDIUM-TERM TREND FORECAST (percent)

	2004–2009
Real GDP	3.4
GDP Deflator	2.1

VIET NAM

REAL GROSS DOMESTIC PRODUCT

After financial crises in 1997–1998, Viet Nam's economy has gradually resumed its high growth rate. According to the preliminary estimates, the growth rate of GDP in 2003 is about 7.2 percent - the highest growth rate since 1997, in which industry increased by 10.3 percent, agriculture, by 3.2 percent, and the service sector by about 6.6 percent. The main factors leading to this success were the strong domestic demand and the considerably high export growth rate.

Total consumption went up by 7 percent, the highest figure since 1995. Private consumption increased by 7.2 percent and government consumption, by 6.2 percent. Investment also achieved a remarkable growth rate, somewhat above 14.7 percent, of which the growth of state-owned sector and private sectors, including foreign direct investment (FDI) enterprises, respectively were 15.8 percent and 11.5 percent respectively.

In 2003, the export turnover was estimated to be US$19.9 billion,19.0 percent higher than in 2002. The exports value of the domestic sector was US$9.9 billion an increase by 11.7 percent; and the value of FDI sector was US$10 billion an increase of 27.2 percent.

Owing to the promulgation of a number of domestic and foreign investment policies, the attitude of foreign investors towards Viet Nam's investment environment has improved. Moreover, Viet Nam's Government has been amending and modifying its Enterprise Law to create a "fair playground" for all economic sectors with a view to mobilising all resources to develop its economy.

Stabilisation of a number of main macro-economic indicators, government's efforts to reform its own structure and its most important institutions, and the strong support from international organisations such as the World Bank, IMF, ADB were the favourable factors that allowed Viet Nam maintain its position as one of the Asian economies with the highest growth rate in short-term and medium-term.

The 2004 forecasts for some of Viet Nam's economic indicators are as follows:

- GDP growth rate: 7.5 – 8.0 percent.
- Exports turnover: US$21.7 billion, increasing by 11 to 12 percent
- Imports turnover: US$26 billion, reaching growth of 8 to 9 percent
- Ratio of investment to GDP: 36 percent
- Budget revenue will increase by 11.9 percent; budget expenditure will grow at the rate of 11.3 percent, and the budget deficit will be about 5 percent of GDP.
- The inflation growth rate is estimated to be 6 to 7 percent.
- GDP per capita will reach US$530.

INFLATION

Though the local demand expanded, the consumer price index of a large number of commodities remained stable. Compared with the previous month, the consumer price index in December 2003 went up slightly (+0,8 percent) and this occurred in all categories of commodities. This consumer price index increased 3 percent - that is lower than the rate of 4 percent in December 2002. The inflation rate for the whole of 2003 was estimated to be 3 percent.

In early 2004, due to the impacts of bird flu, a the rise in prices of a large number of raw materials and fuel such as steel, and fertilisers, petroleum, the inflation rate is likely to reach 6.5 percent, higher than the figure set by The National Assembly.

EMPLOYMENT

By the mid-2003, there were 40.5 million persons employed in the economy, 48.8 percent of them were female. In 2003, the rise in employment occurred largely in such sectors as aquaculture, processing industries, construction, tourism, private and public utilities. The unemployment rate in urban areas was 5.8 percent, satisfying the target of lower than 6 percent, but still higher than the popular rates in other global economies. In 2004, it is estimated that 1.5 million new jobs will be created; of that number 60 thousand employment will be exported to overseas markets.

EXCHANGE RATE

In 2003, the Viet Nam dollar (VND) depreciated only nominally against the US dollar (VND/USD) at nearly the same level as 2002 (2.2 percent as against 2.1 percent). With low inflation and the depreciation of the US dollar against other hard currencies, the competitiveness of Vietnamese goods via the exchange rate was maintained.

The main reasons for the fall of the exchange rate between the VND and USD are as follows:

- The balance of payments in 2003 was an estimated surplus of over US$1.4 billion, despite the current account's deficit of more than US$2.5 billion.
- In the domestic market, the interest rate for VND was higher than that for the USD.
- The USD depreciated remarkably due to the double deficit (budget deficit and trade deficit) of the US economy, and also because the US pursued a policy of a weak domestic currency to help economic recovery. In late July, the US once again made a decrease in the interest rate, down to 1 percent, the lowest level since 1958.

FISCAL POLICY

Due to the fact that the economy maintained its considerable growth rate, the budget revenue in 2003 was 11 percent higher than that in 2002: revenue from FDI enterprises increased by 30 percent; tax payment from non-state businesses increased by 28.5 percent; from crude oil by 1.6 percent; from import- export activities by 10.4 percent; from state-owned enterprises (SOEs) by 17.9 percent. The total budget expenditure went up 14.1 percent compared with that figure for the previous year, of which development investment increased by 6.7 percent; and current expenditure rose by 4.9 percent. Borrowing made up budget deficit from domestic (75 percent) and foreign (25 percent) sources. The budget deficit rate was estimated to account for 5 percent of GDP.

MEDIUM-TERM OUTLOOK

Viet Nam’s medium-term economic perspective is relatively bright: the growth rates for 2004 and 2005 are estimated to be 8 percent and 8.3 percent respectively – higher than that for 2003. This high rate is largely based on the rise in private consumption (more than 6 percent) and that the fact the ratio of investment to GDP was higher than 31 percent. Export revenue will maintain its high growth rate owing to the high oil prices and the recovery trend in the global economy.

FDI flows will also be on rise thanks to: effective implementation of the Viet Nam- Japan joint initiative to improve the investment environment in Viet Nam; multilateral cooperation programmes within the framework of ASEAN, APEC, ASEM; intensification of investment promotion activities in Japan, EU, USA and some other focal regions.

STRUCTURAL REFORM

Structural reforms, especially those in state-owned enterprises and the banking system, implementation of international economic integration commitments, WTO accession, perfection and development of production factor market, and administrative reform – all of these are the basic links representing the new breakthrough in Viet Nam’s economic renovation process.

1. Reforms in State-owned enterprises

To implement the basic targets of restructuring and renovating state-owned enterprises by 2005, the prime minister promulgated Decision No. 183/2001/Q§-TTg, tasking State organisations to prepare some bills, including the Amended Enterprise Law, and submit them to the responsible levels. Ministries, industries, localities, and state-owned corporations have designed the schedule of restructuring SOEs, in which 2857 SOEs are to be restructured from 2003 to 2005, with a focus given to 2003 and 2004. Particularly, 2045 SOEs, accounting for 43.4 percent of the SOEs will be equitized. The government will hold a controlling share in only 1040 of these enterprises; 386 enterprises will be merged (9 percent); 209 enterprises will be sold or contracted (4.5 percent); 42 enterprises will be made semi-budget funded administrative organisation (0.9 percent); and, 139 will dissolve and go bankrupt (3 percent). The schedule for rearranging SOEs in 2002–2003 involved 1655 enterprises; in 2004, 882 enterprises; and in 2005, 413 enterprises. Of the 4704 SOEs in Viet Nam 1847 (39 percent) have 100 percent state investment.

By the end 2005, the number of SOEs will decrease by 37.8 percent, from the existing 4704 to 2924 1847 enterprises will retain their legal entity status, 37 will be formed by merging 109 enterprises; the government will retain the controlling share in 35.6 percent of the total number of SOEs, the majority of which are in key sectors, industries, areas and locations.

2. Strengthening the banking system

Commercial banks (CB) continue to increase funds and to restructure. In 2003, the state-owned CBs received two trenches of additional funds: the first in June 2003 (VND1900 billion) and the second in the last quarter of the year (VND1950 billion). Therefore, the equity and assets of the state-owned CBs have been partially improved.

Banking enterprise reform has included the commercial banking system restructuring program. In accordance with Decision No.665/2003/QD-NHNN, the Viet Nam Jewellery Corporation officially terminated its operation in August 2003 and transferred its network and apparatus to the Bank of Agriculture and Rural Development and the Mekong River Delta Housing Development Bank.

3. International integration commitments

To implement its international integration commitments, Viet Nam has accelerated the negotiation process of WTO accession by reviewing all economic rules and institutions with a view to ensuring that they will harmonise with and correspond to the international practice so that by 2005 Viet Nam will become a full member of this organisation.

In December 2000, the Government approved the overall roadmap of common effective preferential tariff (CEPT) implementation in Viet Nam, for the period 2001–2006, to reduce tariff rates for 97 percent of tariff lines in the existing import tariff nomenclature. The average tariff rate of the IL is 3.1 percent. In reality, the implementation of CEPT has only been pushed since 2001. Since 2001, nearly 2000 tariff lines have been included in the IL with tariff rates of lower than 20 percent. In 2003, 755 tariff lines in the TEL were moved to the IL with tariff rates of lower than 20 percent. On 1 July 2003 the Government announced the list of CEPT implementation for 2003–2006 in accordance with Decree No 78/2003/Nd-CP to suit the ASEAN Harmonized Tariff Nomenclature.

4. Improving the climate for enterprise

In 2003, enterprise support activities have been strengthened, especially towards small and medium enterprises. The Department for Small and Medium Enterprise Development was established under the MPI, and three technical support centres in three regions and support programs have been rolled-out.

Recently, the government of Viet Nam has promulgated Decree No. 38/2003/ND-CP on equitizing foreign-invested enterprises, creating flexibility in transferring investments of foreign investors and introducing a new channel to mobilise funds, thus reducing investment risks and diversifying forms of investment. The prime minister has also Promulgated Decision No 36/2003/QD-TTg allowing foreign direct investors to buy shares and invest up to 30 percent of the registered capital in SOEs and enterprises of other ownership types. These documents show consistency and advocacy of diversifying ownership, mobilising all sources for the development of the economy.

ANNEX I

VIET NAM: OVERALL ECONOMIC PERFORMANCE

	1998	1999	2000	2001	2002	2003
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (billion US$)	29.4	28.8	31.2	32.4	34.8	38.8
Real GDP*	5.8	4.8	6.8	6.8	7.0	7.2
Consumption*	4.3	1.8	3.2	4.6	6.9	7.1
Private Consumption	4.5	2.6	3.1	4.5	7.1	7.2
Government Consumption	3.2	-5.7	5.0	6.6	5.4	6.2
Investment	12.6	1.2	10.1	10.8	10.6	14.7
Private Investment	-0.9	-6.0	13.2	8.5	10.1	11.5
Government Investment	26.5	6.9	7.9	11.6	11.0	15.8
Exports of Goods and Services	1.9	23.3	25.5	3.8	10.0	19.0
Imports of Goods and Services	-0.8	2.1	33.2	3.4	19.4	26.7
Fiscal and External Balance (percent of GDP)						
Budget Balance	2.5	5.0	5.0	5.0	5.0	5.0
Merchandise Trade Balance	-7.3	-2.9	-2.5	-2.3	-4.0	-8.8
Current Account Balance	N.A.	N.A.	3.5	2.2	-2.4	-5.7
Capital and Financial Non-reserve Assets Balance	N.A.	N.A.	-1.7	0.9	7.0	10.0
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	8.8	5.7	3.4	1.9	4.1	5.3
CPI	9.2	0.1	-0.6	0.8	4.0	3.0
M2	25.6	39.3	24.0	21.3	23.3	20.4
Short-term Interest Rate	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Real Effective Exchange Rate (level, 1997=100)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Unemployment Rate – Urban (%)	6.9	7.4	6.4	6.3	6.0	5.8
Population (millions)	75.5	76.6	77.6	78.7	79.7	80.6

ANNEX II

VIET NAM: FORECAST SUMMARY (PERCENT CHANGE FROM PREVIOUS YEAR)

	2003						2004					
	Official	IMF	ADB	OECD	PECC	Link	Official	IMF	ADB	OECD	PECC	Link
Real GDP	7.2	6.0	7.0	N.A.	N.A.	N.A.	8.0	7.0	7.1	N.A.	N.A.	N.A.
Exports	19.0	N.A.	10.5	N.A.	N.A.	N.A.	12.0	N.A.	9.0	N.A.	N.A.	N.A.
Imports	26.7	N.A.	22.3	N.A.	N.A.	N.A.	9.0	N.A.	10.0	N.A.	N.A.	N.A.
CPI	3.0	4.0	4.0	N.A.	N.A.	N.A.	6.5	3.5	4.0	N.A.	N.A.	N.A.

ANNEX III

VIET NAM: MEDIUM-TERM TREND FORECAST (percent)

	2001–2005
Real GDP	7.5
GDP Deflator	4.0

ANNEX III:

ACROYNMS

ACRONYMS

ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
AJCCEP	ASEAN-Japan Committee On Comprehensive Economic Partnership
ANZCERTA	Australia-New Zealand Closer Economic Relations Trade Agreement
APEC	Asia-Pacific Economic Cooperation
API	Indonesian Banking Architecture
ARMs	Adjustable Rate Mortgages
ASEAN	Association of Southeast Asian Nations (Includes Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Viet Nam)
ASEM	Asia-Europe Meeting
ATPDEA	Andean Trade Promotion And Drug Eradication Act
AUS	Australia (APEC Accepted Nomenclature)
BD	Brunei Darussalam (APEC Accepted Nomenclature)
BEDB	Brunei Economic Development Board
BERI	Business Environment Risk Intelligence (based in Washington)
BFIA	Banks And Financial Institutions Act
BIA	Brunei Investment Agency
BIR	Bureau of Internal Revenue
BOC	Bureau of Customs
BOJ	Bank of Japan
BOP	Balance of Payment
BOT	Bank of Thailand
BPNG	Bank of Papua New Guinea
BSE	Bovine Spongiform Encephalopathy
BSP	Bangko Sentral Ng Pilipinas
CACC	Central Agencies Coordinating Committee
CB	Commercial Banks
CBA	Central Bank Act
CDA	Canada (APEC Accepted Nomenclature)
CEFP	Council On Economic And Fiscal Policy
CEPT	Common Effective Preferential Tariff
CFE	Federal Electricity Commission
CGE	Computable General Equilibrium
CGPI	Corporate Goods Price Index
CHL	Chile (APEC Accepted Nomenclature)
CNIE	National Foreign Investment Commission Comisión Nacional De Inversiones Extranjeras
CPDG	Competition Policy And Deregulation Group
CPF	Central Provident Fund
CPI	Consumer Price Index
CPP	Canada Pension Plan
CRR	Cash Reserve Requirement
CT	Chinese Taipei (APEC Accepted Nomenclature)
CTI	Committee on Trade and Investment
DIS	Deposit Insurance Scheme
DOF	Department of Finance
EC	Economic Committee

ECBs	Euro-Convertible Bonds
ECP	Enhanced Cooperation Package
EI	Employment Insurance
FDI	Foreign Direct Investment
FTAs	Free Trade Agreements
GATS	General Agreement On Trade In Services
GATT	General Agreement On Tariffs And Trade
GCE	Government Consumption Expenditure
GDP	Gross Domestic Product
GIR	Gross International Reserves
GNE	Gross National Expenditure
GNP	Gross National Product
GPG	Global Public Goods
HDI	Human Development Index
HKC	Hong Kong, China (APEC Accepted Nomenclature)
HRD	Human Resource Development
IBRA	Indonesian Banking Restructuring Agency
ICCC	Independent Consumer And Competition Commission
ICT	Information and Communication Technology
IDB	Interamerican Development Bank
IEA	International Energy Agency
IFSN	Indonesian Financial Safety Net
IGR	Intergenerational Report (By Australia)
ILO	International Labor Organization
ILRs	Indicator Lending Rates
IMF	International Monetary Fund
IMSS	Mexican Social Security Institute
INA	Indonesia (APEC Accepted Nomenclature)
INEI	National Institute of Statistics
IOSCO	International Organisation of Securities Commissions
ISSSTE	Institute of Social Security For Public Sector Workers
JPN	Japan (APEC Accepted Nomenclature)
KBEs	Knowledge-Based Economies
KFR	Kina Fixed Rate
KLSE	Kuala Lumpur Stock Exchange
LNG	Liquefied Natural Gas
LTO	Large Taxpayer offices
M1	Narrow Money
M2	Broad Money Supply
MAS	Monetary Authority of Singapore
MAS	Malaysia (APEC Accepted Nomenclature)
MEX	Mexico (APEC Accepted Nomenclature)
MLR	Minimum Lending Rate
MOU	Memorandum of Understanding
MPR	Monetary Policy Rate
MSB	Monetary Stabilization Bonds
MSR	Mid-Session Review
MTDS	Medium-Term Development Strategy
MTPDP	Medium-Term Philippine Development Plan
MVIL	Motor Vehicles Insurance Ltd
NBIP	Non Binding Investment Principles
NEC	National Executive Council

NPL	Non-Performing Loan
NZ	New Zealand (APEC Accepted Nomenclature)
OBERAC	Operating Balance Before Revaluations And Accounting Changes
OCR	Official Cash Rate
OECD	Organization For Economic Cooperation And Development
OFW	Overseas Filipino Workers
OPEC	Organization of Oil-Exporting Countries
OPR	Overnight Policy Rate
PCE	Private Consumption Expenditures
PDL5	Moran Petroleum Development License
PE	Peru (APEC Accepted Nomenclature)
PICOP	Paper Industries Corporation of the Philippines
PMB	Pulau Muara Besar
PNG	Papua New Guinea (APEC Accepted Nomenclature)
PPI	Producer Price Index
PPP	Purchasing Power Parity
PRC	People's Republic of China (China Also Acceptable) (APEC Accepted Nomenclature)
PSBR	Public Sector Borrowing Requirements
PTAs	Preferential Trade Agreements
Q1	First Quarter
Q2	Second Quarter
Q3	Third Quarter
Q4	Fourth Quarter
QFII	Qualified Foreign Institutional Investor
RBA	Reserve Bank of Australia
RBA	Reserve Bank of Australia
RBNZ	Reserve Bank of New Zealand
REER	Real Effective Exchange Rate
RIA	Regional Integration Agreement
ROK	Republic of Korea (Korea Also Acceptable) (APEC Accepted Nomenclature)
RP	Repurchase
RP	the Republic of the Philippines (the Philippines Also Acceptable) (APEC Accepted Nomenclature)
RPG	Regional Public Good
RPGs	Regional Public Goods
RRP	Reverse Repurchase
RTAs	Regional Trade Agreements
RUS	the Russian Federation (Russia Also Acceptable) (APEC Accepted Nomenclature)
RWA	Risk Weighted Assets
S$NEER	Singapore Dollar Nominal Effective Exchange Rate
SAFTA	Singapore-Australia Free Trade Agreement (
SARS	Sudden Acute Respiratory Syndrome
SARS	Severe Acute Respiratory Syndrome
SEPO	State Enterprise Policy office
SEPO	State Enterprise Policy office
SIN	Singapore (APEC Accepted Nomenclature)
SMEs	Small And Medium-Sized Enterprises
SMS	Short Message Services
SOM	Senior Officials' Meeting
SPARTECA	South Pacific Regional Trade And Economic Cooperation

SRTA	Sub-regional Trading Arrangements
SSOM	Special Senior Officals' Meeting
TAFIS	Treasury Accounting Financial Information System (In Brunei)
TAMC	Thai Asset Management Corporation
THA	Thailand (APEC Accepted Nomenclature)
TRP	Tariff Reduction Program
UN	United Nation
US or USA	United States (APEC Accepted Nomenclature)
VAT	Value-Added Tax
VC	Value Content
VN	Viet Nam (APEC Accepted Nomenclature)
WCI	Wage Cost Index
WCY	World Competitiveness Year Book
WTI	West Texas Intermediate
WTO	World Trade Organisation
Y-O-Y	Year-To-Year
Y-T-D	Year-To-Date