2002 APEC Economic Outlook

Asia-Pacific
Economic Cooperation

APEC Economic Committee
October 2002

Published by the APEC Secretariat
35 Heng Mui Keng Terrace
Singapore 119616
Tel: (65) 6775 6012
Fax: (65) 6775 6013
E-mail: info@mail.apecsec.org.sg
Website: http://www.apecsec.org.sg

APEC #202-EC-01.1
ISSN 0218-9763

TABLE OF CONTENTS

Foreword... i

CHAPTER 1: ECONOMIC PERFORMANCE AND PROSPECTS IN THE APEC REGION

1. Overview 1

2. Recent Economic Trends in the APEC Region
   - *2.1 Economic slowdown in 2001 .... 1*
   - *2.2 Increased unemployment 6*
   - *2.3 Lower inflation or deflation... 8*
   - *2.4 Tumbled external trade.. 12*
   - *2.5 Persistent external imbalances 18*
   - *2.6 Economic consequences of the terrorist attacks 22*

3. Policy Response and Economic Prospects
   - *3.1 Fiscal policy.. 23*
   - *3.2 Monetary policy 26*
   - *3.3 Foreign exchange market 30*
   - *3.4 World oil market.. 34*
   - *3.5 Prospects for an economic recovery... 36*
   - *3.6 Some risks to the economic recovery.. 39*

CHAPTER 2: MICROBANKING DEVELOPMENT, REGULATION AND SUPERVISION

Introduction.. 43

1. The Relevance of Microbanking for the APEC Region
   - *1.1. Poverty reduction and social safety nets 47*
   - *1.2. Contributing to the development of micro and small enterprises 48*
   - *1.3. Contributing to rural development.. 54*
   - *1.4. Gender considerations 54*
   - *1.5. Community empowerment 57*

2. The State of Microbanking in the APEC Region
   - *2.1 Non governmental organizations 59*
   - *2.2 Cooperatives and credit unions 62*
   - *2.3 Specialized financial institutions 66*
   - *2.4 Government agencies and state-owned institutions 68*
   - *2.5 Commercial banks and multipurpose financial institution............................ 70*
   - *2.6 Size and magnitude of the microbanking sector.. 72*

3. Regulation and Supervision of Microbanking Intermediaries
   - *3.1 What is understood by regulation and supervision of financial intermediaries?.. 74*
   - *3.2 Why have regulation and supervision of microbanking activities come to the forefront of the debate? 75*
   - *3.3 Which institutions should be regulated?... 75*

3.4 What type of regulatory framework is appropriate for microbanking intermediaries? ... 76
3.5 What are the main areas of regulation in microbanking? ... 78
3.6 What type of supervision is appropriate for microbanking intermediaries? ... 79
3.7 APEC economies' experience with microbanking regulation and supervision ... 80
3.8 Interest rates for microbanking in APEC member economies ... 92
3.9 Final consideration ... 94

4. Relevant Tools for the Strengthening of the Microbanking Sector
4.1. Financial sustainability of microbanking activities ... 94
4.2. Solvency and bankruptcy problems: Is deposit insurance relevant? ... 96
4.3. The role of rating agencies and specialized assessment firms ... 101
4.4. The role of credit bureaus ... 103
4.5. Access to new funding sources ... 105
4.6. Microbanking development policies ... 106

Conclusion ... 109
Biliography ... 111

Appendix AI: Indicators of a Knowledge-Based Economy ... 117

Appendix AII: Individual Economy Reports

- Australia ... 133
- Brunei Darussalam ... 139
- Canada ... 147
- Chile ... 153
- China ... 157
- Hong Kong, China ... 165
- Indonesia ... 171
- Japan ... 180
- Korea ... 187
- Malaysia ... 192
- Mexico ... 200
- New Zealand ... 206
- Papua New Guinea ... 211
- Peru ... 224
- Philippines ... 229
- Russia ... 239
- Singapore ... 243
- Chinese Taipei ... 249
- Thailand ... 255
- United States of America ... 263
- Viet Nam ... 269

Appendix AIII: Acronyms ... 277

TABLES AND FIGURES

CHAPTER 1

Table 1.1	Real GDP Growth in the APEC Region	4
Table 1.2	Unemployment Rates in the APEC Region	7
Table 1.3	Consumer Price Inflation in the APEC Region	12
Table 1.4	Direction of Trade in the APEC Region, 1991	13
Table 1.5	Direction of Trade in the APEC Region, 2001	14
Table 1.6	Export of Goods and Services	17
Table 1.7	Import of Goods and Services	18
Table 1.8	Current Account Balances in the APEC Region	21
Table 1.9	Forecast on Budget Balances	25
Table 1.10	Short-term Interest Rate	29
Table 1.11	Forecast on Oil and Non-oil Commodity Prices	35
Table 1.12	Forecasts of GDP Growth in the APEC Region	37
Table 1.13	Forecasts of Consumer Price Inflation in the APEC Region	39
Table 1.14	Forecast on Balances of Current Account	41
Figure 1.1	Real GDP Growth Rates	3
Figure 1.2	Consumer Price Inflation	11
Figure 1.3	Composition of Export Market, 2001	15
Figure 1.4	Current Account Balances	20
Figure 1.5	Short-term Interest Rate	28
Figure 1.6	Exchange Rate of the Yen and the Euro	32
Figure 1.7	Exchange Rates of Northeast Asia	33
Figure 1.8	Exchange Rates of Southeast Asia	33
Figure 1.9	Exchange Rates of the Western Hemisphere and Oceania	34
Figure 1.10	World Oil Prices and Commodity Prices	35

CHAPTER 2

Table 2.1	Typology of Microbanking Intermediaries	60
Table 2.1.1	Non Governmental Organizations	62
Table 2.2.1	Cooperatives and Credit Unions	66
Table 2.3.1	Specialized Financial Institution	68
Table 2.4.1	Government Institutions and Agencies	70
Table 2.5.1	BRI Units vs. Other Microbanking Intermediaries in Indonesia	71
Table 2.5.2	Commercial Banks and Multipurpose Financial Institutions	72
Table 3.4.1	Differences between Traditional Banking and Microbanking	77
Table 3.7.1	Regulation of Microbanking in APEC Economies	83
Table 3.7.2.1	Minimum Paid-up Capital	85
Table 3.7.2.2	Minimum Number of Members	87
Table 3.7.3	Supervision of MBIs in Selected APEC Member Economies	91
Table 3.8.1	Microbanking Interest Rates in Selected APEC Economies	93
Table 4.2.1	Recent Microbanking Insolvency and Bankruptcy Events in APEC Economies	97
Table 4.2.2	Deposit Insurance Schemes in APEC Economies	99
Table 4.3.1	Characteristics of Five Specialized Assessment Firms for Microbanking Intermediaries	102
Table 4.6.1.1	Lending to Small and Medium Enterprises in Korea	107
Figure 2.6.1.	Share of Total Microbanking Assets as a Percentage of the Financial Sector Total Assets, as of Year-end 2000	73
Text Box 1.1.1	Microbanking as Part of Thailand's Economic Strategy	50
Text Box 1.2.1	The Role of the US Government in Microlending	51

Text Box 1.2.2 Credit Guarantee Funds: The Experience of Korea and Chinese Taipei ... 53
Text Box 1.4.1 Microbanking Gender Perspective in New Zealand................................. 55
Text Box 1.4.2 Microbanking Gender Perspective in Japan 56
Text Box 1.5.1 The US Experience with the Community Reinvestment Act.................... 58
Text Box 2.2.1 Credit Unions in Canada and the United States....................................... 64
Text Box 3.7.2 Corporate Governance Guidelines in the People's Republic of China...... 89
Text Box 4.6.2.1 The US Treasury "First Accounts" Program 108

APPENDIX AI: Indicators of a Knowledge-Based Economy

Table A.1 Specification of Indicators for the Country Scorecards...........................114
Table A.2 Data Status and Reference Values for the Charts....................................116
Figure A.1 KBE Indicators for Selected APEC Economies......................................117

FOREWORD

The *APEC Economic Outlook*, tailored to serve APEC policy priorities, is submitted to the annual 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 bearing on the priority themes of the TILF and ECOTECH agendas.

This year's outlook report asserts that since early 2002, the world economy has shown evidence of bottoming out of the cyclical trough. Especially in the APEC region, a strong growth potential is leading the global recovery. The APEC economy is expected to build up growth momentum in the near future. Major forecasting institutions have projected that the APEC economy as a whole will accelerate the recovery pace and grow at the rate of over 3 percent in 2002 and 4 percent in 2003—up from a meager 0.5 percent in 2001. This baseline forecast of a promising economic recovery could be thwarted by some short-run risk factors including exchange rate volatility, widening external imbalances, and poor corporate performances. In addition, scandals related to corporate accounting practices may have negative implications for world financial markets, while the high uncertainty of the situation in the Middle East may adversely affect world oil prices. In this context, the Outlook report concludes that, in order to sustain economic growth in the medium-term, most APEC members need to maintain their structural reforms to improve the efficiency of their own economic systems.

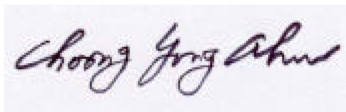
The structural chapter titled "Microbanking Development, Regulation and Supervision in the Asia-Pacific Region" aimed to present a descriptive survey, assessing the state of microbanking in the Asia Pacific region, as well as the current trends in regulation and supervision. This study suggests that government action should be geared at creating an enabling policy environment and a legal and regulatory framework for the growth and expansion of sound and sustainable microbanking intermediaries, fostering their gradual and full integration into the domestic financial system. In sum, the experience reviewed in this study concludes that the APEC region is at the forefront of the microbanking industry.

The *2002 Economic Outlook* is produced through a collaborative effort of all member economies, with the Office of the EC Chair and Mexico serving as co-coordinators. The EC

Chair's Office led the first part of the Outlook report in analyzing the economic performance and prospects of the APEC member economies, while Mexico led the structural chapter. And as instructed by the Ministers, the KBE Knowledge Status Indicators (KSI) have been included in this year's report thanks to Australia taking the lead on gathering and analyzing the data from each member economy.

Mexico also hosted the Symposium on Microbanking Development, Regulation, and Supervision in the Asia-Pacific Region in Mexico City on July 25~26. The symposium brought together members of the national microbanking community, as well as interested scholars and practitioners from all over the world to gather a diverse array of views and inputs.

A very special thanks goes to Mr. Salvador Pérez Galiando and Ms. Ana Lourdes Garza for leading the structural chapter of the *2002 Economic Outlook*; and, Dr. Sangkyom Kim for leading the performance and perspective chapter. Dr. Nam Doo Kim's analysis for the performance and perspective chapter is much appreciated as well. Thanks are also due to Drs. Yunjong Wang and Doo Yong Yang for their invaluable intellectual contributions. And as always, I cannot leave out Mr. Charles Jose, Director (Program) at the APEC Secretariat for his tireless and dedicated assistance in seeing this report through its publication.



Choong Yong Ahn
Chair, APEC Economic Committee
Seoul, October 2002

CHAPTER 1

ECONOMIC PERFORMANCE AND PROSPECTS IN THE APEC REGION

1. OVERVIEW

The global economy suffered an economic slowdown with a mild recession during 2001, which was caused by the cyclical downturn and external shocks like the terrorist attacks on the United States and its subsequent counter-activities. As a major factor in the cyclical downturn, inventory adjustments were made in major economies. Especially affected are the information and communication technology (ICT) sectors where inventory has accumulated as a result of over-investment during the last expansion period (since the mid 1990s).

Beginning to slow down in early 2001, the US economy recorded a mild recession with minus growth over three consecutive quarters in 2001. The September 11 terrorist attacks on the United States and subsequent US counter-activities have depressed consumer and business confidence, with adverse effects on the global economy. Reflecting the substantial fall in final demand of major advanced economies, world trade volume was sharply reduced in 2001. These changes had severe adverse effects on APEC member economies whose economic growth depends heavily on external demand.

For 2001, most APEC member economies experienced lower GDP growth rates and some had negative growth. The real growth rate of the APEC economy as a whole dropped sharply, from 3.6 percent and 4.0 percent in 1999 and 2000 respectively, to 0.7 percent in 2001, the lowest level since 1992.

Since late 2001, after a mild recession, the major economies have begun to recover their growth momentum. The global upturn towards recovery is being driven both by expansionary policy responses and by the scattering of a number of negative forces deriving the last economic downturn. As ICT investment begins to unwind from overhang, inventory levels gravitate towards a normal level. Consumer and business confidence has bounced back since around the end of 2001. Policy responses with monetary and fiscal stimuli have helped to limit the magnitude and duration of the downturn. Due to the sustained disinflation and fiscal consolidation efforts made during the 1990s, most economies' policy authorities had ample room for maneuver, in some cases in 2001. The US economy is emerging with inventory re-stocking, brisk business investment, and expanded public spending and is leading the world's economic growth. Strong economic rebound in the US enables other APEC members to increase their exports to the US market and thus reinvigorate their domestic production.

Since early 2002, the world economy showed evidence that it has bottomed out of the cyclical trough. Especially in the APEC region, strong growth potential is leading the global recovery. The APEC economy is expected to build up growth momentum in the near future. Major forecasting institutions suggest in their projections that in the APEC economy as a whole the recovery pace would be accelerated and would grow at the rate of over 3.0 percent in 2002 and 4.0 percent in 2003, up from a meager growth rate of 0.7 percent in 2001.

This baseline forecast of a promising economic recovery could be thwarted by some short-run negative risks to the recovery. Negative risk factors include widening external imbalances, especially massive US current account deficits; poor performances of corporate profits combined with improper corporate accounting practice scandals and their implications for world financial markets; and the volatile situation in the Middle East and its adverse effect on the world oil price.

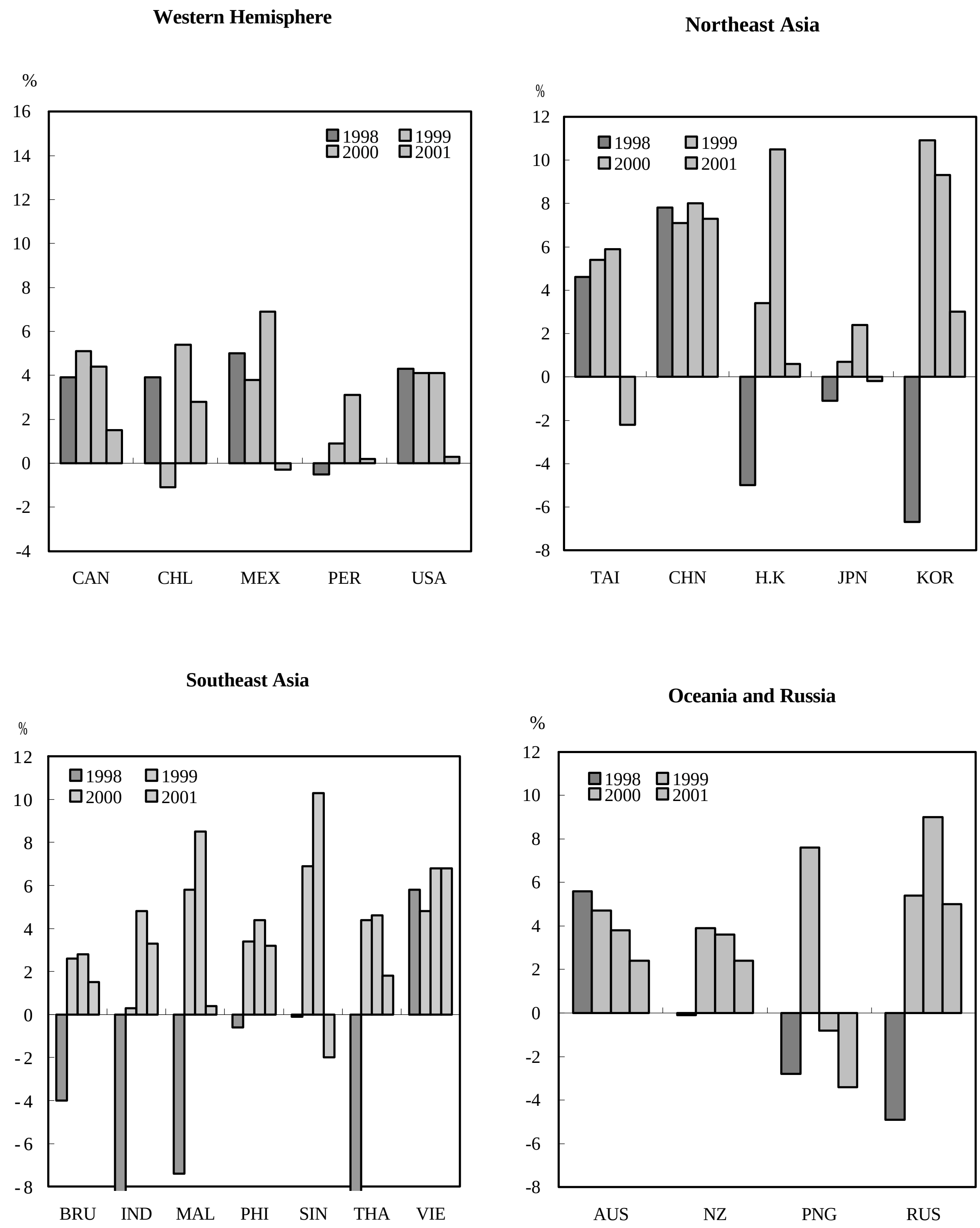
2. RECENT ECONOMIC TRENDS IN THE APEC REGION

2.1 Economic Slowdown in 2001

World economic growth slowed markedly in 2001 after an impressive performance in 1999 and 2000. The world economy grew by 1.4 percent in 2001, down from 4.0 percent in 2000. The

APEC economy as a whole grew by only 0.7 percent, sharply down from 4.0 percent in 2000. However economic performance in the APEC region was differentiated by sub-region and by member economy. In terms of real growth rate in 2001, some economies such as *China* and *Viet Nam* enjoyed high growth rates of around 7.0 percent. At the other end of the spectrum, economies such as *Japan*, *Mexico*, *Chinese Taipei*, *Singapore* and *Papua New Guinea* suffered negative economic growth, i.e., contraction in production. And *Peru*, *Hong Kong, China* and *Malaysia* registered almost zero economic growth with growth rate of less than one percent. All other member economies showed substantial drops in their GDP growth rates during 2001.

Figure 1.1: Real GDP Growth Rates



Source: Individual Economy Reports.

Table 1.1: Real GDP Growth in the APEC Region (percent)						
	1996	**1997**	**1998**	**1999**	**2000**	**2001**
Western Hemisphere	**3.5**	**4.5**	**4.2**	**4.1**	**4.0**	**0.4**
Canada	1.6	4.3	3.9	5.1	4.4	1.5
Chile	7.4	7.4	3.9	-1.1	5.4	2.8
Mexico	5.2	6.8	5.0	3.8	6.9	-0.3
Peru	2.5	6.7	-0.5	0.9	3.1	0.2
The United States	3.6	4.4	4.3	4.1	3.8	0.3
Northeast Asia	**4.5**	**3.2**	**-0.1**	**2.7**	**3.5**	**1.5**
China	9.6	8.8	7.8	7.1	8.0	7.3
Hong Kong, China	4.3	5.1	-5.0	3.4	10.2	0.6
Japan	3.5	1.8	-1.1	0.7	2.4	-0.2
Korea	6.8	5.0	-6.7	10.9	9.3	3.0
Chinese Taipei	6.1	6.7	4.6	5.4	5.9	-2.2
Southeast Asia	**7.4**	**4.1**	**-7.7**	**3.9**	**5.9**	**2.1**
Brunei Darussalam	1.0	3.6	-4.0	2.6	2.8	1.5
Indonesia	7.8	4.9	-13.7	0.3	4.8	3.3
Malaysia	10.0	7.3	-7.4	5.8	8.5	0.4
The Philippines	5.8	5.2	-0.6	3.4	4.4	3.2
Singapore	7.7	8.5	-0.1	6.9	10.3	-2.0
Thailand	5.9	-1.4	-10.5	4.4	4.6	1.8
Viet Nam	9.3	8.2	5.8	4.8	6.8	6.8
Oceania	**3.7**	**3.5**	**4.7**	**4.6**	**3.7**	**2.3**
Australia	3.2	3.6	4.3	5.1	3.2	2.7
New Zealand	3.6	2.2	-0.2	4.0	3.8	2.4
Papua New Guinea	7.7	-3.9	-3.8	7.6	-1.3	-3.4
Russia	-3.4	0.9	-4.9	5.4	9.0	5.0
APEC	**3.9**	**3.9**	**2.0**	**3.6**	**4.0**	**0.7**
WORLD	**3.3**	**3.5**	**2.3**	**3.0**	**4.0**	**1.4**
WORLD *	**4.0**	**4.2**	**2.8**	**3.6**	**4.7**	**2.5**

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 Parities (PPP) exchange rates as weights.

Sources: Individual Economy Reports. IMF, *World Economic Outlook*, September 2002.

Entering 2001, the *United States* economy started to recede slowly and its growth rate registered in the minus for three consecutive quarters up to the third quarter. Thanks to the economic rebound in the fourth quarter, US real GDP grew by 0.3 percent for the entire year of 2001, down from 4.1 percent in 1999 and 3.8 percent in 2000. Dragging down the GDP was a fall in business investment and external exports, while private consumption and government expenditure had a positive effect on GDP growth. The terrorist attacks of September 11 aggravated the economic recession after the longest-running US economic expansion. The decline in consumer and business confidence following the terrorist attacks had a larger and more durable macro-economic effect than the physical destruction and was sufficient to scuttle any possibility of avoiding a recession. However, after a slight contraction over three quarters, real GDP grew at 2.7 percent in the fourth quarter. The US economy is picking up momentum that could sustain the fledgling recovery. In the first quarter of 2002, real GDP grew 5.0 percent at an annual rate, its best quarterly growth rate since the fourth quarter of 1999. Growth in the second quarter of 2002 slowed down to 1.1 percent, which reflected negative effects on GDP growth of import surge and sluggish consumer spending dampened by the floundering stock market.

Under the decade-long economic slump, the Japanese economy went into recession again with negative growth of 0.2 percent in 2001, from positive growth of 0.7 percent and 2.4 percent in 1999 and 2000, respectively. The weakness in 2001 can be ascribed to three main causes. First, both exports and business investment, as the engine for Japanese economic recovery, were weak. Second, consumption also failed to pick up. And finally, the economy was under pressure from the non-performing loans (NPLs) and excessive debts.

As an exceptional case, *China* maintained its trend of strong economic growth even in 2001. Since it opened up its economy in late 1970s, China has been achieving outstanding growth of above 10 percent annually on average over the last two decades, led mainly by dynamic increases in export and investment. However, its growth slowed to the range of 7.0–8.0 percent since 1998, when neighboring economies were hit hard by the Asian financial crisis. China's GDP in 2001 reached US$1,159 billion, an increase of 7.3 percent over the previous year. Such economic growth was led by continued stimulation of fixed capital formation and unswerving implementation of a proactive fiscal policy and a stable monetary policy.

Facing a sharp drop in external demand from their major export markets, most Asian emerging economies experienced very poor economic performances. In addition to Japan, *Chinese Taipei, Singapore* and *Papua New Guinea* recorded contractions in real GDP in 2001. Hit hard by the global economic downturn and high-tech downturn, their economies underwent minus growth over the course of 2001, the first since the Asian financial crisis. The *Chinese Taipei* economy was in a severe recession in 2001. With notable declines in investment and consumption, real GDP fell by 2.18 percent, representing the worst economic performance in thirty years. Economic recession was caused by both external and internal factors. In the global context, the worldwide high-tech downturn had a significant impact on Chinese Taipei's export-led production. Private consumption registered a positive growth of 1.04 percent, contributing to the increase of 0.62 percent of GDP. As the government cut spending, government consumption was 1.02 percent smaller than the previous year, contributing to the decrease of 0.12 percent of GDP. The *Singapore* economy registered a growth rate of minus 2.0 percent in 2001, after achieving 10.0 percent growth in 2000. This sharp reversal in growth was primarily due to the slump in external demand although weak household consumption and business investment also contributed to the contraction. All key economic sectors appeared to have lower growth compared to the previous year. In particular, the manufacturing sector fell by 12.0 percent, a sharp reversal from the 15.0 percent expansion the year before. Also *Hong Kong, China's* economy underwent a severe slowdown over the course of 2001. Real GDP growth in 2001 decelerated sharply to a mere 0.6 percent, from 10.2 percent in 2000. As the adverse impact on the external front spread, the domestic economy also turned more sluggish, with local sentiment further depressed by the terrorist attacks in the United States. With a deteriorating business outlook, investment spending was up by only 2.9 percent in real terms for 2001 as a whole.

Although there was a severe slowdown in most of the Asian economies, *Korea*, the *Philippines*, *Indonesia*, *Australia*, and *New Zealand* all registered relatively moderate economic growth. *Korea* has suffered the adverse effect of the worldwide economic downturn in 2001 and high oil prices. Increases in public utility charges in the second half of the year also contributed to the Korean economy's sharp slowdown in domestic consumption and investment. The GDP growth rate was 3.0 percent in 2001, down from 8.8 percent in 2000. In the *Philippines*, GDP grew by 3.2 percent in 2001, well beyond the less than 3 percent growth forecasts of private analysts and multilateral agencies. The better than expected performance of the economy is anchored on the continued growth of all agriculture, industry and service sectors. Favorable weather conditions and the revitalized support of the government contributed to the 3.7 percent growth of the agriculture sector. *Indonesia* has also been influenced by unfavorable international developments. Moreover, domestically, social, political and security condition has yet to be resolved, resulting in very high degree of economic and financial risk. Nevertheless, GDP grew at 3.3 percent, following the previous year's 4.9 percent. The *Australian* economy strengthened as 2001 progressed, in sharp contrast to the weakening seen in most of the rest of the world. Its real GDP increased by 2.4 percent in 2001 following growth of 3.4 percent in 2000. The *New Zealand* economy has performed strongly since 1999. Despite the marked slowdown in global growth in 2001, the New Zealand economy has continued to grow, by 2.4 percent in 2001.

Canada and *Mexico*, which border the United States, have both suffered abrupt economic downturns. The slowdown in the *Mexican* economy that began at the end of 2000 became more pronounced during 2001. Gross domestic product decreased by 0.3 percent in real terms during 2001 as compared to the previous year. In *Canada*, real GDP slowed to grow by only 1.5 percent in 2001, the lowest level in a decade. The slowdown in the final domestic demand growth from 4.0 percent in 2000 to 2.2 percent in 2001 resulted in a declining business investment, especially in machinery and equipment, after a sharp increase in 2000. The retrenchment was severe in telecommunications and industrial equipment. Consumer expenditure growth weakened to 2.5 percent in 2001 from 3.6 percent in 2000. This reduction was widespread among the goods and services categories. However, growth in the fourth quarter of 2001 rebounded with widespread strength in goods. Thus 2001 marked the tenth consecutive year of economic growth, continuing the longest and most stable expansions of the post-war era.

Among the developing economies in the Western Hemisphere, both *Peru* and *Chile* showed meager growth rates in 2001. Real GDP in *Peru* grew by 0.2 percent in 2001 due to a 1.9 percent increase of the primary sectors reflecting mainly the initial operations of a mining mega-project, Antamina. The *Chilean* economy recorded a slight reduction in GDP growth rate of 2.8 percent, below its potential rate of growth of 5.2 percent. The economy decelerated in 2001, despite a strong export performance, owing to a contraction in domestic demand of 0.5 percent and deteriorated terms of trade.

All the Southeast Asian economies experienced reductions in real growth rate. With high dependence on trade of about 200 percent of GDP, the *Malaysian* economy registered a sharp reduction in its growth rate from 8.3 percent in 2000 to 0.4 percent in 2001, which was mainly due to the downturn of the U.S. economy and global electronics. The *Thai* economy grew at a rate of 1.8 percent in 2001, compared to 4.6 percent in 2000. Its slowdown was also mainly attributed to the adverse impact of the sluggish world economy. Thai exports contracted by 6.9 percent, while private consumption, business investment, public consumption, and public investment grew at 3.4 percent, 5.1 percent, 1.6 percent and -6.6 percent, respectively.

The *Vietnamese* economy registered 6.8 percent growth in 2001, up from 4.8 percent in 1999 and 6.7 percent in 2000. Thus the average economic growth rate was 7.6 percent per annum during 1991–2000 and 7 percent between 1996 and 2000 despite the financial crises in its neighboring countries. It had one of the highest rates in the region. The *Russian* economy experienced another year of fast expansion, growing 5.0 percent in 2001. This growth was spurred by rising domestic demand and the increased production of oil and gas, Russia's major export items. Nevertheless, the continued real appreciation of its currency, the rouble, upward adjustments in regulated domestic energy prices and rising wage costs have reduced profit margins in Russian industry. Industrial output remained essentially flat in the latter part of 2001 and early 2002.

2.2 Increased Unemployment

Reflecting the economic slowdown in 2001, the employment situation in APEC member economies remains bleak. The unemployment rate rose in most member economies. However, in *Korea*, *New Zealand*, and *Thailand*, rates have fallen steadily from 1998 to 2001.

In 2001, the *United States'* unemployment rate increased to 4.8 percent, contrary to its downward trend since 1993. The unemployment rate went from 4.0 percent in December 2000 to 4.8 percent in December 2001. The average duration of unemployment rose by 2 weeks during 2001, ending the year at 14.5 weeks. Private non-farm payrolls dropped by roughly 1.5 million in 2001. The bulk of the decline occurred in manufacturing, especially in durable goods-producing industries, where over one million jobs were shed in 2001.

The employment situation in *Japan* continued to deteriorate during 2001. Although overtime work hours have increased, the unemployment rate has remained at a high level and wages have continued to weaken. The unemployment rate was 5.0 percent in July 2001, the highest level since 1953. It peaked at 5.5 percent in December.

Table 1.2: Unemployment Rates in the APEC Region (percent)

	1996	1997	1998	1999	2000	2001
Western Hemisphere						
Canada	9.6	9.1	8.3	7.6	6.8	7.2
Chile	6.5	6.1	6.2	9.7	9.2	8.7
Mexico	5.5	3.7	3.2	2.5	2.2	2.5
Peru	7.0	7.7	7.8	8.0	7.4	7.9
The United States	5.4	5.0	4.5	4.2	4.0	4.8
Northeast Asia						
China	3.0	3.1	3.1	3.1	3.1	3.6
Hong Kong, China	2.8	2.2	4.7	6.2	4.9	5.1
Japan	3.4	3.4	4.1	4.7	4.7	5.0
Korea	2.0	2.6	6.8	6.3	4.1	3.7
Chinese Taipei	2.6	2.7	2.7	2.9	3.0	4.6
Southeast Asia						
Brunei Darussalam	3.9	4.2	4.7	4.5	4.7	4.7
Indonesia	4.9	4.3	5.1	6.4	6.1	8.1
Malaysia	2.5	2.4	3.2	3.4	3.1	3.7
The Philippines	8.6	8.7	10.1	9.8	11.2	11.1
Singapore	2.0	1.8	3.2	3.5	3.1	3.3
Thailand	1.5	1.2	4.4	4.2	3.6	3.4
Vietnam	N.A.	N.A.	6.6	7.4	6.4	6.3
Oceania						
Australia	8.2	8.2	7.7	7.0	6.3	6.7
New Zealand	6.1	6.6	7.5	6.8	6.0	5.3
Papua New Guinea	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Russia	9.7	9.8	13.2	13.0	10.5	8.7

Source: Individual Economy Reports.

With the contraction of its economy and extensive structural reform after the financial crisis, *Korea's* unemployment rate decreased for three consecutive years from 1998 when it had peaked at 6.8 percent. In 2001, the rate declined to 3.7 percent down from 4.0 percent in 2000. Strong growth in private consumption helped to improve labor market conditions. By the beginning of 2002, unemployment had fallen to its lowest rate since the onset of the Asian financial crisis

Australia; China; Hong Kong, China; Chinese Taipei and most ASEAN members experienced higher unemployment during 2001. In *Australia*, the unemployment rate increased steadily over most of the year to peak at 7.0 percent in October 2001, before declining slightly to 6.7 percent in December 2001. By the end of 2001, the total number of employees in *China* was 730.25 million, with an increase of 9.4 million more than the previous year. Its total number of laid-off employees of state-owned enterprises was 5.15 million. In 2001, every effort was made to help 2.27 million laid-off workers to find new jobs. In China, the urban registered unemployment rate was 3.6 percent at the end of 2001. Unemployment will remain an important issue in the long-run in China. In *Hong Kong, China*, labor demand moderated upon more extensive corporate downsizing and lay-offs in 2001. In parallel with a further expansion in labor supply, there was a marked loosening in the overall manpower resource balance. The unemployment rate jumped from 4.5 percent in the first quarter of 2001 to 6.2 percent in the fourth quarter. The rise in the unemployment rate occurred extensively across almost all sectors and occupation categories. In 2001, the *Chinese Taipei* labor market generally reflected severe recession and investment outflows. Moreover, the domestic labor market has failed to adjust during cyclical change due to inflexibility, while foreign laborers have come to take most jobs in construction, commerce, and housekeeping. As a result, the number of employees fell 1.1 percent from the previous year and the unemployment rate jumped to a historical high of 4.6 percent. Crisis in *Indonesia* so far has a detrimental effect on employment. In spite of higher economic growth than in neighboring economies, *Indonesia's* economic growth was not sufficient enough to absorb the excess workforce. The unemployment rate was estimated to increase to 8.1 percent in 2001 from 6.1 percent in 2000. Although the *Malaysian* unemployment rate edged upwards from 3.1 percent in 2000 to 3.7 percent in 2001, it remained below the 4.0 percent deemed as the full employment level. *Singapore's* labor market was affected by the deterioration in the external environment in 2001. A rapid contraction in economic activity caused 25,600 retrenchments in 2001, more than double the 11,624 seen in 2000. Employment in goods-producing industries experienced a sharp decline, but this was mitigated by employment growth in the services sector. Overall unemployment rate rose to a 15-year high of 4.7 percent at the end of 2001. For the whole of 2001, the unemployment rate averaged 3.3 percent, compared to 3.1 percent in 2000.

Although many jobs were created in *Canada* and *the Philippines*, unemployment rates remained very high in 2001. *Canadian* employment grew at an average rate of 2.6 percent over 1997–2000, bringing the unemployment rate to 6.8 percent in 2000, its lowest level in 25 years. Following these four consecutive years of robust gains, Canadian employment growth slowed early in 2001, raising the unemployment rate to 7.2 percent in 2001. A major factor was the job losses in agriculture and manufacturing, as sharp declines in information and communication technology industries largely offset the continued gains elsewhere. Consequently, the unemployment rate moved up during the year, peaking at 8.0 percent in December. In *the Philippines*, all sectors registered increases in job creation with the services sector generating 776,000 jobs followed closely by agriculture with 669,000 and industry with 257,000. Unemployment remained at double digit rates of 11.1 percent although it was slightly lower compared to 2000. Under-employment rates also declined from 21.7 percent in 2000 to 17.2 percent in 2001.

In *New Zealand*, *Viet Nam*, and *Thailand*, the employment condition improved in 2001. In *New Zealand*, three years of relatively strong economic growth have been reflected in the significant improvements seen in the labor market. Initially, employment growth was in the agricultural and manufacturing sectors, but recently has spread widely into the health, education and community services sectors. For the last three years New Zealand's unemployment rate has fallen steadily from 7.5 percent in 1998 to 5.3 percent in 2001. *Viet Nam* has achieved a significant reduction in population growth with an average annual rate of 1.7 percent during the last 10 years and 1.35% in 2001. Due to its strong growth the economy was able to absorb more than one million new labor entries in 2001. The number of urban unemployed and rural underemployed is decreasing with the unemployment rate dropping to 6.3 percent from 6.4 percent in 2000. In *Thailand*, the number employed increased by 2.6 percent, reflecting the ability of the labor market to absorb new labor entries. As a result the unemployment rate dropped slightly to 3.3 percent in 2001, compared with 3.6 percent in 2000, with the economy still producing below its potential level.

2.3 Lower Inflation and Deflation

On the back of weaker demand, some signs of over-capacity and a softening of primary commodity prices, the price inflation in the APEC region remained on a stable path in 2001. Consumer price inflation (CPI) in the APEC region in 2001 fell or remained at lower levels than in 2000. *Japan*; *Hong Kong, China*; *Chinese Taipei*; and *Peru* all recorded price deflation in 2001. In most other member economies such as the *United States; China*; *Malaysia*; *Singapore*;

Thailand; and *New Zealand*, consumer prices were subdued with an inflation rate of less than 2.0 percent. Economies with relatively higher inflation, such as *Mexico*; *the Philippines*; *Papua New Guinea;* and *Russia* also showed a substantial fall in price inflation in 2001. Inflation in the *United States* slowed considerably in 2001. The consumer price index rose only 1.6 percent for the year, compared to 3.4 percent in 2000. The decline in the inflation rate was largely due to lower demand and favorable energy price developments. Consumer energy prices tumbled 13.0 percent in 2001. The core CPI, which excludes volatile food and energy prices, increased 2.7 percent, slightly above the 2.3 percent average rate recorded over the past four years.

Japan's consumer prices have been falling since 1999 and its GDP deflator has been negative since the mid-1990s. It is the first time an advanced economy has experienced this phenomenon since World War II. Falling steadily from the third quarter of 2000, Japan's consumer prices declined 0.8 percent in 2001, mainly due to a fall in the prices of industrial products such as consumer durable goods and food products. In *Hong Kong, China,* consumer prices fell for three consecutive years up to 2001. During 2001, local inflationary pressure subsided amidst more instances of pay freezes or pay cuts as well as further easing in property rentals. Also contributing to the fall was a continued easing in import prices, due to generally soft world commodity prices and the relative strength of the US dollar at that time. Apart from the cyclical economic downturn, the rise in unemployment was also related to the ongoing restructuring of the economy towards more knowledge-based activities, which has tended to impinge more on the less educated and lower-skilled workers.

After recording a price deflation in 1998 and 1999, *China's* consumer prices had almost no inflation—less than 1.0 percent throughout 2000 and 2001. The consumer price index for 2001 was up by 0.7 percent over the previous year. Prices rose slightly in the first half of the year and declined in the second half of the year. China's consumer prices fell 0.8 percent in the first half of 2002. Although, in *Chinese Taipei,* the depreciation of the New Taiwan dollar generated upward pressure on import prices in 2001, the economic recession and softening international prices of oil, raw materials and finished products produced an opposite effect. In sum, they helped keep the change in wholesale prices to a negative 1.3 percent. Consumer prices slipped a little by 0.01 percent. *Peru* also registered price deflation, i.e., inflation of -0.13 in 2001, which was the lowest since 1939.

In *Brunei Darussalam*, consumer price inflation registered at 0.6 percent in 2001, compared to 1.2 percent in 2000. *Malaysia's* CPI inflation remained low with 1.4 percent in 2001. Further moderation of its inflation came from the stability of the exchange rate, the low rate of inflation abroad, lower prices for many commodities, and excess capacity in several sectors of the economy. The appreciation of the *ringgit* against non-US dollar currencies, as well as a lower producers' price index (which fell by 5 percent in 2001) also contributed to lower CPI inflation in 2001. In *Singapore*, the consumer price index rose by only 1.0 percent in 2001. Price increases were attributed solely to domestic factors that were responsible for 1.2 percent increase in the CPI, while external factors reduced the CPI by 0.2 percent. In *New Zealand*, headline CPI inflation fell down through much of 2001, largely due to the appreciation of its currency and the stable oil price. Core measures of inflation were, however, running somewhat higher. Although, in *Thailand*, the baht depreciated by more than 10.0 percent in 2001, headline inflation was recorded at 1.6 percent, only slightly higher than in 2000 (1.5 percent). The subdued inflation was a result of the slowdown in the Thai economy coupled with a decline in oil prices. *Viet Nam's* inflation in terms of domestic CPI was low with a rate of 0.1 percent in the year 1999, -0.6 percent in the year 2000 and 0.8 percent in the year 2001. In the first half of 2002, the price index increased by 2.9 percent.

In the Western Hemisphere, inflation improved in all APEC member economies. *Canada's* underlying price and cost pressures remained subdued in 2001, with CPI inflation averaging 2.6 percent. *Chile's* inflation in 2001 was 2.6 percent, which was 0.4 percent below the range that its central bank had fixed as a target, and continued the declining trend of previous years. This resulted mainly from the sharp drop in imported commodities such as fuel and a depressed domestic demand. The *Mexican* Government's fiscal discipline and Banco de México's prudent monetary policy resulted in a significant reduction in inflation during 2001. The INPC registered its lowest rate since the INPC was established in 1968, registering an increase of 4.4 percent for the twelve-month period ending on 31 December 2001, significantly lower than the official target of 6.5 percent established by Banco de México for the year.

Figure 1.2: Consumer Price Inflation (%, per annum)

Source: IMF, *International Financial Statistics,* June 2002.

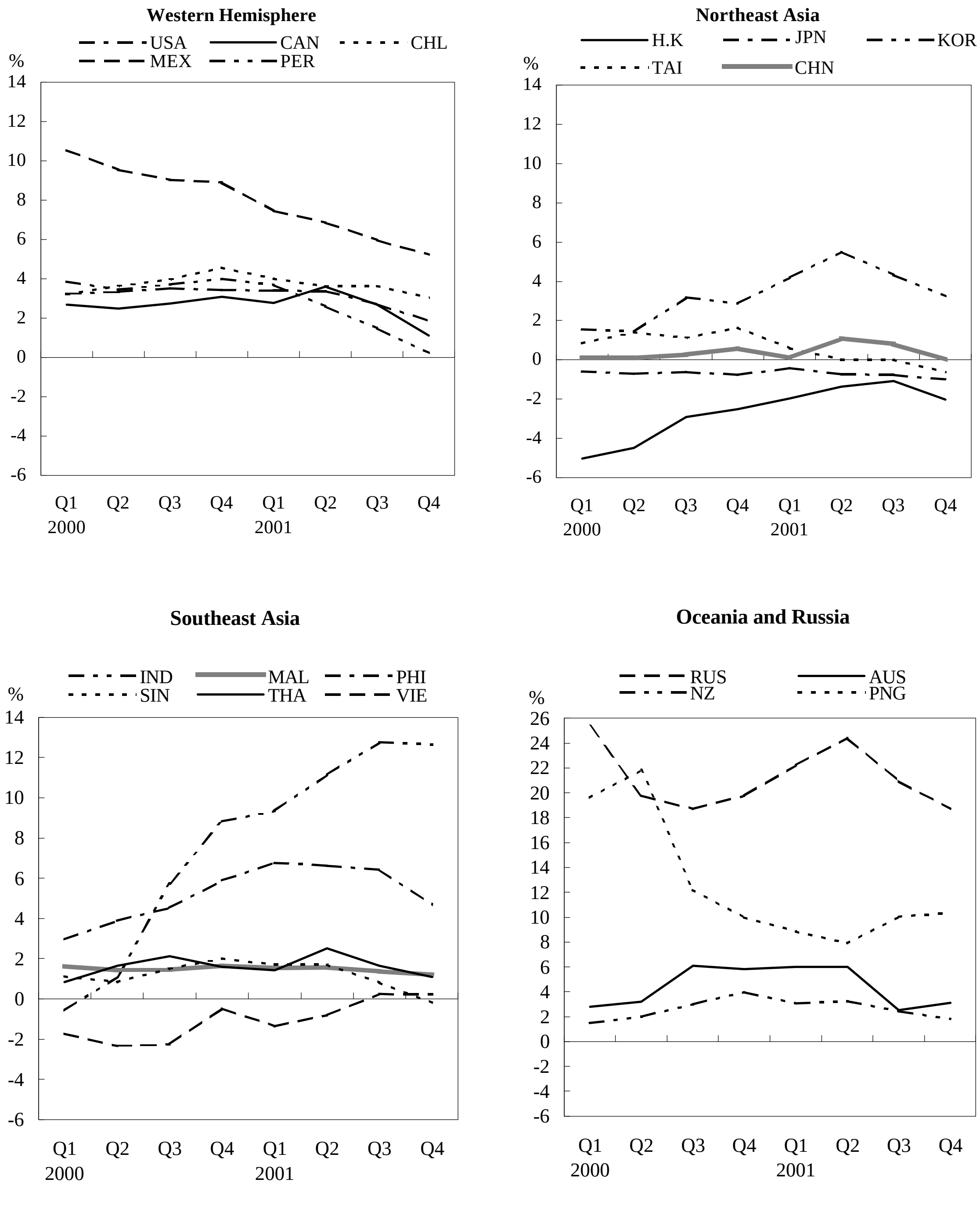


Table 1.3: Consumer Price Inflation in the APEC Region (percent)						
	1996	**1997**	**1998**	**1999**	**2000**	**2001**
Western Hemisphere						
Canada	1.6	1.6	0.9	1.7	2.7	2.6
Chile	6.6	6	4.7	2.3	4.5	2.6
Mexico	27.7	15.7	18.6	12.3	9.0	6.4
Peru	11.5	8.5	7.3	3.5	3.8	-1.3
The United States	3.3	1.7	1.6	2.7	3.4	1.6
Northeast Asia						
China	8.3	2.8	-0.8	-1.4	0.4	0.7
Hong Kong, China	6.3	5.8	2.8	-4	-3.8	-1.6
Japan	0.1	1.8	0.6	-0.3	-0.7	-0.7
Korea	4.9	4.5	7.5	0.8	2.3	4.1
Chinese Taipei	3.1	0.9	1.7	0.2	1.3	-0.0
Southeast Asia						
Brunei Darussalam	2.0	1.7	-0.4	-0.1	1.2	0.6
Indonesia	6.5	10.3	77.6	20.7	9.4	12.6
Malaysia	3.5	2.7	5.3	2.8	1.6	1.4
The Philippines	9.1	5.9	9.7	6.7	4.4	6.1
Singapore	1.4	2	-0.3	0	1.3	1.0
Thailand	5.9	5.6	8.1	0.3	1.6	1.6
Viet Nam	4.5	3.6	9.2	0.1	-0.6	0.8
Oceania						
Australia	2.6	0.3	0.9	1.5	4.5	4.4
New Zealand	2.6	0.8	0.4	0.5	4.0	1.8
Papua New Guinea	6.3	5.3	21.8	13.2	10.0	10.3
Russia	22.0	11.0	84.4	36.5	20.2	18.6

Sources: Individual Economy Reports.
IMF, *World Economic Outlook*, September 2002.

In contrast to the lower inflation trend in the APEC region, some members experienced higher inflation in 2001. *Korea's* consumer prices rose 4.3 percent in 2001, up from 0.8 percent in 1999 and 2.3 percent in 2000 due mainly to increases in the prices of farm products and housing rents. Consumer prices increased considerably for the first half of the year, but gradually stabilized during the second half of the year. Higher inflation in 2001 was mainly attributable to the Government's stimulative macro-economic policies in the latter part of 2001, which contributed to economic recovery and financial market stabilization. The *Australian* consumer price index increased by 4.4 percent in 2001 and 4.5 percent in 2000. The price of food increased substantially throughout the year with inflation effects resulting from the events of September 11 2001, and the collapse of both a major Australian insurance firm and the second largest Australian airline. *Indonesia's* consumer price inflation rose to 12.6 percent in 2001 from 9.4 percent in 2000, the second highest level among the APEC members after *Russia*'s 18.6 percent. The high pressure on Indonesia's inflation was stemmed from the impact of some adjustments in government administered prices, e.g., increases in fuel prices, transportation and the electricity tariff. In addition, the weaker exchange rate and deteriorating inflationary expectation caused producer prices to rise.

2.4 Tumbled External Trade

In terms of the weight of the intra-regional trade, there has been a trend over the last decade of growing interdependencies among the economies in the APEC region. Dependence of APEC exports on APEC markets was as high as 73.2 percent in 2001 with many APEC members exporting more than three-fourths of their goods to fellow members. The degree of dependence in

1991 was 63.8 percent. Especially the weight of the US market for APEC members' exports has increased sharply from 26.0 percent in 1991 to 34.2 percent in 2001. On the other hand, the weight of the European market has fallen from 19.9 percent to 17.2 percent during the same period.

Due to the abruptly withering external demand of major APEC economies and the interdependencies among members, the trade volume of the APEC region decreased sharply in 2001. The largest casualty occurred in trade in manufactured goods, especially in the information and communication technology sector. Most economies in the region registered a fall in both export and import volumes in 2001, after large increases in 1999 and 2000. Even in relatively high growth economies like *China*; *Indonesia*; *Viet Nam;* and *New Zealand*, the increasing rate of export and imports fell sharply, to an extremely low level, in 2001. In *China*, export and import volumes increased only 6.4 percent and 8.2 percent in 2001, respectively, compared with 27.8 percent and 35.8 percent in 2000.

Table 1.4: Direction of Trade in the APEC Region(1991) (percent)

From \ To	APEC						Memorandum			
	Western Hemi-sphere	North-east Asia	South-east Asia	Oceania	Russia	APEC Total	US	JPN	CHN	EU
Western Hemisphere										
Canada	77.0	8.9	1.1	0.5	0.0	87.5	76.5	5.0	1.3	8.2
Chile	20.8	28.9	1.6	0.3	0.0	51.5	18.0	18.6	0.9	33.6
Mexico	21.6	26.1	1.6	0.3	0.0	49.6	18.7	19.3	0.9	34.9
Peru	28.8	20.8	1.1	0.2	0.0	50.9	23.3	9.7	4.9	30.2
The United States	29.0	22.0	4.9	2.3	0.0	58.3	-	11.5	1.5	25.7
Northeast Asia										
China	10.0	64.9	5.9	0.9	0.0	81.7	8.9	14.7	-	10.2
Hong Kong, China	25.8	37.6	6.8	1.6	0.0	71.8	23.4	5.5	27.9	19.3
Japan	32.9	20.4	12.0	2.4	0.0	67.7	29.5	-	2.8	20.5
Korea	30.2	28.1	10.3	1.6	0.0	70.2	26.3	17.5	1.4	14.8
Chinese Taipei	32.2	30.1	9.9	2.0	0.0	73.1	29.3	12.1	0.0	17.1
Southeast Asia										
Brunei Darussalam	1.1	75.7	19.9	2.8	0.0	99.5	1.1	62.7	0.2	0.5
Indonesia	12.7	54.0	11.3	2.2	0.0	85.7	12.0	36.7	4.1	1.7
Malaysia	18.0	29.3	29.0	2.0	0.0	78.2	16.7	15.7	1.8	15.0
The Philippines	37.6	31.2	7.2	1.3	0.0	77.3	35.7	20.1	1.5	19.1
Singapore	21.3	22.8	24.0	3.1	0.0	71.3	20.4	9.0	1.5	14.3
Thailand	23.0	27.6	11.7	1.6	0.0	64.0	21.3	18.0	1.2	22.6
Viet Nam	0.0	69.6	22.4	0.2	0.0	92.2	0.0	31.3	0.8	5.23
Oceania										
Australia	12.1	46.2	12.6	6.6	0.0	77.5	10.2	28.2	2.9	12.3
New Zealand	16.7	28.4	7.3	23.1	0.0	73.4	13.8	17.1	1.8	16.0
Papua New Guinea	2.1	33.4	7.4	40.8	0.0	83.7	2.0	23.0	0.3	15.2
Russia	2.2	11.5	1.5	0.0	-	15.2	1.8	4.0	7.0	52.2
APEC	30.6	26.1	8.6	2.2	0.0	63.8	26.0	10.8	3.7	19.9

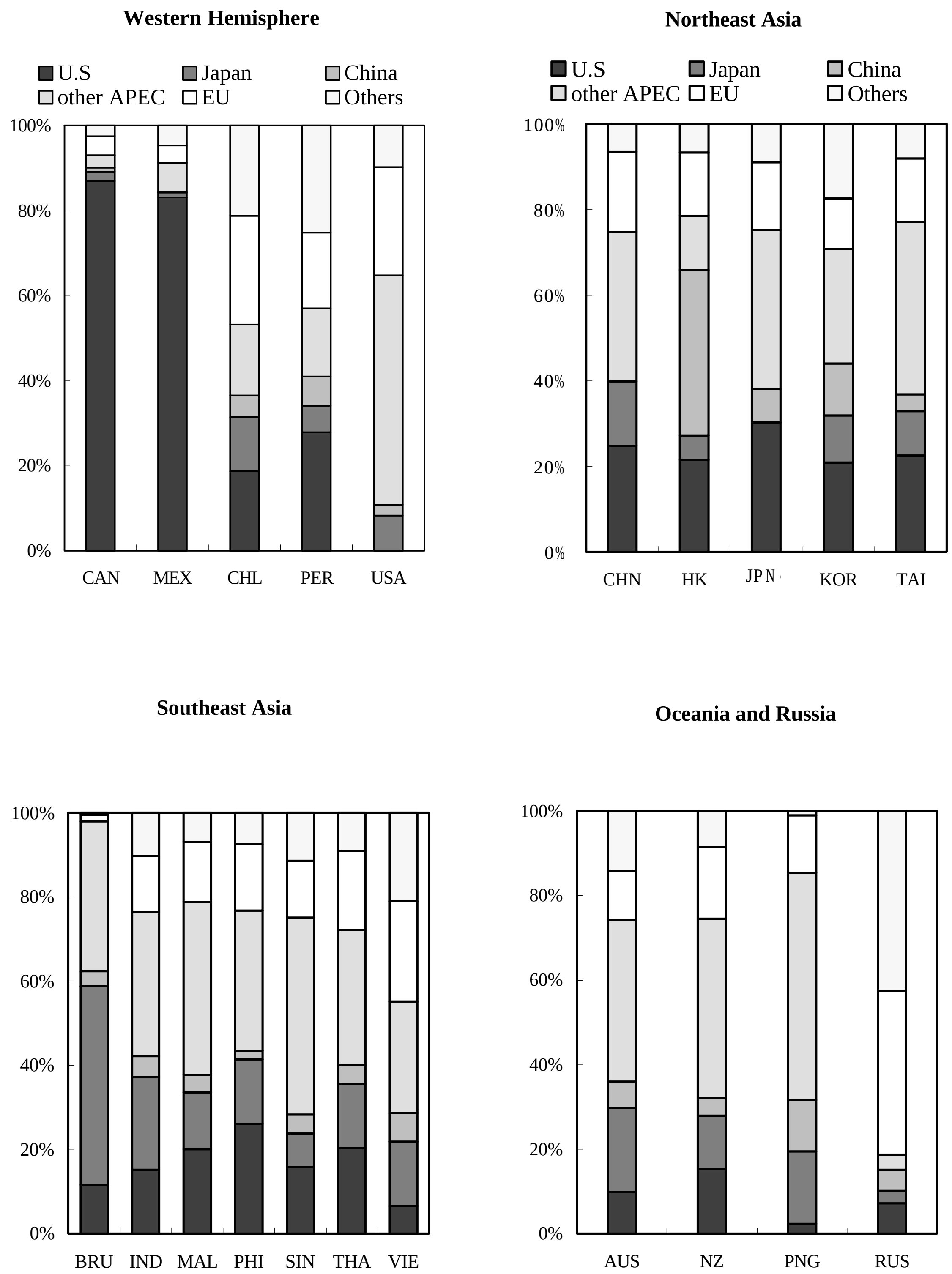
Note: * 1992.
Source: IMF, *Direction of Trade Statistics*, June 1992.

Table 1.5: Direction of Trade in the APEC Region (2001) (percent)

To / From	APEC						Memorandum			
	Western Hemi-sphere	North-east Asia	South-east Asia	Oceania	Russia	APEC Total	U.S	Japan	China	EU
Western Hemisphere										
Canada	87.8	4.2	0.5	0.3	0.1	92.9	87.0	2.1	1.0	4.5
Chile	28.2	23.7	1.2	0.2	0.0	53.3	18.7	12.7	5.0	25.4
Mexico	88.4	2.1	0.4	0.3	0.0	91.2	83.0	1.2	0.3	4.1
Peru	36.7	16.6	2.7	0.5	0.4	56.9	27.9	6.2	6.9	18.0
The United States	37.9	18.4	6.1	1.9	0.4	64.7	-	8.1	2.7	25.6
Northeast Asia										
China	27.2	39.5	5.9	1.6	0.6	74.8	24.8	15.0	-	18.6
Hong Kong, China	23.9	47.3	6.0	1.3	0.1	78.7	22.3	5.9	36.9	14.4
Japan	33.4	26.1	13.5	2.0	0.2	75.2	30.3	-	7.8	15.8
Korea	24.0	33.9	10.7	1.6	0.6	70.8	20.9	11.0	12.1	11.8
Chinese Taipei	24.8	38.9	11.9	1.3	0.2	77.1	22.5	10.4	3.9	14.8
Southeast Asia										
Brunei Darussalam	11.6	63.1	16.4	6.9	0.0	98.0	11.6	47.2	3.6	1.5
Indonesia	16.5	39.1	17.5	3.2	0.1	76.4	15.1	22.0	5.0	13.4
Malaysia	21.5	30.2	24.3	2.6	0.2	78.8	20.0	13.5	4.2	14.3
The Philippines	27.8	34.1	14.0	0.8	0.0	76.7	26.1	15.3	2.1	15.9
Singapore	16.8	28.3	26.7	3.2	0.1	75.1	15.8	7.9	4.5	13.5
Thailand	22.2	30.0	17.4	2.4	0.1	72.1	20.3	15.3	4.4	18.8
Viet Nam	7.4	28.4	11.8	7.0	0.5	55.1	6.5	15.3	6.8	23.8
Oceania										
Australia	11.9	42.6	12.8	6.8	0.2	74.3	9.9	19.8	6.3	11.5
New Zealand	19.3	26.3	9.5	19.4	0.0	74.5	15.3	12.7	4.1	17.0
Papua New Guinea	2.6	34.4	7.7	40.7	0.0	85.4	2.3	17.2	12.2	13.6
Russia	7.4	9.8	1.5	0.0	-	18.7	7.2	3.0	4.9	38.8
APEC	36.9	25.3	8.9	1.9	0.3	73.2	34.2	9.2	6.7	17.2

Source: IMF, *Direction of Trade Statistics*, June 2002.

Figure 1.3
Composition of Export Market (2001)



Source: IMF, *Direction of Trade Statistics*, June 2002.

The slowdown in *the United States* and other economies depressed both US imports and exports, evidenced by a greater drop in exports. Because of a sharp reduction in exports of capital goods, especially high-technology goods, the US real exports of goods and services declined by US$51.5 billion. Real imports declined by US$41.8 billion. *Japan's* exports in 2001 dropped by 7.0 percent with imports also decreasing but by a smaller margin. Exports of electronic appliances and general machinery are on a sharp increasing trend, reflecting the worldwide economic recovery in the first half of 2002.

China and *Australia* maintained high growth in foreign trade in 2001. *China's* exports reached US$262.2 billion, increasing at 6.8 percent. Imports reached US$243.6 million, increasing by 8.2 percent. Exports in machinery-building and electronic products increased relatively faster. The export volume of high-tech and new-tech products increased by 25.4 percent to US$46.5 billion, which accounted for 17.5 percent of total exports. *Australia's* merchandise exports increased 8.5 percent in 2001, while export volumes increased 1.1 percent in 2001. Imports increased 1.3 percent in 2001, while import volumes fell 4.7 percent in 2001.

Most Asian member economies recorded a fall in external trade. *Hong Kong, China's* merchandise exports fell by 5.7 percent in value terms to US$190.9 billion in 2001. Reflecting the downturn in both re-export trade and domestic demand, imports of goods likewise shrank, by 5.4 percent in value terms to US$199.3 billion in 2001. As goods exports fell somewhat faster than imports, the visible trade deficit widened slightly to US$8.3 billion or 4.2 percent of the value of imports of goods in 2001. The world economic slowdown and downturn of electronic industries hit *Chinese Taipei's* and *Malaysia's* trade the most. *Malaysia's* exports declined at 10.4 percent during 2001. Most categories of exports were adversely affected, particularly electronics and non-household electrical appliances as well as crude oil and palm oil. Imports also declined by 9.9 percent, which helped to contain the slight decline in the trade surplus to US$14.1 billion in 2001 from US$16.3 billion in 2000. *Chinese Taipei's* merchandise exports contracted 17.2 percent to US$122.9 billion in 2001. Most affected were ICT exports, down 23.4 percent from the previous year. Imports in value terms decreased 23.4 percent to US$107.2 billion, depressed by a slump in the purchase of capital equipment. Chinese Taipei's trade balance showed a surplus of US$15.6 billion for the year. Because the *Philippines'* export sector was particularly vulnerable to the weak global economy, its exports of goods and services contracted 5.2 percent in 2001 after growing by 17.7 percent in 2000. Merchandise exports slid by 1.6 percent in 2001. Imports of goods and services likewise declined by 0.8 percent. The decelerated growth in merchandise imports and continued drop in non-merchandise imports in 2000 and 2001, contributed to the weak import performance. *Thailand's* exports experienced a sharp decline of 6.9 percent in 2001. Even with the plunge in exports, the trade balance in 2001 remained in surplus at US$2.5 billion since imports declined, by 2.8 percent. The services balance decreased slightly from a surplus of US$ 3.9 million in 2000 to a surplus of US$3.7 million in 2001. *Brunei Darussalam's* exports decreased by 5.7 percent to BN$6,348.9 million in 2001. Petroleum exports decreased by 8.6 percent, reflecting lower oil price and volume, while exports of LNG increased by 0.7 percent. Total oil and gas exports decreased by 4.6 percent to only BN$5,612.1 million in 2001. *Viet Nam's* exports were US$15.0 billion in 2001, slightly higher than in 2000. However exports in the first half of 2002 registered a negative growth rate, minus 5.9 percent. Exports from FDI firms increased by 14.8 percent while exports from local firms decreased by 6.8 percent.

Canadian exports of goods and services fell 2.1 percent in 2001 to C$469.4 billion, equivalent to 43.3 percent of GDP. Imports of goods and services fell by 2.9 percent to C$413.8 billion or around 38 percent of GDP. Thus the merchandise trade balance represented 5.7 percent of GDP in 2001, about the same as in 2000. Compared to 2000, *Mexico's* exports and imports decreased by 4.8 percent and 3.5 percent, respectively. The decrease in exports was primarily attributable to the fall in international oil prices and the recession in the United States. The decrease in import volume was primarily due to a reduction in imports by the *maquiladora*, or in-bond industries, as well as a result of the slowdown in domestic demand.

Table 1.6: Export of Goods and Services (percent)

	2000	2001	2002				2003			
			Official	OECD	ADB*	DRI-WEFA*	Official	OECD	ADB*	DRI-WEFA*
Western Hemisphere										
Canada	7.6	-3.7		2.8		-1.2		9.1		11.4
Chile	7.5	-4.0	4.9			3.1	14.9			8.2
Mexico	16.4	-5.1	4.2	2.4		4.4		8.7		12.9
Peru*	14.5	1.5				7.1				6.8
The United States	9.7	-5.4		-2.8		-4.7		7.3		7.5
Northeast Asia										
China	27.8	6.4			6.0	7.5			10.0	12.9
Hong Kong, China	16.5	-1.8	6.1		1.6	3.3			6.2	5.2
Japan	12.4	-7.0	-0.3	1.9		-0.4		9.0		12.5
Korea	20.5	1.0	7.0	5.4	7.0	8.9		13.0	10.0	11.8
Chinese Taipei	17.3	-8.2	6.2		5.5	4.7			8.0	6.7
Southeast Asia										
Brunei Darussalam	51.1	0.6								
Indonesia	16.1	1.9	3.1			5.1				12.4
Malaysia	16.1	-7.6	4.4		7.0	4.6			11.9	8.6
The Philippines	17.7	-5.2	3.9~4.4		3.0	3.7	8.5~9.0		6.0	3.8
Singapore	15.3	-7.3				0.0				5.5
Thailand	19.6	-6.9	1.7			4.7	5.0			6.7
Viet Nam*	25.2	8.6				10.6				16.7
Oceania										
Australia	10.9	0.8	-2.0	2.8		1.3	6.0	7.8		6.5
New Zealand	7.4	2.3		1.4		5.0		7.5		7.7
Papua New Guinea	16.7	-13.7	-0.7				0.2			
Russia	8.7	3.3				-2.2				5.0

Note: * Based on merchandise exports valued at current U.S dollars.
Sources: Individual Economy Reports.
ADB, *Asian Development Outlook*, April 2002.
DRI-WEFA, *World Overview*, June 2002.
OECD, *OECD Economic Outlook*, June 2002.

Table 1.7: Import of Goods and Services (percent)

	2000	2001	2002				2003			
			Official	OECD	ADB*	DRI-WEFA*	Official	OECD	ADB*	DRI-WEFA*
Western Hemisphere										
Canada	8.1	-5.7		1.6		-0.7		9.5		10.7
Chile	10.1	-4.7	5.7			1.2	12.9			6.9
Mexico	21.5	-2.9	5.1	3.6		4.2		10.2		13.1
Peru*	9.3	-2.0				2.8				6.9
The United States	13.2	-2.9		2.3		1.1		8.8		9.5
Northeast Asia										
China	35.8	8.2			10.0	6.1			14.0	17.8
Hong Kong, China	16.8	-1.7	4.3		1.9	3.0			7.8	5.3
Japan	9.6	-0.8	-3.0	-5.6		-4.8		3.1		12.1
Korea	20.0	-2.8	9.5	5.8	12.0	8.8		10.7	14.0	18.2
Chinese Taipei	19.1	-13.5	7.2		8.0	2.2			10.0	7.8
Southeast Asia										
Brunei Darussalam	-1.4	6.9								
Indonesia	18.2	8.1	9.0			2.7				16.8
Malaysia	24.2	-8.6	4.8		10.0	11.7			16.1	13.5
The Philippines	4.0	-0.8	5.2~5.7		2.5	2.4	8.3~8.8		4.0	3.3
Singapore	22.1	-13.8				-1.9				7.7
Thailand	31.4	-2.8				5.2	5.7			5.8
Viet Nam*	33.2	7.1				9.9				17.5
Oceania										
Australia	7.4	-4.5	2.0	8.0		6.0	11.0	8.0		11.3
New Zealand	1.0	2.0		5.2		6.4		7.5		6.0
Papua New Guinea*	0.7	-6.4	-7.9				-13.2			
Russia	12.7	13.9				4.7				13.3

Note: * Based on merchandise exports valued at current U.S dollars.
Sources: Individual Economy Reports.
ADB, *Asian Development Outlook,* April 2002.
DRI-WEFA, *World Overview*, June 2002.
OECD, *OECD Economic Outlook*, June 2002.

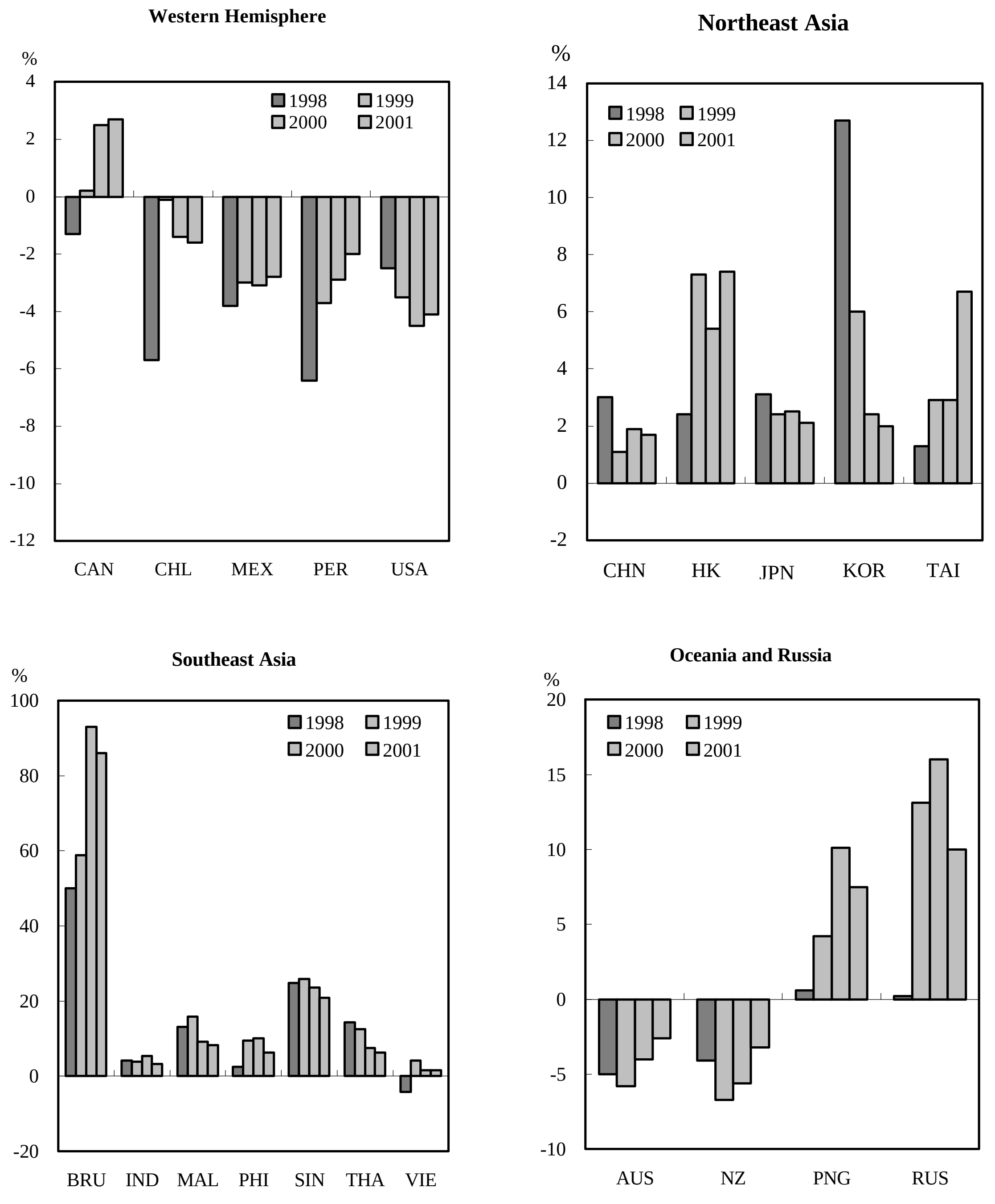
2.5 Persistent External Imbalances

Amidst shrinking trade in the APEC region, current accounts continued to be in wide imbalances among major economies. Member economies in the Western Hemisphere and Oceania, with the exception of *Canada*, registered alarming levels of current account deficits while all member economies in Asia recorded large surpluses. Especially in the case of *Hong Kong, China* and *Chinese Taipei*, current account surpluses with respect to their GDPs rose to 7.2 percent and 6.7 percent, respectively, in 2001. *Singapore's* surplus has been about 20 percent of its GDP for the last four years.

Among the external imbalances of the major countries in the APEC region, *the U.S.* current account deficit in particular played a vital role in sustaining the recent recovery, which heavily dependent on the US economic growth. Since the mid-1990s, the *US* deficits have steadily risen to US$410.3 billion, or about 4.2 percent of GDP in 2000. Although the figure fell slightly to US$393.4 billion, or 3.9 percent in 2001, it is expected to rise again with the US economic rebound in the near future. The figure is forecast to exceed 5 percent in 2002 and 2003. This could bring about some concerns over the sustainable growth of the world economy. In previous postwar recessions, the US's current accounts usually moved into balance, as imports dropped and exports remained steady. However, this post-recession period is unusual in that the US has a bulging current account deficit.

Japan's current account surplus fell slightly from 2.5 percent of GDP in 2000 to 2.1 percent in 2001. It was a result of increasing imports due to structural reasons like the development-and-import scheme, where exports significantly dropped following the US economic recession and the decrease of ICT-related demand. The surpluses in merchandise trade and the current account are expected to increase slightly in 2002 and 2003, as the global economy experiences a mild recovery of the global economy and the relative stagnation of the Japanese economy brings about sluggish imports and active exports. The current account surplus is expected to be approximately 2.3 percent of GDP in FY2002.

Figure 1.4: Current Account Balances (% of GDP)



Source : Individual Economy Reports

Table 1.8: Current Account Balance in the APEC Region (% of GDP)

	1996	1997	1998	1999	2000	2001
Western Hemisphere						
Canada	0.5	-1.3	-1.3	0.2	2.5	2.7
Chile	-5.1	-5.0	-5.7	-0.1	-1.4	-1.6
Mexico	-0.7	-1.9	-3.8	-3.0	-3.1	-2.9
Peru	-6.1	-5.2	-6.4	-3.7	-2.9	-2.0
The United States	-1.5	-1.5	-2.3	-3.2	-4.2	-3.9
Northeast Asia						
China	0.9	3.3	3.0	1.1	1.9	1.5
Hong Kong, China	N.A.	-3.1	2.7	7.5	5.5	7.2
Japan	1.4	2.2	3.0	2.6	2.5	2.1
Korea	-4.4	-1.7	12.7	6.0	2.4	2.0
Chinese Taipei	3.9	2.4	1.3	2.9	2.9	6.7
Southeast Asia						
Brunei Darussalam	54.2	51.7	53.8	62.6	92.8	89.1
Indonesia	-3.5	-2.3	4.2	3.9	5.3	4.7
Malaysia	-4.4	-5.9	13.1	15.9	10.2	9.0
The Philippines	-4.8	-5.3	2.4	9.7	11.3	6.4
Singapore	13.8	19.2	24.0	20.0	17.2	20.9
Thailand	-14.4	-3.1	14.3	12.5	9.3	6.2
Viet Nam	-10.3	-6.5	-4.3	4.1	1.6	1.5
Oceania						
Australia	-3.9	-3.1	-4.9	-5.8	-4.0	-2.6
New Zealand	-5.9	-6.6	-4.1	-6.7	-5.6	-3.2
Papua New Guinea	6.0	-2.4	1.6	4.2	10.2	9.6
Russia	2.8	0.5	0.2	13.1	18.5	11.2

Sources: Individual Economy Reports.
ADB, *Asian Development Outlook*, April 2002.
OECD, *OECD Economic Outlook*, June 2002.

In 2001, *China* registered a decline in its current account surplus to US$17.4 billion from US$20.5 billion in 2000. The shrinking surplus was attributed largely to slowing external demand for Chinese exports. China recorded US$34 billion surplus in merchandise trade and US$5.96 billion deficit in services trade. Although its exports continued to decline by a slump in overseas demand, *Korea* has kept substantial surpluses in the current account for four consecutive years since 1998.

Hong Kong, China's merchandise exports fell somewhat faster than imports. The trade deficit, reckoned on a balance of payments (BOP) basis, widened slightly to US$8.3 billion or 4.2 percent of merchandise imports in 2001. This was nevertheless considerably offset by the sizeable invisible trade surplus of US$17.1 billion in that year, thereby yielding a combined surplus of US$8.8 billion, equivalent to 3.9 percent of the total value of imports of goods and services in 2001. *Chinese Taipei's* trade balance showed a surplus of US$15.6 billion in 2001. Trade in services posted a deficit of US$4.2 billion, down from US$6.9 billion in 2000. *Singapore's* current account surplus was registered at 20.9 percent of GDP, slightly down from 17.2 percent in 2000.

In contrast, *Indonesia*, *Malaysia*, *the Philippines*, *Canada* and *New Zealand* showed improvements in their balance of payments. *Indonesia's* balance of payments has improved, as evidenced by a large surpluses of 3 to 5 percent of GDP since 1998, and it is expected to improve further in 2002. *Malaysia's* external position remained fundamentally strong despite the slowdown in the global economy. In fact, the overall balance of payments position turned around and recorded a surplus in 2001. The improvement was due partly to lower outflows in the financial account. The sizeable surplus reflected a moderate decline in the trade account and improvements in the income and services accounts. In *the Philippines*, the balance of payments deficit narrowed down to US$192 million in 2001. Despite the slowdown in external demand, the current account remained in surplus at US$4.6 billion. The *Canadian* current account has improved dramatically from its deficits in the 1990s. It recorded a surplus of 0.2 percent of GDP in 1999, and since then has improved to a surplus of 2.7 percent of GDP in 2001. The main factor underpinning this improvement was an increase in the merchandise trade surplus from C$22.8 billion in 1998 to C$1.5 billion in 2001.In *New Zealand*, the current account deficit decreased from 7.0 percent of GDP in the first quarter 2000 to 3.2 percent in the fourth quarter 2001, its lowest figure in the last nine years. In the coming year the current account deficit is expected to increase to about 4.5 percent of GDP.

Sustaining their current account surpluses, some Asian APEC economies improved their net external debt position in 2001 and 2002. In the case of *Korea*, total external liabilities stood at US$121.0 billion as of the end of February 2002. This figure has declined since August 2001 and was its lowest level since the onset of the financial crisis. The decreasing trend of total external liabilities was mainly attributed to the early repayment of IMF loans and financial institutions' repayment of overseas borrowings. Korea's external assets totaled US$162.7 billion as of the end of February 2002. As a result, Korea's net external assets reached US$41.7 billion, strengthening its net creditor position since September 1999. *Thai's* external debt also declined from US$79.7 billion in 2000 to US$67.5 billion at the end of the year 2001, comprised of US$28.3 billion for public external debt and US$39.2 billion for private external debt. The drastic decline was mainly a result of increase in both public and private long-term external repayments. The *Singapore* government did not record any external debt at the end of 2001. The developing members in the Western Hemisphere suffered a worsening debt position. *Chile's* foreign debt reached US$37.7 billion in 2001, representing almost 50 percent of its GDP and an increase of 2.5 percent over the previous year. Most of the amount is comprised by medium- and long-term liabilities, which account for 82.8 percent of total foreign debt. As of the end of 2001, *Mexico's* net public sector external debt amounted to 11.7 percent of GDP, a decrease of 1.1 percent points as compared to the end of 2000. The outstanding amount of net public sector external debt at the end of 2001 was US$76.6 billion.

2.6 Economic Consequences of the Terrorist Attacks

The September 11 terrorist attacks were a dreadful shock to the world economy. Policymakers reacted promptly to the attacks, which helped to limit the short-run impact of the shock on the global economy. Despite the ongoing efforts to be better prepared for such emergencies, further attacks and counter-activities could have negative effects on the world economic recovery. Over the longer run, the heightened terrorist threat may have some lasting, macro-economic effects. The following three channels of influence can be considered: higher perceived risk, more expensive transport costs, and stepped-up public spending on security and military operations.[1]

First, in terms of international trade and insurance, the terrorist attacks and consequent anti-terrorist campaign caused an unprecedented insured loss prompting increases in premiums and reductions in coverage. According to OECD estimates, the costs of the attacks for the insurance sector are estimated to range from US$30 billion to over US$60 billion, making these events the largest insurance event ever. Reinsurance companies rather than primary insurers are shouldering the largest share of this burden.

Second, the attacks have also made border-crossings more expensive. Following the attacks, border controls were immediately reinforced, causing a temporary decrease in border throughput.

[1] "Economic consequences of terrorism," *OECD Economic Outlook* (June 2002).

The highest level of alert in customs would require sustained anti-terrorist questioning and enhanced inspections of travelers and goods at every port entry, which may negatively impact international trade through rising transaction costs. OECD studies suggest that even a seemingly modest change in the cost of crossing borders might significantly affect international trade volumes and therefore openness and, ultimately, economic growth.

Third, the attacks will cause public spending on security to rise. Mainly in connection with the end of the Cold War, defense spending among NATO nations dropped from 4.5 percent in mid-1980s to 2.5 percent in late 1990s. In the *US* the fall was even steeper, from a peak of 6.2 percent in 1986 to 3 percent of GDP in 1999. But following the September 11 attacks, defense and homeland security spending rose. In the absence of sufficient aggregate demand, rising security spending would tend to bolster aggregate demand and output. However, as with heightened uncertainty and more cumbersome border-crossing procedures, heavier spending on security may reduce productivity due to a diversion of resources away from more productive uses.

3. POLICY RESPONSE AND ECONOMIC PROSPECTS

Due to lower medium-term inflationary pressure, monetary authorities in major countries have cut interest rates more aggressively in 2001 than during previous downturns. By the start of 2002, nominal short-term interest rates stood at their lowest levels in four decades in *Canada* and *the United States* and at historical record low levels in most Asian APEC economies. Based on projected consumer price inflation, real short-term interest rates are slightly below zero in the United States but they are well above that in the other major OECD countries.

3.1 Fiscal Policy

Against the economic slowdown in 2001, most APEC economies, especially *the United States* and *Canada*, increased public expenditures substantially to avoid a deep recession and to return to economic recovery. The governments in the APEC region will continue their policy stance for economic recovery, but there is an increasing possibility of slower and gradual consolidation if and when economic recovery becomes obvious.

According to measures taken and policy intentions stated in the federal budget, fiscal policy in *the United States* will be expansionary in 2002, assuming that the FY2002 budget and the recent stimulus package are fully implemented. Assuming that the administration’s budget proposal for FY2003 is implemented, the fiscal stance will be slightly restrictive in 2003. The US government ran the second largest surplus in history for FY2001 of US$127 billion, compared with US$ 236 billion in 2000. Because of the recession, tax cuts, and the war on terrorism, deficits are currently projected for fiscal years 2002–2004, although they are expected to decline from US$ 106 billion in FY2002 to US$14 billion in FY2004.

In *Japan*, where the fiscal situation is difficult, the government’s macro-economic and fiscal management policy is to steadily implement structural reform and carefully watch the economic situation. In October 2001, the government adopted the “Front-Loaded Reform Program” to accelerate the pace of structural reform and subsequently formulated the first supplementary budget of one trillion yen. It also focused on the creation of new jobs and a safety net concerning job security and small and medium-sized enterprises. In FY2002 budget, preferential resource allocations were made to seven priority areas, while keeping the issuance of government bonds under 30 trillion yen.

Because increased volatility of price variables including interest rates, stock prices and foreign exchange rates is anticipated in accordance with the developments in the external environment in 2002, the *Korean* government intends to carry out a fiscal policy with a focus on early economic recovery by stimulating domestic demand.

Australia's fiscal balance has been in surplus on a cash basis since financial year 1997–1998. A statutory measure was implemented to assess the long-term effect of government policies and secure a sound fiscal condition. In compliance with the Charter of Budget Honesty Act 1998, an Intergenerational Report (IGR) will be compiled every five years to assess the sustainability of current government policies for the subsequent forty years. *New Zealand* has been running an operating surplus since FY1994 with surplus of 1.3 percent of GDP in 2001. Also, operating expenses have been reduced from 41.6 percent of GDP in 1992/93 to 32.5 percent in the 2001/02 fiscal year.

In *Hong Kong, China*, the 2001–2002 financial results showed a deficit of HK$63.3 billion, equivalent to 4.9 percent of the forecast GDP for 2001 as compared with the original budget deficit of HK$3.0 billion. In the medium range forecast to 2006–2007, expenditure is planned to grow (at money terms) at annual average rate of 1 percent below the trend GDP growth rate of 4.4 percent a year. In 2001, *China's* total deficit in the central budget for 2001 accounted for 2.7 percent of GDP. The outstanding debts totaled US$188.58 billion, accounting for 16.3 percent of GDP. Both the deficit and the remaining total debt were within safe limits. *Chinese Taipei's* fiscal deficit was NT$457 billion in 2001, following increases in both government revenue of NT$210 billion and government expenditure of NT$255.7 billion, increases of 13.1 percent and 22.1 percent respectively from the previous fiscal year. Tax revenues fell for the third consecutive year due to the economic recession and a series of tax cut measures, including a tax waiver on capital gains and a lowering of the land tax base. Tax revenues as a percentage of GNP continued to fall, to 12.9 percent, the lowest on record, with a corresponding lessening of the tax burden. Although government expenditure increased, the ratio of tax revenue to government expenditure continued to shrink to 50.5 percent, the lowest in its history.

In 2002, the Government of *Indonesia* is committed to directing its policy toward achieving fiscal sustainability. For this purpose, two strategic objectives are suggested. The first is to reduce budget deficits, and the second is to reduce the ratio of government debt to GDP. The main thrusts of the fiscal policy are aimed towards: optimizing domestic revenues from both taxes and non-taxes, improving efficiency in state expenditures, reducing subsidies, allocating balanced funds for regional autonomy, and reducing reliance on external financing.

Table 1.9: Forecast on Budget Balances (% of GDP)						
	2000	2001	2002		2003	
			OECD	ADB	OECD	ADB
Western Hemisphere						
Canada	3.3	2.4	1.0		1.1	
Chile	0.1	-0.3				
Mexico	-1.1	-0.7	7.3		7.6	
Peru	-3.2					
The United States	2.3	0.4	-1.0		-0.7	
Northeast Asia						
China	-2.8	-2.6	-3.3	-3.0	-3.0	-2.8
Hong Kong, China	-0.6	-5.0		-3.5		-3.0
Japan	-7.0**		-8.4**		-7.8**	
Korea	1.3	1.3	7.8	1.5	7.1	1.6
Chinese Taipei	-1.3	-4.7		-4.2		-4.0
Southeast Asia						
Brunei Darussalam	11.9	4.9				
Indonesia	-5.1	-3.7		-2.5		-0.5
Malaysia	-5.8	5.5		-5.2		-3.0
The Philippines	-4.1	-4.0		-3.2		-3.0
Singapore	3.5	1.9		-0.5		1.2
Thailand	-2.4	-2.7		-3.8		-3.0
Vietnam	-3.0	-2.9		-5.4*		-6.5*
Oceania						
Australia	2.0	0.8	0.1		2.0	
New Zealand	1.4	1.3	0.1		0.0	
Papua New Guinea	-2.0	3.7				
Russia	2.5	3.0	2.0		0.0	

Notes: * Excluding grants and including net lending.
** Excluding Social Security.
Sources: ADB, *Asian Development Outlook*, April 2002.
OECD, *OECD Economic Outlook*, June 2002.

From 1998 to 2001, *Malaysia's* budgetary position incurred deficits, largely because of expansionary fiscal policy designed to support economic growth and recovery. The focus of the 2002 budget is, therefore, to continue the recovery process to a level consistent with Malaysia's growth potential. The three main thrusts of the 2002 budget as presented to parliament in October 2001 were directed at strengthening the nation's economic growth through increased domestic demand, enhancing the private sector's resilience and competitiveness, diversifying the sources of growth and ensuring a more equitable distribution of wealth. *Singapore's* fiscal policy seeks to create an environment that promotes a dynamic private sector, generates robust growth and employment, and advances the development of Singapore. The focus of government expenditure is on the delivery of essential public goods and services, particularly in the key areas of education, housing, economic infrastructure, basic healthcare and national security. On the revenue side, taxation policy in 2001 continued to focus on ensuring an internationally competitive tax structure that would encourage entrepreneurship and attract investments. The *Thai* government continued to implement an expansionary fiscal policy in 2001, and will again in 2002, in order to stimulate its sluggish economy. The budget deficit is expected to be 2.2 percent of GDP in FY2001 and 3.9 percent in FY2002. However, in FY2003, as the economic outlook is anticipated to improve and the private sector is likely to become the major force of economic growth, the government plans to consolidate fiscal policy out of concern for fiscal sustainability. To impose fiscal discipline, the government aims to reduce the budgetary deficit, projected to be 156.2 billion baht or 2.8 percent of GDP in FY2003. The government has realized the importance of fiscal sustainability in the medium-term. *Russia's* fiscal policy continues to be tight, and the Russian government has expressed a determination to avoid a fiscal deficit in 2002 even in the event of weak oil prices.

The *Mexican* government's fiscal discipline and prudent management of economic policy contributed to maintaining a stable domestic environment characterized by lower inflation and interest rates. Despite a significant slowdown in economic activity and lower oil-related revenues, the overall public sector deficit amounted to 0.73 percent of GDP, a figure consistent with the target originally established for the year and 34.8 percent lower in real terms than the deficit recorded in 2000. *Canada* recorded the largest financial balance improvement of all G-7 countries from 1992 to 2000. According to the OECD, Canada is the only G-7 country projected to record a surplus in 2001, 2002 and 2003. Canada's federal budgetary surplus for 2001 and 2002 will post another surplus. This will mark the fifth consecutive year that the federal government has recorded a surplus. Also, net public debt has declined by over C$36 billion over the last five years. Targeted spending in the last budget coupled with tax cuts introduced in 2000 amount to C$31 billion in 2002 or 2.8 percent of GDP. These fiscal measures will continue to help support a strong recovery in the months ahead. *Chilean* fiscal policy was counter-cyclical but prudent for 2001, registering 0.3 percent deficit. Total expenditure of the public sector rose at a rate of 5 percent during the year, offsetting the contraction in private domestic demand.

In the long run, forces affecting the fiscal position have changed. Recent fiscal surpluses were facilitated by robust economic expansion, slower growth of health care costs, a demographic structure stemming from the low birth rates of the 1930s and early 1940s, and the end of the Cold War, which led to a sharp decline in military spending. In the foreseeable future, however, economic growth is not expected to be as strong as before. A demographic wave is expected to increase social security and health care spending by the end of this decade, and public spending on security are forecast to be substantially higher. If structural reforms are not introduced to increase tax revenues or to reduce entitlement spending, most economies will face bigger fiscal deficits, which will restrain the government arm's ability to utilize fiscal tools during economic recessions.

3.2 Monetary Policy

Monetary policies were loosened aggressively during the last economic slowdown, with the central banks of major countries lowering interest rates to alleviate global financial difficulties after the terrorist attacks in 2001. Although APEC economies in general pursued monetary policy to support economic recovery rather than by stabilizing inflation and adjusting exchange rates in 2001, the tools and contents of this policy were reconsidered under unexpected or short-term situations. Because of a sharp reduction in policy-controlled interest rates, the money market interest rates of most economies fell by a wide margin in 2001 and they remain at historical low levels.

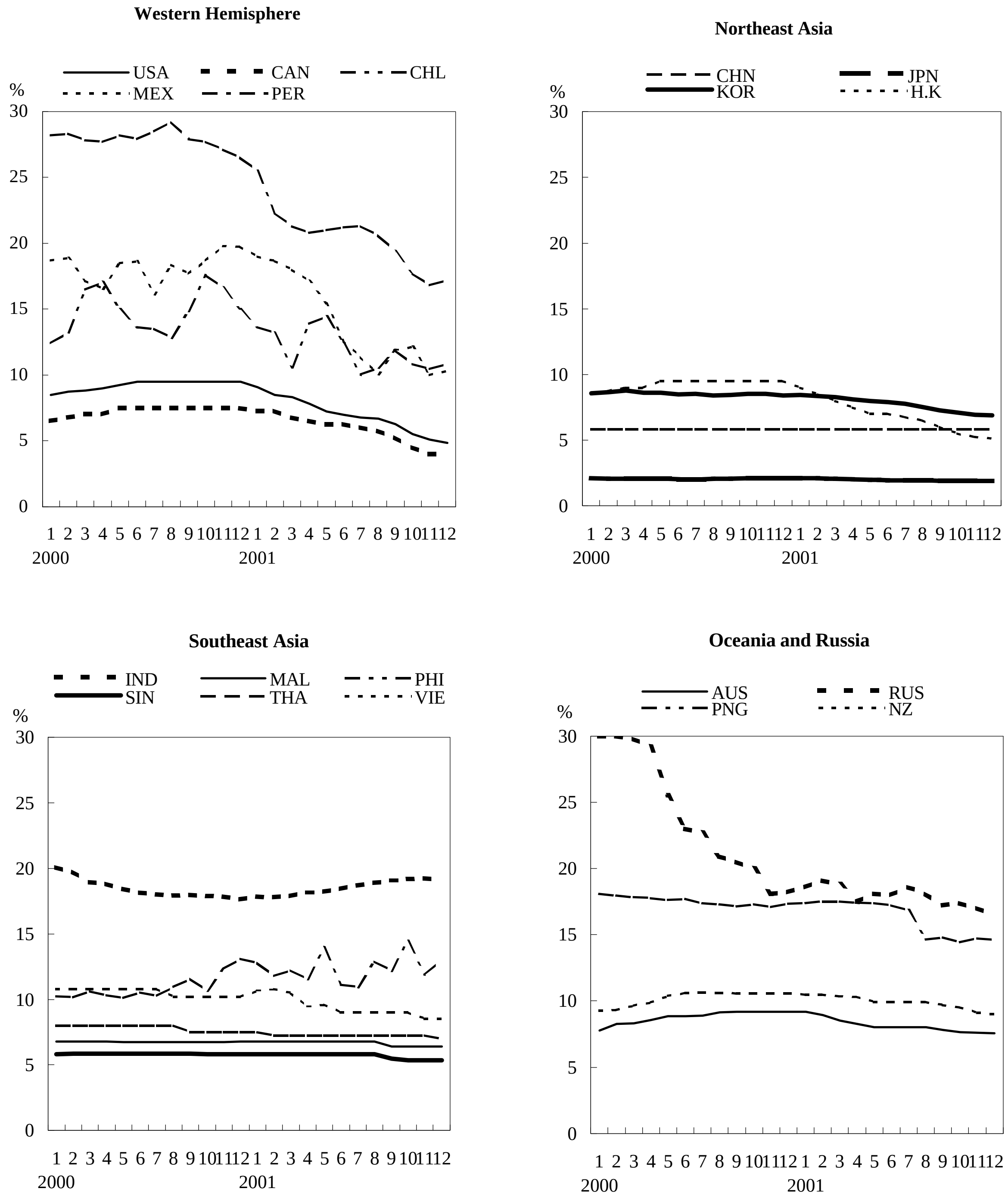
Monetary easing has been most aggressive in *the United States*, where the federal funds rate has been reduced 11 times to 1.75 percent, its lowest level in the last 40 years. Out of the cumulative 475 basis points cut, 175 basis points were shed after the terrorist attacks on September 11, in order to support market confidence and demand. The effective federal funds rate plunged to 1.2 percent on September 19, a level last seen in the early 1960s. However, this stimulus, though it lowered the short-term interest rate was somewhat offset by exchange rate appreciation and weakening equity prices. The Federal Reserve's target rate has not changed since early December 2001. Taking into account poor growth performance of 1.1 percent in the second quarter of 2002 and the unstable development of the financial market, the Federal Reserve may lower the interest rate to stimulate growth and to restore the stability of the financial market in 2002 and 2003.

In *Japan*, the short-term rate has been stuck at zero for over a year. In Japan, lending by the principal private banks was down by 2.5 percent in July 2002 on a year-over-year basis and broad money was up by 2.1 percent in 2001. Such weak credit reflects the effects of deflation and depressed activity on demand. It also reflects the hesitancy of a weakened banking system to take a risk and translate monetary policy impulses into credit supply expansion. Sound banking and financial systems are greatly needed for the Japanese economy to escape from their mired deflation and to achieve sustainable economic growth.

China has experienced a trend of either almost zero inflation or deflation, raising real interest rates and narrowing profit margins for corporations. China's central bank lowered interest rates in February 2002, the first rate cut since 1999. In *Hong Kong, China*, narrow money grew strongly, up by 16.4 percent in the first half of 2002 from a year ago, largely reflecting the low opportunity cost of holding narrow money. Broad money shrank by 0.9 percent, broadly in line with movements in nominal GDP. Domestic credit slackened on the back of weak economic fundamentals.

In *Korea*, the Bank of Korea operated its monetary policy in a flexible manner in 2001 with a focus on the stability of the financial market and the prevention of a sharp slowdown in the economy. Monetary policy will continue to be conducted in a flexible manner, keeping a careful watch on the developments of the external environment, the status of business activity, price movements, and the financial markets. In *Chinese Taipei*, an expansionary monetary policy was adopted amid stable prices. The central bank lowered rediscount rates twelve times from 4.625 percent in 2000 to 2.125 percent. The non-performing loan ratio continued to hit record levels in 2001, which hinders its economic recovery. The key factor is the worsening performance of community financial institutions, which being very small and confined to local communities, were widely and deeply struck by recent movements in financial liberalization and internationalization.

Figure 1.5: Short-term Interest Rate * (%, per annum)



Note: * Lending rate of line 60p in *International Financial Statistics.*
Source: IMF, *International Financial Statistics* June 2002.

Table 1.10: Short-term Interest Rate (%, per annum)						
	1996	**1997**	**1998**	**1999**	**2000**	**2001**
Canada	4.35	3.61	5.05	4.94	5.71	3.87
Chile	7.30	6.80	9.60	6.00	5.40	4.50
Mexico	31.4	19.8	24.8	21.4	15.2	11.3
The United States	5.15	5.20	4.91	4.78	6.00	3.47
China	9.72	7.65	6.34	5.58	5.58	5.58
Hong Kong, China	5.46	7.12	8.06	5.84	6.11	3.56
Japan	0.60	0.60	0.70	0.20	0.20	0.10
Korea	13.53	18.55	7.70	7.16	7.08	5.32
Chinese Taipei	5.03	5.21	4.66	4.42	4.24	2.13
Brunei Darussalam	3.00	6.50	1.50	3.00	2.70	1.40
Indonesia	14.10	30.50	64.10	26.00	12.50	15.90
Malaysia	7.39	8.70	6.46	3.18	3.25	3.27
The Philippines	12.40	13.10	15.30	10.20	9.90	9.90
Singapore	3.40	4.10	1.70	1.68	1.70	1.10
Thailand	N.A.	22.36	13.59	1.48	1.28	2.07
Viet Nam						
Australia	7.15	5.40	5.00	5.01	6.18	4.90
New Zealand	9.30	7.70	7.40	4.80	6.50	5.70
Papua New Guinea	8.40	13.75	19.00	22.68	15.67	10.15
Russia	85.8	32.0	41.8	39.7	24.4	17.9
LIBOR* (3-months US $)	5.56	5.81	5.07	6.00	6.40	1.88

Note: * End of period.
Source: Individual Economy Reports.

In *Australia*, price stability is regarded as a critical element in achieving these objectives. In pursuing the goal of medium-term price stability, the Reserve Bank of Australia has adopted the objective of keeping inflation between 2.0 and 3.0 percent, on average, over the cycle. The medium-term focus of the inflation target provides the bank with the flexibility to 'look through' temporary fluctuations in the CPI. In response to weaker international economic conditions and restrained inflationary pressures in 2001, the Reserve Bank of Australia loosened monetary policy by 200 basis points. The target cash rate was reduced to 4.25 percent by December 2001, its lowest level since the Reserve Bank began announcing cash rate targets in 1990. The Reserve Bank of *New Zealand* is also charged with maintaining price stability in New Zealand. The Policy Targets Agreement between the Minister of Finance and the Governor of the Reserve Bank requires the bank to maintain inflation in the range of 0 percent to 3.0 percent over any 12-month period.

In *Indonesia*, Bank Indonesia will continue to direct its policies toward maintaining monetary stability that is consistent with attaining a single digit inflation target by the end of 2002. To attain this monetary stability, Bank Indonesia will continue to control liquidity in the market consistent with liquidity needs in the economy. The bank will focus on absorbing excess liquidity through open market operations and foreign exchange sterilization to mitigate the pressures on the rupiah exchange rate and inflation. *Singapore's* monetary policy remained focused on maintaining low and stable inflation over the medium-term, while ensuring support for economic activity during a period of weak external demand conditions and subdued inflationary pressure. The monetary policy of the *Philippines* in 2001 was focused on maintaining stable prices while broadly supporting the economy's output growth objective. The moderate inflation in the third quarter of 2001 and falling interest rates in advanced economies provided the leeway to reduce interest rates to invigorate domestic demand in the face of a weak external environment. The Bangko Sentral ng Pilipinas (BSP) has reduced policy rates 16 times by a cumulative 725 basis points since December 2000. In Thailand, the Bank of Thailand (BOT) adopted a tight monetary policy aimed at strengthening external stability, raising the 14-day repurchase rate from 1.50 percent to 2.50 percent in June 2001. This policy slowed down capital outflow, contributing to external economic stability. With the background of strong external stability and stabilized inflation, around year-end the BOT started to ease monetary policy to stimulate growth, cutting the repurchase rate from 2.5 percent to 2.0 percent. This expansionary monetary policy should enhance domestic demand, the expected major driving force of an economic recovery.

Malaysian monetary policy in 2001 was directed at promoting domestic activities to mitigate the effect of the global economic slowdown. The absence of inflationary pressures enabled monetary policy to remain accommodative, with interest rates remaining low and stable. Nevertheless, in the wake of the September 11 incidents, the central bank, Bank Negara Malaysia, reduced its intervention rate by 50 basis points to 5.0 percent on 20 September 2001, its first cut in more than two years. The reduction was aimed at countering the impact from the worsening external environment and at stimulating domestic consumer and business activities.

In Mexico, Banco de *México* responded to the economic slowdown by maintaining its expansionary policy stance with the aim of countervailing the Mexican economy's downward trend in 2001. The short-term interest rate fell substantially to 11.3 percent in 2001 from 15.2 percent in 2000. *Chile's* monetary policy was expansionary in 2001. This monetary stance was substantially reduced particularly during the first half of 2002, due to the slow reactivation process in internal demand in response to internal price changes.

In *Canada*, since 1991 the federal government and the Bank of Canada have maintained an official target range for the inflation rate, which has been gradually lowered to between 1.0 to 3.0 percent. This commitment to a low and stable inflation rate enables policy to best contribute to a sustained economic expansion in Canada, thereby leading to the likelihood of lower unemployment and improved productivity.

3.3 Foreign Exchange Markets

Over the past decade, the US dollar has been the strongest global currency. Strong demand for US financial assets helped push the US dollar to a new high every year, even though the financial markets did not expect the currency to sustain its gains year after year. The huge current account deficit was a major threat to the dollar. As it turned out, however, the US dollar remained in favour among investors, and even the introduction of the euro failed to attract investors away from the US dollar.

As the US economy contracted in 2001, most would have expected the US dollar to lose some ground. To the contrary, the currency managed to hold onto its gain during the U.S. downturn. The heightened financial market uncertainty associated with the events surrounding September 11 initially translated into a temporary downward pressure on the US dollar, but during the last quarter of 2001, the US dollar strengthened, while the other major currencies weakened. In particular, the Japanese yen suffered a sharp sell off to levels not seen since 1997–98. This remarkable movement was driven by expectations of a turnaround in the global economy, led by the United States.

While strong capital inflows into the United States helped the US dollar strengthen in the first quarter of 2002, sentiment toward the dollar was mixed as the currency remained close to record high levels. From the second quarter of 2002, however, there was some evidence that the dollar's strength was waning. The yen started to regain some ground. The surprising performance of the yen continued in July, as the dollar slipped about 115 yen in Tokyo, a 15 percent drop since January. Markets had been near unanimous at the start of the year that the yen would weaken significantly, especially as the authorities in the euro area, Japan, and the United States seemed ready to permit this. However, after the first quarter of mild weakening, the yen snapped back.

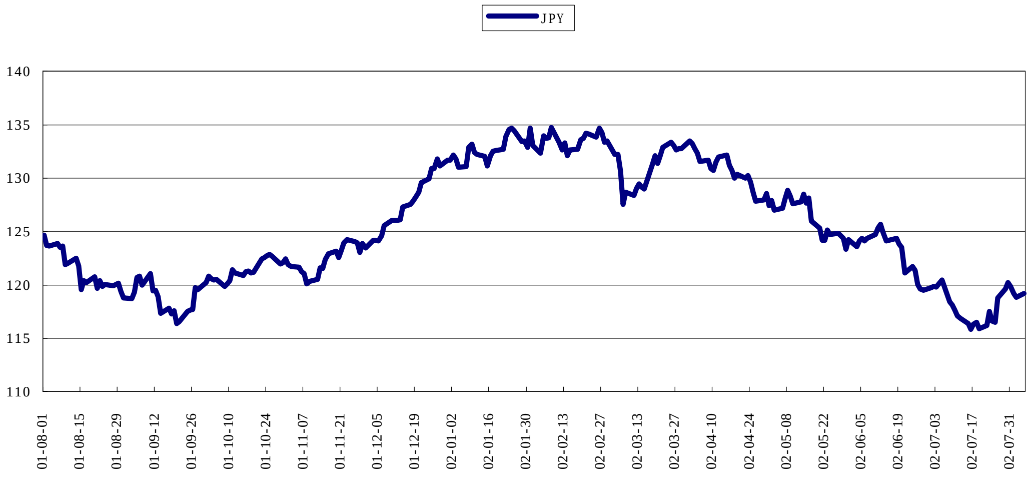
The mid-term prospects for the US dollar are still sanguine, although a few observers show concern that the US economy will fall into a twin deficit status. As the US economy begins to pick up steam in the second half, corporate earnings should recover, boosting equity markets and the dollar. Despite a series of corporate scandals in the United States, improved confidence in the U.S. financial markets should provide some support for the dollar. While the US economy is hardly a picture of perfect soundness, neither are Europe's or Japan's, or many emerging markets that are overwhelmingly dependent on the United States for growth. The lack of alternative global growth engines has inhibited large US capital outflows during the last decade. Ongoing problems in Argentina and Brazil have not helped the case for investing in emerging markets. Heightened prospects of a "double dip" in the US economy would suggest a weaker dollar over the second half of 2002. However, given that the United States still leads and everyone else follows in the world economy, a sudden dollar crash is unlikely to be seen.

Currencies in the Asia Pacific have shown differing performances in the first half of 2002, depending on their exchange rate regime. *China*; *Hong Kong China*; and *Malaysia* maintained a fixed exchange rate regime, while other currencies floated up and down *vis-à-vis* the U.S. dollar. Asian floaters such as *Korea*; *Chinese Taipei*; and ASEAN economies such as *Indonesia*, the *Philippines*; *Singapore*; and *Thailand* have shown such a similar pattern as the Japanese yen fluctuated vis-à-vis the US dollar. Exchange rate co-movements among Asian currencies show that yen-dollar fluctuations are an important source of external shocks but that they tend to adjust in a similar direction.

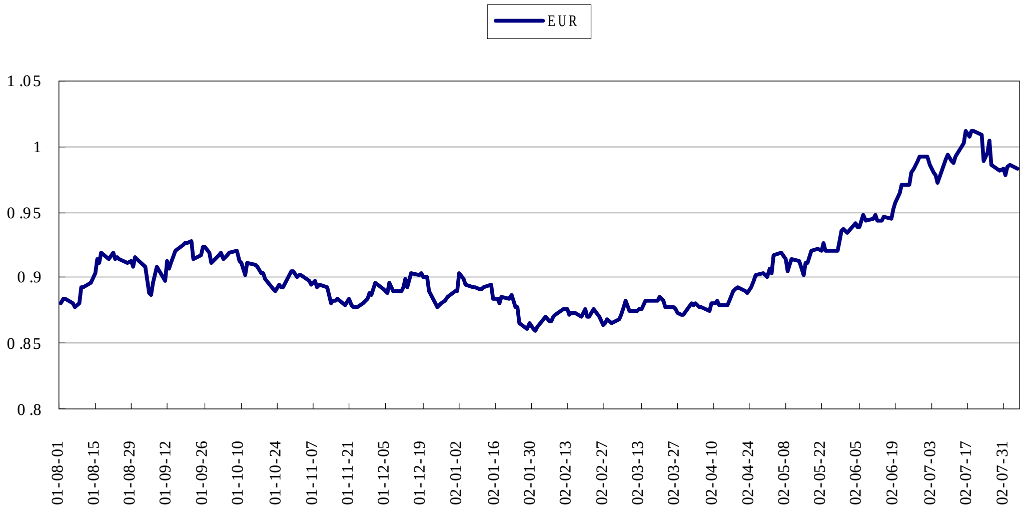
However, currencies in the Western Hemisphere have shown a different pattern. The *Canadian* dollar has moved tightly with the US dollar. The *Mexican* peso showed very brief signs of weakness in early 2001 but otherwise posted a strong performance for most of the time. However, since the second quarter of 2002, it started to weaken along with the US dollar. The *Chilean* peso, which had depreciated over most of 2001, touched all-time lows, prompting the central banks to undertake several rounds of intervention. However, the Chilean peso recovered around the year-end and weakened only for a few days after the collapse of the Argentine peso. Since the second quarter of 2002, the Chilean peso has started once again to weaken along with the US dollar. In 2001 the *Australian* and *New Zealand* dollars ended their depreciating trend against the US dollar in the context of a surge in domestic growth and more favourable interest rate differentials. However, from the first half of 2002, they once again started to depreciate against the US dollar, while Asian currencies gained in strength.

Figure 1.6: Exchange Rates of the yen and the euro

Yen/US dollar

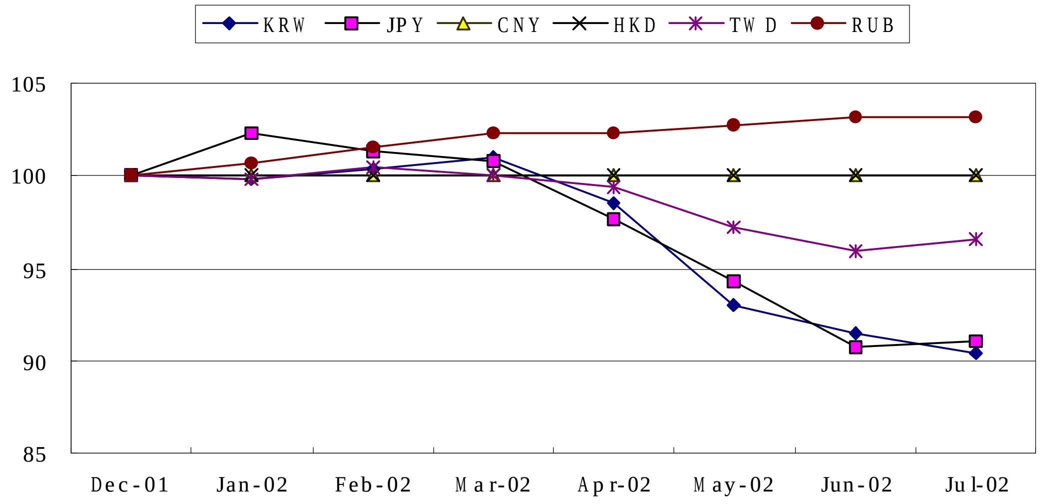


US dollar/euro



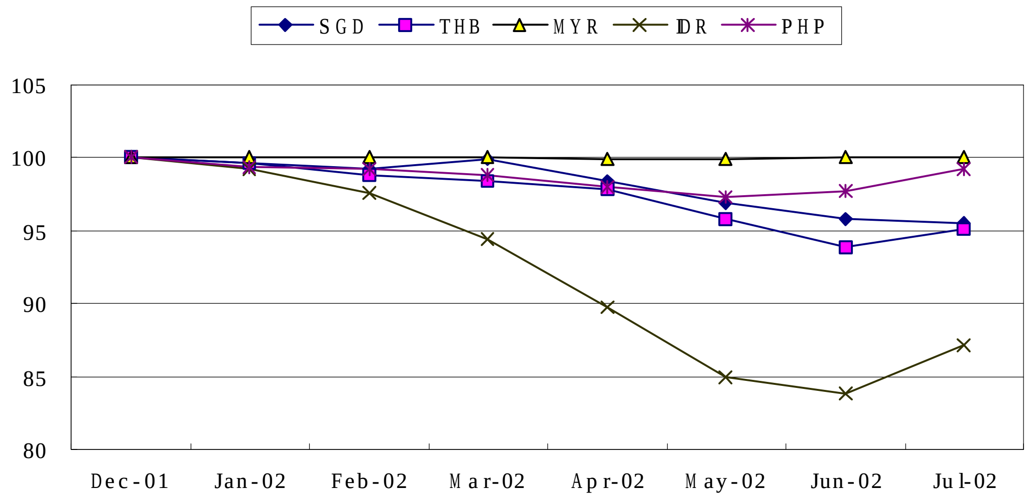
Source: Bloomberg

Figure 1.7: Exchange Rates of Northeast Asia



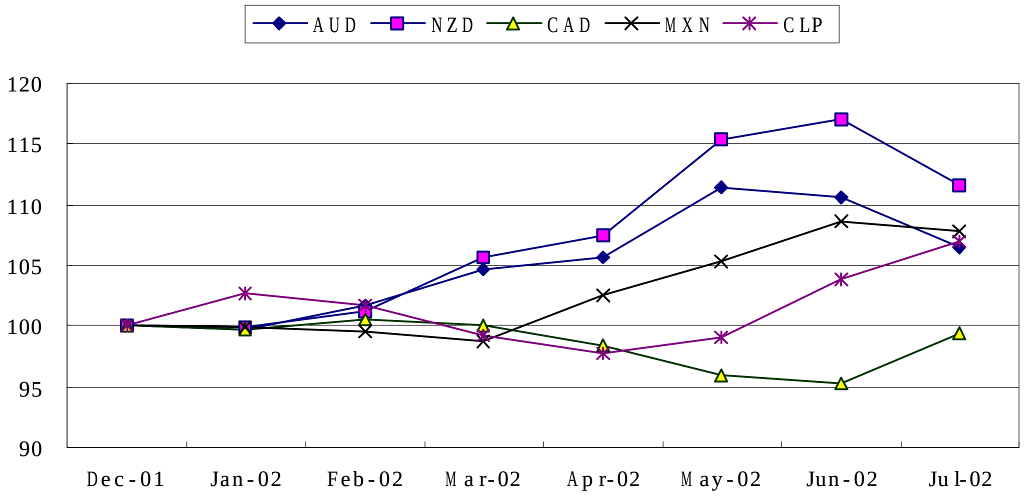
Note: KRW, JPY, CNY, HKD, TWD and RUB are Korea Won, Japan Yen, China Rinminbi, Hong Kong Dollar and Russia Ruble, respectively.
Source: Bloomberg.

Figure 1.8: Exchange Rates of Southeast Asia



Note: SGD, THB, MYR, IDR and PHP are Singapore Dollar, Thailand Baht, Malaysia Ringgit, Indonesia Rupiah and Philippines Peso, respectively
Source: Bloomberg

Figure 1.9
Exchange Rates of the Western Hemisphere and Oceania



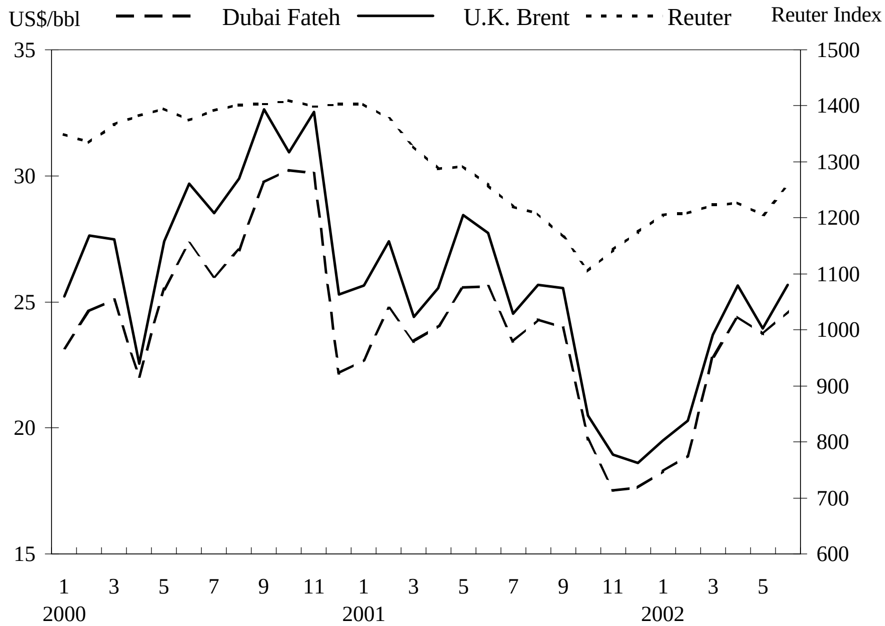
Note: AUD, NZD, CAD, MXN, CLP and PEN are Australia Dollar, New Zealand Dollar, Canada Dollar, Mexico Peso and Chile Peso, respectively

Source: Bloomberg

3.4 World Oil Market

Due to the sluggish demand during the economic downturn, prices of oil and non-oil commodities fell substantially in 2001, which helped dampen overall inflation in 2001. Since early 2002, however, oil prices have risen slightly to US$25 per barrel from increased oil demand due to economic growth and recent political and military conflicts in the Middle East. Underlying supply and demand conditions in the oil market also suggests a slight increase in oil prices in 2002. The cumulative reduction over 2001 has reached 15 percent of the initial production level among the members of the Organization of Petroleum Exporting Countries (OPEC). With demand gradually rising, oil prices are assumed to remain around the US$25 per barrel mid-point of the OPEC target. In its recent economic outlook report, the OECD assumed the average import oil price would increase by 1.5 percent to reach US$23.9 per barrel for the whole of 2002.

Figure 1.10: World Oil Prices and Commodity Prices



Sources: IMF, *International Financial Statistics*, June 2002; Reuters

Table 1.11: Forecast on Oil and Non-oil Commodity Prices

	1999	2000	2001	2002***	2003***
OECD import oil price ($/bbl)*	17.3	28.0	23.5	23.9	25.0
Change in oil price (%)	37.3	62.1	-15.9	1.5	4.6
Change in non-oil commodity prices**	-7.1	3.0	-9.5	-6.7	4.5

Note: * Average cif unit prices as calculated by the International Energy Agency.
** Total Hamburg commodity price index, excluding energy.
*** OECD projections.

Source: OECD

Industrial raw material prices started to rise again in late 2001, underpinned by further production cuts and improved market sentiment on economic growth. The Reuter index for prices of major primary commodities fell from 1,402.7 at the end of 2000, to 1,175 at the end of 2001. Beginning in 2002, the index rose by 7.0 percent to 1,256.7 at the end of the first half of 2002. The OECD (2002) comments that bulk commodities, such as iron ore and coal, are exceptions. Metal markets will be switching from hefty excess supply to increasing excess demand, leading to an inventory reduction and upward price pressures over the period of 2001 and 2003. But for food, tropical beverages and agricultural raw materials, the price outlook remains weak.

3.5 Prospects for an Economic Recovery

The world economy began to recover growth momentum in late 2001. The recovery is mainly driven by fiscal and monetary policies to support aggregate demand through lower interest rates and increased government spending. As the adjustment of inventory accumulated during the long expansion period of the 1990s and the increased demand for consumption and business investment are directly channeled to the increase in production, economic recovery is inevitable. However, the timing and strength of the initial pick-up are likely to differ across economies.

The APEC region with its strong growth potential is expected to lead the global recovery this time. Most economies in the APEC region will build up growth momentum in the near future. Major institutions forecast that the APEC economy as a whole would accelerate the pace of recovery and grow at a rate of over 3.0 percent in 2002 and 4.0 percent in 2003, from a meager growth rate of 0.7 percent in 2001.

The US economic rebound has been emerging with inventory re-stocking, brisk business investment, and expanded public spending. As of the middle of 2002, there are concerns about the sudden fall in stock prices and the US dollar, subsequent falls in market confidence in economic recovery and the seemingly increasing possibilities of a "double dip" recession. However, it does not look likely that the recent turmoil in US stock markets will bring about a banking crisis or lead to another economic recession. The US economy is widely expected to experience a short and shallow slowdown and then to return to its growth path towards a full-fledged recovery in the near future. As in the past, economic growth in the US is committing new opportunities for other APEC members to increase their exports and thus reinvigorate their domestic production. The forecasting institutions expect around 2.5 percent growth for the year 2002. In addition, private forecasters are predicting a solid growth rate of 3.5 percent in 2003, which is in line with the Bush administration's forecast of 3.8 percent.

Table 1.12: Forecasts of GDP Growth in the APEC Region (percent)

	2001	2002					2003					Medium-term	
		Official	IMF	OECD	ADB	DRI-WEFA	Official	IMF	OECD	ADB	DRI-WEFA	Official	DRI-WEFA (2004-5)
Western Hemisphere													
Canada	1.5	3.0	3.4	3.2		3.3	3.8	3.4	4.0		3.8	3.2	3.2
Chile	2.8	3.3	2.2			3.0	4.5	4.2			4.5		5.2
Mexico	-0.3	1.7	1.5	1.8		1.7		4.0	4.5		4.5		5.5
Peru	0.2	3.7	3.5			3.5		3.0			4.2		5.1
The United States	0.3	2.6	2.2	2.5		2.4	3.6	2.6	3.5		3.4	3.1	3.5
Northeast Asia													
China	7.3	7.0	7.5	7.1	7.0	7.0	7.0	7.2	7.6	7.4	7.2	7.0	7.3
Hong Kong, China	0.6	1.5	1.5		2.1	1.7		3.4		4.8	5.1	3.0	5.5
Japan	-0.6	0.0**	-0.5	-0.7		-0.1		1.1	0.3		1.4	1.5 over	2.3
Korea	3.0	6.0	6.3	6.0	4.8	5.8		5.9	6.5	6.0	6.0		6.5
Chinese Taipei	-1.9	2.55	3.3		2.8	2.0		4.0		4.0	4.4		5.2
Southeast Asia													
Brunei Darussalam	1.5	3.0	3.0			2.5	4.8	2.9			3.0	4.1	2.5
Indonesia	3.3	3.5	3.5		3.9	3.2	4.1-5.1	4.5		3.6	4.8	4.5-5.9	5.3
Malaysia	0.4	3.5	3.5	6.0	4.2	3.4		5.3		5.8	5.7	7.5	5.4
The Philippines	3.2	4.0-4.5	4.0		4.0	4.0	5.0-5.5	3.8		4.5	4.9	5.4-6.3	5.5
Singapore	-2.0	2.0-4.0	3.6		3.7	3.3		4.2		6.5	6.4		5.5
Thailand	1.8	3.5-4.0	3.5		3.7	2.9	3.0	3.5		4.2	3.6		5.0
Vietnam	6.8	7.0	5.3		6.2	6.4		6.5		6.8	7.2	7.0-7.5	7.1
Oceania													
Australia	2.4	3.75	4.0	3.7		3.4	3.75	3.8	4.0		3.8	3.75	3.7
New Zealand	2.4		3.0	2.9		2.9		2.9	3.5		3.6		3.5
Papua New Guinea	-3.4	-0.4	1.2		1.2	2.5	1.1	2.8		1.8	3.5	1.6	4.0
Russia	5.0	3.9	4.4	3.5		3.9		4.9	4.0		4.2		3.5
World	1.4		1.8			1.9		3.3			3.3		3.5
World*	2.2		2.8					3.7					

Note: * See Note in Table 1.1.
** Refer to fiscal year (April to March)

Sources: Individual Economy Reports.
ADB, *Asian Development Outlook*, April 2002.
DRI-WEFA, *World Outlook*, June 2002.
IMF, *World Economic Outlook*, September 2002.
OECD, *OECD Economic Outlook*, No.71, June 2002.

As an exceptional case in the APEC region, *Japan* does not share the prospects of the coming global economic recovery in 2002 with other APEC members. As of mid-2002, the Japanese economy continues to be in a difficult situation. But it showed a rebound in the first quarter, which was due to increased exports stemming from the US and Asian major economies and the weak yen. As for short-term prospects, there are concerns over the downward pressure on private demand. On the other hand, export as the main engine of economic growth and progress in inventory adjustments are expected to prevent further deterioration in the economy. It is expected that the Japanese economy will begin to move gradually towards recovery by concentrating on private demand in the second half of the fiscal year 2002. However, the growth rate for FY2002 is expected to record approximately zero percent. By 2003, the Japanese economy is expected to begin a broad-based growth, with the growth rate improving to around 1.0 percent.

All other APEC members are forecast to enjoy higher growth rates in 2002 and 2003 than in 2001. Forecasting institutions have relatively lower growth rate projections for economies, like

Mexico; *Hong Kong, China;* and *Chinese Taipei*. In 2003, they are expected to grow rapidly, around 3.0 to 5.0 percent equal to the level of their potential GDP growth rates.

Asian developing member economies will continue to grow with strong exports and industrial production. *China* and *Viet Nam* are expected to register around 7.0 percent of GDP growth. Taking into account the rebounding private demand and a big boost from the government sector, *China*'s economic condition should remain healthy in 2002 and 2003. Reflecting recovering global demand and the price competitiveness of Chinese goods resulting from the weak Chinese currency, exports will continue to perform well. Because the Chinese renminbi is pegged to the US dollar, recent weakness in the dollar has become another positive factor for Chinese exports. China's entry into the WTO also improves its ability to attract foreign direct investment to China, which would boost the medium-term economic outlook. Fuelled by higher domestic demand, the *Russian* economy should continue to expand in 2002, but at a slower pace than in 2001. Relatively rapid import growth is likely to continue, thanks to higher demand and a stronger rouble, reducing the current account surplus further in the absence of substantially higher oil and gas prices.

Despite renewed growth, slow response of the labor market to dynamic production activity and a renewed rise in oil and raw materials prices, wage and price inflation is expected to be low in 2002 and 2003. This is mainly because the global economy has a huge excess capacity and because higher productivity gain is expected.

In *the United States*, CPI inflation has been remarkably subdued and should remain below 2 percent in 2002 and rise to slightly higher than 2.0 percent in 2003. In the case of *Japan*, *China*, *Hong Kong, China*, *Chinese Taipei* and *Singapore*, either price deflation or no inflation is expected to continue until 2003. In FY2002, it is expected that Japanese prices will continue to fall, but the rate of decline will be somewhat reduced by a slight improvement in oversupply conditions. As a deflationary pressure has surfaced, *China's* consumer price inflation went negative in September 2001 and deflation accelerated to above 1.0 percent in the first half of 2002. In *Korea*, amid expectations of stable prices of international raw materials, including crude oil, and a slow increase in public utilities charges, it is forecast that inflationary pressures will not be so large on the demand side in 2002. Thus consumer prices are expected to increase 3.0 percent, showing a slowing of their upward trend, compared with 2001.

For 2002 and 2003, forecasting institutions show *Canada*'s CPI inflation to average near the mid-point of the inflation target bands of 1.0 to 3.0 percent set jointly by the government and the Bank of Canada. *New Zealand's* CPI inflation is forecast to remain at or above 2.5 percent over the remainder of 2002, before ameliorating somewhat going into 2003.

In spite of the trend of lower inflation in the APEC region, *Indonesia* as well as *Russia* are expected to register somewhat high inflation rates of around 10.0 percent in 2002 and still higher in 2003. *Indonesia's* inflation in 2002 will be influenced primarily by government policy on prices and by inflationary expectations. As was the case in the preceding years, the implementation of government policies will exert strong pressure on inflation in 2002. In addition, inflationary pressures are predicted to rise as the result of an expansion of private consumption that will not be entirely matched by the supply side. Taking into account the various macro-economic developments and prospects for inflationary pressures, the Bank Indonesia sets the target for 2002 CPI inflation rate in the range of 9.0 to 10.0 percent. However, within a five-year term, the Bank Indonesia is committed to gradually lower the inflation to around 6.0 to 7.0 percent.

Table 1.13: Forecasts of Consumer Price Inflation in the APEC Region (percent)

	2001	2002					2003					Medium-term	
		Official	IMF	OECD	ADB	DRI-WEFA	Official	IMF	OECD	ADB	DRI-WEFA	Official	DRI-WEFA (2004~5)
Western Hemisphere													
Canada	2.6	1.9	1.8	1.9		1.7	2.9	2.1	2.2		1.4	2.0	1.7
Chile	2.6	3.0	2.1				3.0	2.8					
Mexico	6.4	4.5	4.8	4.6		5.1		3.7	4.1		4.8		4.1
Peru	2.0		0.4					2.0					
The United States	1.6	1.7	1.5	1.8		1.8	2.5	2.3	2.4		2.9	3.1	2.8
Northeast Asia													
China	0.7	1~2	-0.4	0.8	1.0	-1.0	3.5	1.5	1.4	1.5	1.4	3.5	3.3
Hong Kong, China	-1.6	-2.8	-2.4*		-0.8	-1.3		-0.5*		0.6	0.7	0.4*	1.8
Japan	-0.7	-0.6**	-1.0	-1.2		-1.0		-0.6	-1.2		0.1	1.0*	0.8
Korea	4.1	3.0	1.4*	3.3	3.5	3.1		2.0*	3.0	4.0	4.9		4.0
Chinese Taipei	0.0	0.6	-0.4*		0.7	0.7		1.4*		2.1	1.3		1.8
Southeast Asia													
Brunei Darussalam	0.6	-2.0	1.4			1.8	1.0	1.6			1.5	1.0	2.0
Indonesia	12.6	10.1	11.9		13.1	11.5	7~9	8.7		7.7	7.1	6~7	6.1
Malaysia	1.4	1.8	1.8		2.3	1.9	2.0	2.5		2.8	2.5	2.0	2.8
The Philippines	6.1	4.5~5.5	4.0		5.0	4.7	4.0~5.0	5.0		6.0	5.5	3.5-4.5	5.5
Singapore	1.0	0.0			0.4	0.4		1.0*		1.4	2.0		1.9
Thailand	1.6	1.3	0.7		2.0	1.1	2.4	1.9		2.2	2.3	2.6	2.7
Vietnam	0.8	4.0	4.1		3.0	3.7	4.5	3.8		4.0	4.1	3~4	5.6
Oceania													
Australia	4.4	2.75	2.3*	2.8		4.4	2.75	2.0*	2.6		3.0	2.75	2.9
New Zealand	1.8	2.5	0.9*			2.7		1.1*			3.0		2.8
Papua New Guinea	10.3	11.2	7.5			8.0	9.3	4.7			8.0	5.0	7.7
Russia	18.6	14.0	15.8	15.0		16.2		11.0	10.0		14.6		12.4
World	3.1					3.1					4.8		5.1

Note: * GDP deflator.
** Refer to fiscal year (April to March).

Sources: Individual Economy Reports.
ADB, *Asian Development Outlook*, April 2002.
DRI-WEFA, *World Overview*, June 2002.
IMF, *World Economic Outlook*, September 2002.
OECD, *OECD Economic Outlook*, June 2002.

3.6 Some Risks to the Economic Recovery

In the medium term, economic growth follows the potential GDP growth pattern. The potential growth rate of an economy is determined primarily by the growth rates of its supply-side components such as: population, labor force participation, the working hours, capital accumulation, and productivity gains. There are, however, some risk factors to the economic recovery to the growth rate of potential GDP.

The first risk relates to the heavy dependency of APEC economies on US economic expansion. As seen recently, small variations in US domestic variables have a profound influence on almost all other economies. For example, turmoil in the US stock markets shook all stock markets worldwide almost simultaneously. It also affected the foreign exchange market with a sudden fall in the US dollar. Moreover, the degree of appreciation of other currencies is differentiated among currencies, embarrassing economies with uncertain effects on their external trade and domestic economic activities as well as their own financial markets. The greater their dependence on the US, the more uncertain the economic outlook will be for APEC economies. In terms of export dependence on the US market in 2002, APEC dependence rate averaged 34.2 percent, substantially higher than that on the EU of 17.2 percent. In *Canada* and *Mexico*, this rate is well above 80 percent. All the Northeast Asian economies and some Southeast Asian economies also depend heavily on the U.S. market with dependency rates of above 20 percent.

Another risk is the problem of substantial external imbalances among members. US current account deficits in particular could give rise to large exchange rate changes and associated capital market disruption. The United States recorded a current account deficit of around 4.0 percent of GDP in 2001. The deficit is still on the rise, projected to reach 5.0 percent of GDP by the second half of 2003. The widening US deficit could cause some concerns regarding the sustainable growth of global trade and the world economy as well as stable foreign exchange markets. Excessive external imbalances could also generate trade friction, leading to widespread protectionist actions.

Third, the financial fragility of some emerging countries is a threat. Although the crisis in Argentina has spilled over only to neighboring countries in Latin America up to now, contagion effects could worsen and spread globally if the global economy and international trade does not recover as expected.

The fourth and most immediate risk is a large and enduring increase in oil prices, against the background of heightened tensions in the Middle East. The cyclical upturn of the global economy was helped by the decline in oil prices. If oil prices increase above US$25 per barrel, higher prices will affect production and inflation. A small temporary price hike would not visibly alter the shape of the cycle, but a lasting and sizeable increase in oil prices would.

Finally, in order to sustain economic growth in the medium term, most APEC economies need to maintain their structural reforms to improve the efficiency of their own economic system. On-going issues include: liquidation of non-performing loans in the financial sector; improvements in corporate accounting and auditing procedures; enhancing the transparency of corporate management and governance; and harmonizing economic systems to be consistent with global rules.

Table 1.14: Forecast on Balances of Current Account (% of GDP)							
	2001	2002			2003		
		OECD	IMF	ADB	OECD	IMF	ADB
Western Hemisphere							
Canada	2.7	1.9	1.7		2.0	1.9	
Chile	-1.6						
Mexico	-2.8	-2.6			-3.0		
Peru	-2.0						
The United States	-4.1	-4.4	-4.6		-4.9	-4.7	
Northeast Asia							
China	1.7	1.2		1.0	0.7		0.4
Hong Kong, China	7.2		9.2			9.7	
Japan	2.1	3.3	3.0		4.3	2.9	
Korea	2.0	1.4	1.5	1.9	2.8	0.9	0.7
Chinese Taipei	6.7		5.8	3.9		5.9	3.4
Southeast Asia							
Brunei Darussalam	89.1						
Indonesia	4.7			1.5			0.7
Malaysia	9.0			5.3			2.6
The Philippines	6.4			2.0			1.5
Singapore	20.9		21.7	19.8		22.3	19.0
Thailand	5.3			4.1			3.0
Viet Nam	1.5			0.3			-0.2
Oceania							
Australia	-2.6	-3.8	-3.6		-3.9	-3.9	
New Zealand	-3.2	-4.0	-3.5		-4.0	-4.1	
Papua New Guinea	9.6	-0.8		2.7			5.7
Russia	11.2	8.0			6.0		

Sources: Individual Economy Reports.
ADB, *Asian Development Outlook*, April 2002.
IMF, *World Economic Outlook*, September 2002.
OECD, *OECD Economic Outlook*, June 2002.

CHAPTER 2

MICROBANKING DEVELOPMENT, REGULATION AND SUPERVISION

INTRODUCTION

Financial exclusion

The existence of broad segments of the population who lack access to financial services has been identified as a cause of concern for policy-makers in several parts of the globe, including the Asia-Pacific region. The World Bank estimates that about 200 million poor households in developing economies of the region still have limited or no access to institutional financial services[2], while experts from the Inter-American Development Bank have estimated that less than 3 percent of the existing micro-enterprises in Latin America have access to formal or semi-formal credit institutions.[3]

Financial exclusion, the process which prevents the poor and disadvantaged from accessing formal financial systems, also occurs in developed economies. In these economies, privatization and rationalization impelled by the internationalization of finance have brought structural changes to domestic financial markets. In some cases such restructuring has led to the withdrawal of conventional financial institutions from particular geographic areas or demographic categories. In other cases, increasing economic and social polarizations have caused conventional financial institutions to focus their services on 'high yield' market segments and to neglect others. Gender is a variable influencing access in all economies. Policy-makers in industrialized economies have responded to such exclusion in a number of cases.[4]

The general relevance of microbanking to APEC lies in the fact that financial exclusion occurs to some extent in all APEC economies. Such exclusion requires a response, and the generic label 'microbanking' may be applied to the variety of financial sector responses that are emerging to overcome financial exclusion. More formally, microbanking may be defined as an activity consisting of the provision of small-scale financial services, such as credit, savings, insurance, and remittance services that are targeted towards low-income segments of the population and micro-enterprises. This activity can be undertaken by a broad array of intermediaries, ranging from non-governmental organizations (NGOs) to credit unions, thrifts, savings banks, commercial banks and state banks, among others.

Due to the successful experience of some of the aforementioned intermediaries, new microfinancial products, delivery methods and institutional structures have been developed over the past 15 years. This has resulted in the emergence of successful and sustainable microbanking institutions (MBIs). In this sense, microbanking is understood as a line of business that differs from traditional banking, although any financial institution, including large commercial banks, can hold a microbanking portfolio. Hence, this study understands microbanking as an activity, rather than a specific legal or institutional form.

The scope of microbanking

The definition of microbanking given above is broad, encompassing financial services demanded by both micro-enterprises and 'low-income segments of the population'. Further, financial service providers defined as 'microbanks' include both regulated financial institutions and a range of registered and unregistered entities operated by voluntary or civil society organizations. Informal mechanisms also exist, including rotating savings and credit associations (ROSCAs), moneylenders and pawnbrokers. The definition covers the disparate circumstances of the full

---

[2] World Bank (WB), (2002a).
[3] Inter-American Development Bank (IADB), (2001).
[4] In the United States, for instance, the existence of 40 million Americans who are not using mainstream banking services led the Treasury Department to launch the program "First Accounts" in late 2001. Further details of this initiative are included in section 4 of the study.

range of APEC member economies. It permits the problem of financial exclusion to be generalized, and solutions to be explored for all economies.

The distinction between micro- and small enterprises is important if we are to understand the scope of microbanking. Micro-enterprises are largely household-based and informal. They are usually un-enumerated and commonly do not conform to national standards on such matters as minimum wages or occupational health and safety. They do not usually pay direct taxes. A small enterprise, on the other hand, is formal and enumerated in most economies and particularly so in the developed economies. A small enterprise may suffer from disadvantages in regard to its access to formal financial services, but these are qualitatively different from the difficulties faced by the unbanked, financially excluded, micro-enterprise.

The fact that the economic activity of micro-enterprises is typically un- or under-enumerated poses difficulties for attempts to estimate the demand for microbanking services. Further, since microenterprises usually resort to informal financial service providers (including family and friends, ROSCAs and moneylenders), this is an additional source of difficulty in estimating the financial services gap that the more formal microbanking institutions might be required to fill. The absence of data on micro-enterprise activity and on the demand and supply of microbanking services in APEC economies combines with some definitional confusion to impede reporting of microbanking in member economies on a comparable basis. This is evident below, from data reported in section 2 of this chapter.

The household as the unit of analysis

Microbanking, as defined above, targets ‘low-income segments of the population and micro-enterprises’. Thus microbanking services are extended to individuals and households as well as to micro-enterprises. In principle, the household, and not the individual or the micro-enterprise, is the most appropriate unit of analysis for studying the demand for microbanking services. Households may be both units of production and of consumption. In the developing economies they are both of these and the household-based micro-enterprise is the most numerous business entity and the greatest source of employment. Microbanking in such economies can raise the productivity of households as producers as well as increasing the welfare of households as consumers.

In the developed economies, micro-enterprise is insignificant and the household is predominantly a unit of consumption. There are household production units in developed economies’ agriculture sector, but these are usually highly capitalized enterprises, not micro-enterprises. Financial exclusion impacts negatively on the consumption of a proportion of households, and microbanking can improve their welfare as consumers.

This study aims to analyze why this topic is relevant to a greater or lesser extent in all APEC economies, regardless of their level of development or financial deepening. For this reason, this study does not establish a strict quantitative definition of microbanking activities (i.e. average individual deposits or loans), but rather aims to establish the key qualitative distinction that differntiates microbanking from other financial-related activities: the provision of financial services to the traditionally “unbanked” population.

The relevance of microbanking

The relevance of microbanking development rests on the fact that it contributes to economic efficiency and to the sharing of prosperity. Microbanking’s contribution to economic efficiency derives from its capacity to promote financial deepening, particularly in the developing APEC economies. Secondly, it promotes the export competitiveness of industrializing economies by supplying the low cost wage-goods and services demanded by industrial workers, thus helping to keep labour costs low. It contributes to the sharing of prosperity in all economies by raising the consumption levels of financially excluded households. In developing economies it assists poor households to meet both their production and consumption needs. And in all economies it assists households headed by women, which are over-represented among the financially excluded.

Microbanking does not replace informal sources of credit and savings but combines characteristics of such mechanisms, like the information advantages of village moneylenders and the rotational lending of ROSCAs. Since the financially excluded are a heterogeneous group, microbanking intermediaries use specialized methods and hence are constituted in different legal forms to serve their particular market niches. These can include commercial and development banks, credit unions, mutual or community banks, non-governmental organizations (NGOs), cooperatives, and other specialized intermediaries. At the same time, however, establishing fundamental principles of finance regulation and supervision for MBIs is necessary in order to protect the savings of the low-income segment of the population.

Microbanking operations have grown significantly over the past fifteen years, shifting from pure micro-lending activities to broader-based savings mobilization schemes. Considering the specific risk profile of MBIs, including credit risk from the use of non-conventional collateral or correlated risks from a homogeneous clientele[5], liquidity risks, management risk, and governance risk, the issue of designing an appropriate regulatory and supervisory framework for their efficient operation has become crucial, particularly when savings from large and vulnerable segments of the population are included.[6]

The challenge, however, is not only to set appropriate regulation and supervision policies that improve overall risk management, but also to secure microbanking as a sound and sustainable financial activity. This is particularly significant since, over time, funds from donors will become increasingly scarce and MBIs will have to attract commercial financing or increase the mobilization of public savings. It is clear that only financially viable institutions will be able to attract the necessary resources to continue their operations.

One of the key aspects of sustainability is diversification of clients and products. At present, it has become evident that microbanking can be considered as an industry in itself, capable of offering a wide range of flexible financial services for a variety of poor clients, not just micro-entrepreneurs. Among microbanking potential clients are people who may prefer to devote their financial resources not only to small businesses, but also to other asset-building activities that are not typically considered productive investments, such as education, nutrition, and dealing with emergencies. This has been especially the case with households headed by women.

By providing incentives to being regulated and supervised, MBIs can not only better serve larger segments of the population, but also improve their chances of enhancing their financial sustainability and ultimately becoming fully integrated into the national financial system. This has effectively been the experience of some industrialized economies, for example with credit unions in Canada and the United States, and in some developing economies, as with the BRI Unit system in Indonesia.

The scope of this study

This study aims to present a descriptive survey, assessing the state of microbanking in the Asia-Pacific region, as well as the on-going trends in regulation and supervision. The focus is on formal or semi-informal institutions, since they show the greatest potential for growth. Due to

---

[5] Although the microbanking clientele is considered heterogeneous in terms of their specific needs and characteristics, it is also regarded as homogeneous when considering its risk profile, as explained in section 3 of this study.

[6] Hanning and Braun (2000).

lack of appropriate information, informal mechanisms or institutions—such as ROSCAs, pawnbrokers, etc.—are not included in the study.

This paper is divided into four main sections. The first section explores the relevance of microbanking for the region as a whole, in terms of (a) poverty reduction and social safety nets, (b) micro-enterprise financing, (c) rural development, (d) gender considerations, and (e) community empowerment. The second section describes the state of microbanking in the region using a typology of the existing intermediaries. An assessment of the industry's size and penetration relative to the entire financial system is also included. The third section of the study analyzes the rationale behind the regulation and supervision of microbanking intermediaries, while presenting an overview of the trends and features in the APEC region. The fourth and last section provides an overview of other related issues, ranging from financial sustainability of microbanking activities to specific trends in governmental policies.

This paper includes information from those APEC economies that provided inputs for drafting this study as well as those for which is publicky available information. Among APEC's 21 member economies, references to 16 have been incorporated in this study. They are: Australia; Canada; Chile; People's Republic of China; Indonesia; Japan; Korea; Malaysia; Mexico; New Zealand; Papua New Guinea; Peru; Philippines; Chinese Taipei; Thailand; and the United States.

1. THE RELEVANCE OF MICROBANKING FOR THE APEC REGION

Before discussing the specifics of microbanking and understanding why regulation is needed, the following questions must be addressed: Why is microbanking relevant for APEC economies? What are its benefits and social impact? Who are the beneficiaries and for what purpose should microbanking be developed? These are some of the issues that this section addresses.

This section identifies some of the most relevant topics related to microbanking among APEC economies. For this purpose, a broad conceptual approach is employed, while using concrete examples of APEC economies to better depict the trends in this industry. Five key areas have been identified in this regard: (1) poverty reduction and safety nets; (2) development of micro- and small enterprises; (3) rural development; (4) gender considerations; and (5) community empowerment. Although these areas are mentioned in order of importance, it should be noted that this order might vary from one economy to the other, along with the degree of success in dealing with each of their specific challenges. It is also worth noting that in various APEC economies some microbanking activities represent successful market-based responses to financial exclusion. Others are more in the nature of government-inspired and government-subsidized responses to social deprivation.

1.1 Poverty Reduction and Social Safety Nets

Poverty is typically associated with low income. However, as Amartya Sen's seminal work has pointed out, poverty also involves deprivation of basic capabilities, such as the freedom to choose a lifestyle, participating in the life of a community, and having self-respect [7]. By providing access to credit and savings, among other financial services, microbanking can make a difference for the poor, both by providing them the opportunity to generate income, as well as by enhancing and broadening individual capabilities through improved business skills and community participation.[8]

Several APEC economies have recognized the importance of microbanking for reducing poverty, and building up social safety nets enable the poor to better weather economic and financial crises.

Indonesia; the Philippines; and Thailand are good examples of how microbanking has been incorporated into social and economic programs, particularly in the aftermath of the 1997 financial crisis in East Asia.

Following Indonesia's banking and currency crisis in 1997, microbanking provided a valuable social safety net as massive lay-offs led many workers to rely on self-employment and micro-enterprises. Moreover, while commercial lending came to a virtual stop, microbanks were the only banks that continued extending loans to customers.[9] Indeed, some rural banks were even able to increase their savings position while maintaining portfolio quality and increasing their margins.[10] This was a market-based and commercially viable response to the situation.

As a result of the crisis, Indonesia used its well-established and longstanding network of MBIs (Bank Rakyat and Rural Banks) to extend the scope of poverty alleviation programs. Examples of this included the PHBK (*Pengembangan Hubungan Bank dengan Kelompok Swadaya Masyarakat*) projects, which are self-help groups linked to rural banks, as well as the PKM (*Proyek Kredit Mikro*) micro-credit projects.

---

[7] Amartya Sen refers to a person's capability as "the alternative combinations of functions that are feasible for her to achieve. Capability is thus a kind of freedom to achieve alternative functioning combinations (or less formally put, the freedom to achieve various lifestyles)". Sen (1999), p 75.
[8] Sen (1999).
[9] Sukarno (1999).
[10] Abdullah (2001).

In the Philippines, a Presidential Commission to Fight Poverty (PCFP) created in 1994 incorporated micro-credit as a key policy dimension for poverty reduction. Later on, the National Strategy for Microfinance formulated in 1997 incorporated this as an official government strategy for poverty alleviation. Since then, microbanking activities in the Philippines have steadily expanded their coverage to thousands of low-income families in the countryside.[11]

Like Indonesia, Thailand has a longstanding microbanking tradition in rural areas, particularly through the Bank for Agriculture and Agricultural Cooperatives (BAAC). However, the government has recently launched new microbanking programs aimed at expanding access to credit and savings among low-income groups, in both urban and rural areas. Furthermore, these programs have been incorporated as a part of a new economic strategy that emphasizes the need to achieve a balance of external and domestic demand in fostering economic growth—an initiative known as the "Dual track Plus Development Program".[12] (See Text Box 1.1.1 for further details)

However, this experience is not exclusive to Southeast Asia. In Latin America, APEC economies such as Mexico and Peru have incorporated microbanking as the centrepiece of social policy.

In Mexico, microbanking was incorporated into poverty reduction programs in 1993 through the creation of *cajas solidarias*, which were financial cooperatives designed to deliver savings and credit services in poor rural communities. More recently, in 2001 several steps were taken to strengthen MBIs and to incorporate them more decisively into poverty reduction efforts. The 2002–06 National Program to Finance Development (PRONAFIDE) has also incorporated the development of a popular savings and credit system as part of broader efforts to enhance domestic savings and further deepen the financial sector in Mexico.

A similar situation has occurred in Peru, where microbanking activities steadily increased during the 1990s. This expansion was achieved based on a new policy aimed at formalizing the activity of microcredit non-profit organizations, by transforming them into new regulated MBIs.

In sum, experience has shown the growing importance of microbanking as part of broader social policy objectives. Strong provision of deposit services among the poor has been identified as a particularly relevant aspect which acts as a safety net. However, the strengthening of a sound and sustainable microbanking industry ultimately depends on linking financial services' provision to the poor to a country's overall financial strategy development.[13]

---

[11] Government of the Philippines, (2002).

[12] Ministry of Finance of Thailand, (2002a).

[13] The comments from Carlos Cuevas and Bikki Randhawa from the World Bank were particularly useful for stressing the importance of this factor in achieving a sustainable microbanking industry in the APEC region.

1.2 Contributing to the Development of Micro- and Small Enterprises[14]

The insufficient provision of financial services to micro- and small enterprises has been identified as a common problem in many parts of the world, including economies whose financial systems are thoroughly developed. According to the World Bank (2002b), this situation is associated with information gaps about credit quality, as well as with the relatively high fixed costs of small-scale financial operations.

Traditionally, micro-enterprises have relied on informal mechanisms, such as moneylenders and ROSCAs. Over the past few years, some efforts have been made to build up more formal arrangements through a wide range of MBIs, including NGOs. Nevertheless, the results are still very limited. According to Westley (2001), only 2.6 percent of the 59 million micro-enterprises in Latin America have access to formal (i.e. banks) or semiformal credit (i.e. NGOs, credit unions).

In most economies, commercial bank personnel may be unfamiliar with the needs of micro-enterprises and the low-income segment of the population, and hence have a preference to lend to clients with whom they have more experience in dealing, such as large businesses. Government regulation may encourage banks to hire staff who are more qualified to deal with micro-enterprises, and to work with community groups to acquire more information in order to make credit decisions.[15]

It is estimated that there are currently 500 micro-enterprise development (MED) programs operating in the United States today.[16] Each year, agencies administering these programs spend between US$70 million to US$100 million and serve at least 100,000 clients. Virtually all MED programs are operated by non-profit organizations. Unlike microlending institutions in some developing economies, these organizations do not accept deposits, nor operate as traditional banks.

Some of these agencies were specifically established to manage MED programs, whereas others have a much wider scope of operations. MED agencies in the United States are funded almost entirely by federal, state, and local governments, private corporations and charitable foundations. It is estimated that the average loan size from MED programs to individuals in the United States is US$10,776. While MED programs are extremely diverse and can vary in many different dimensions, such as mission, target clients, and size, 92 percent of the times they provide at least some business training or counseling (See Text Box 1.2.1).

---

[14] Despite remarks made in the Introduction to this chapter, emphasizing the important distinction between micro-enterprise and small enterprise (including the fact that the household-based micro-enterprise is the true constituency for microbanking) much of the discussion in this and following sections deals with both 'micro-' and 'small' enterprise. They are combined together because reporting by member economies usually does not make any distinction between them. Also separate, dedicated micro-enterprise development (MED) programs are much less common than activities in support of SME. While it could be said that MED is catered for at the bottom end of SME programs, this is an unsatisfactory strategy due to the qualitative differences between micro-enterprise and SME. The decision of the SME Ministerial, 24-25 August 2002 in Acapulco, to create a Sub-Group on Micro-enterprises permanently within the SME Working group represented welcome recognition of the qualitative differences between SME and Micro-enterprise, including the ‘financial exclusion’ of the latter, which may in time lead to more differentiated policy approaches in APEC economies.

[15] Mellick (2002).

[16] Defined here as a business with five or fewer employees, including the owner, and startup capital needs of US$25,000 or less.

TEXT BOX 1.1.1: MICROBANKING AS PART OF THAILAND´S ECONOMIC STRATEGY

As part of Thailand's government efforts to surmount the effects of the 1997 financial crisis and the negative impact of slower global economic growth, microbanking has played a pivotal role in stimulating domestic demand.[1] Two recent initiatives established in 2001 have been particularly relevant in this regard: the National Village and Urban Community Fund and the People's Bank.

- **THE NATIONAL VILLAGE AND URBAN COMMUNITY FUND (NVUCF)**

Launched with the objective of providing support for productive activities among rural villages and poor inner-city communities, the NVUCF is directly under the responsibility of the Office of the Primer Minister's Secretary General. The NVUCF works through the establishment of one million baht (aprox. US$ 23,000) revolving funds per member community (74,000 communities were receiving this fund as of mid-2002). The NVUCF is fully funded by the Government Savings Bank (GSB) and the government sets up the budget for principal and interest payments to the GSB.

This revolving fund is managed through local committees, composed by 15 to 19 members each, which in turn are responsible for granting loans and receiving repayments. Average loans are between 20,000-50,000 baht (US$455 - US$1,336) and can be used for a wide array of purposes, including agriculture, start-up businesses, manufacturing, services, etc.

As of June 2002, a total amount of $70,439 million baht (approx. US$1,600 million) were transferred to village fund accounts, of which disbursement was around $48,607 million baht (approx. US$1,104.70) or 69.01%. About 75% of these loans were for agricultural projects.

- **THE PEOPLE'S BANK**

The People's Bank was officially established on June 25, 2001, with the aim of improving access to financial services for small entrepreneurs, as well as fostering competition among local money lenders. The project is run by the Government Savings Bank, which not only provide credit and saving services, but also financial advisory services to ensure that its target customers are able to operate commercially.

The target customers of the People's Bank are retail customers and small entrepreneurs who are unable to access services from commercial banks. The initial credit line for this program is $30,000 baht per account (approx. US$682). No collateral is required to obtain the loan, but the presence of two guarantors to endorse the loan is necessary. For loan repayment, borrowers are required to do monthly loan repayment. The interest rate charged is fixed at 1% per month (flat rate), and borrowers must repay within 25 months after the initial disbursement. Additional loans can be extended to $ 50,000 baht (approx. US$1,136) and beyond that amount a collateral guaranteed by two members of the Government Saving Bank is required.

As of June 2002, the People's Bank had 491,624 registered clients, with total deposits amounting to $1,288.69 million baht. Of these clients, 286,858 had been granted loans amounting to $3,819.35 million baht.

Region in Thailand	Members				Loan Approval			
	Total Members		Members Requested Loans		Number of Members	Total Amount (Million Baht)	In Percentage (%)	
	Number of Members	Total Deposit (Million Baht)	Number of Members	% of total members			Of Total Members	Of Members Requested Loans
Central Region	210,907	461.76	156,024	73.98	136,038	1,995.88	64.50	87.15
Northern Region	94,105	268.38	78,504	83.42	70,963	1,088.65	75.41	90.36
North-Eastern Region	150,306	430.67	113,494	75.51	96,265	1,449.07	64.05	84.82
Southern Region	70,556	185.08	54,099	76.68	48,708	742.47	69.03	90.03
Total	**525,874**	**1,345.91**	**402,121**	**76.47**	**351,974**	**5,276.08**	**66.93**	**87.53**

[1] In 2001, the Thai economy grew 1.8%, higher than the expected rate of 1.3 -1.5%, and due to a large extent to domestic consumption. The 2001 figures showed a strong private consumption per GDP growth rate of 56.9% which increased from 56.1% in 2000. Moreover, the unemployment rate declined from 3.6% in 2000 to 3.4% in 2001. This situation contrasts with other economies in the region, which were badly hit by the decline in external demand.

Source: Government of Thailand (2002)

TEXT BOX 1.2.1: THE ROLE OF THE US GOVERNMENT IN MICROLENDING

In 1987, the Office of Community Services (OCS), a branch of the Department of Health and Human Services, began a pilot project: The Demonstration Partnership Program (DPP). The DPP sponsored two grants for community action agencies in its first year of operation—the Small Business Development Program in Belmont, NY, and the Job-Start Community Linkage Project in Barre, Vermont. Since those first two grants, more agencies have become involved in microlending initiatives, such as the Small Business Administration, the Treasury, the Department of Labor, the Department of Housing and Urban Development and the US Department of Agriculture. These agencies have spent more than US$300 million and given more than 700 grants or loans to support MED programs in the last 15 years.

A summary of major funding for the MED Field, 1983-1999

(Nominal Dollars)

	Total Dollars	Years of Data	Average Dollars/year
Foundations			
Ford	$49,709,000	17	$2,924,059
Mott	26,033,000	15	1,735,533
Subtotal	**$75,742,000**		**$4,659,592**
Federal Agencies			
Dept. of Health/Human Services	-	-	-
OCS-DPP	$3,250,000	4	$812,500
OCS-JOLI	23,810,000	9	4,030,571
ORR	5,879,000	5	1,175,800
Small Business Administration	209,231,000	8	26,153,875
Treasury: CDFI	25,849,000	4	6,462,162
Dept. of Labor	5,164,000	2	2,582,000
Dept. of Housing & Urban Development	20,135,000	2.5	8,054,000
Dept. of Agriculture	15,799,000	3	5,266,333
Subtotal	**$309,117,000**		**$54,537,241**
Total	**$384,859,000**		**$59,296,833**

Source: Else, (2001).

Similar to the US MED Program, in 2001 Mexico introduced a new initiative, the PRONAFIM (*Programa Nacional de Financiamiento al Microempresario*), which is aimed at channeling resources to micro-entrepreneurs mainly through non-profit organizations.

In New Zealand, special government-sponsored programs have been devoted to providing technical and funding assistance to small businesses through a range of schemes. These include grants for establishing or expanding small businesses, as well as venture capital funds, targeted particularly at proposals that are unlikely to be funded at reasonable cost through the financial system.

Chinese Taipei and Korea have well-developed financial sectors. However, both economies have identified the lack of financial services access as an on-going problem for small- and medium-enterprises (SMEs). To overcome this situation, government efforts have been geared at establishing credit guarantee funds. (See Text Box 1.2.2)

In Peru, the economic crisis and terrorism during the 1970s and 1980s increased migration to Lima, and self-employment and micro-enterprises began to develop massively in marginal areas of the city. This situation encouraged the creation of different kinds of MBIs. These institutions covered most of Lima's informal credit activities but they did not succeed, in part due to inflation and financial repression policies (i.e. interest rate controls).

On May 1980, Peru enacted the first law that creates and regulates the functioning of the *Cajas Municipales* outside Lima, in order to facilitate the provision of financial services to the low income strata. Under this framework, the first *Caja Municipal* was established in Northern Peru in 1982. To date, there are 13 *Cajas Municipales*, with a philosophy that emphasizes deposit mobilization in the provinces and allocation of resources within the provinces.

In the 1990s, NGOs introduced financial aid programs aimed at supporting micro-enterprises located in Lima's marginal areas through small loans. As micro-enterprises spread to other parts of the country, the need for savings and credit eventually led to the creation of new type of microbanking intermediary such as the EDPYME – *Entidad de Desarrollo para la Pequeña y Microempresa* (small business and micro-enterprise development institutions) and the *Cajas Rurales* (rural savings and loans institutions).

TEXT BOX 1.2.2: CREDIT GUARANTEE FUNDS: THE EXPERIENCE OF KOREA AND CHINESE TAIPEI

- ***Chinese Taipei***

SMEs have long played an important role in Chinese Taipei's economy. In the early 1970s, many SMEs were badly hit by the impact of the oil crises. In the ensuing recessionary and inflationary climate, financial institutions adopted conservative lending policies and set strict collateral requirements for extending loans to SMEs. In response to this situation, the government created the Small and Medium Business Credit Guarantee Fund (SMBCGF) in 1974.

The goal of the SMBCGF is to provide credit guarantees for SMEs that are operating normally but lack collateral for external financing. By providing guarantees, the SMBCGF enables such enterprises to secure credit from financial institutions. In 2001, the SMBCGF provided 149,610 credit guarantees, an increase of 23% from the previous year. The total amount of the guarantees reached NT$147.8 billion (US$4.22 billion), up 7% from the year before. At the end of 2001, the outstanding credit covered by SMBCGF guarantees amounted to NT$145.1 billion (US$ 4.15 billion).

More recently, in 1983 the *Agriculture Credit Guarantee Fund (ACGF)* was established on a trial basis to provide financing assistance to farmers, fishermen, and others earning a livelihood in the agricultural and fishery sectors. Its goals were to help eligible applicants to obtain credit, to counsel them on the use of funds, and to give them guidance on operational management. In addition to providing credit guarantees for qualified applicants who lack collateral for securing loans, the ACGF also shares financing risks with agricultural financial institutions to facilitate their lending activities. In 2001, it issued 4,907 credit guarantees amounting to NT$6.84 billion (US$195,000). As of the end of 2001, it had granted 105,527 credit guarantees, amounting to NT$133.2 billion (US$3.8 billion) since its inception. Its contributed capital stood at NT$166.3 billion (US$4.75 billion) at year-end 2001.

Performance of Credit Guarantee Funds in Chinese Taipei as of year-end 2001

Item	Credit Guarantee Fund	Small and Medium Business Credit Guarantee Fund (SMBCGF)	Agriculture Credit Guarantee Fund (ACGF)
Guarantees Provided	Cases	149,610	4,907
	Amount (NT$ million)	147,804	6,804
Total Amount Supported	Amount (NT$ million)	233,913	8,505
Outstanding Guarantee Liabilities	Cases	114,723	17,886
	Amount (NT$ million)	145,143	23,343
Payment after Claim	Cases	3,750	86
	Amount (NT$ million)	5,179	833
		From 1974 to the End of 2001	From 1984 to the End of 2001
Cases Guaranteed		1,973,109	105,527
Amount Guaranteed	(NT$ million)	2,329,640	133,283
Amount Supported	(NT$ million)	3,171,829	166,327

US$1=NT$34.99 (Dec. 31, 2001)

- ***Korea***

The Korea Credit Guarantee Fund, established in 1976 channels contributions from the government and banking institutions, with the objective of extending credit guarantees, providing credit information, giving management and technical assistance, and participating in capital investment in SMEs

Under a similar operating scheme the Korea Technology Credit Guarantee Fund was established in 1997. Its role is to extend credit guarantees to SMEs, primarily to help them to adopt new technology for commercial production.

1.3 Contributing to Rural Development

Historically, commercial banks have had little incentive to provide services in rural areas. This is a critical issue because financial services are an indispensable element in a complete strategy for rural development. In industrialized economies this problem was gradually eliminated as living standards for farmers improved and urban and rural financial systems were integrated. In many cases, governments responded by creating specialized rural and agricultural banks, but with limited success. For this reason, informal financial arrangements still prevail in many developing economies.

In the APEC region, formal MBIs have an active presence in rural areas, providing a wide range of services, including credit, savings, and even remittances. In fact, the experiences of Thailand and Indonesia with rural financial institutions have been highlighted as being among the most successful in the world.[17]

In the case of Bank Rakyat Indonesia (BRI) and its rural units, their financial viability was enhanced by pooling agricultural and non-agricultural risks, while maintaining high repayment rates in rural areas (better than 97 percent, even during the financial crisis in 1998 and 1999). Among the reasons for this success, were the appropriate incentives offered to loan officers, as well as the practice of rebating a small part of the loan for early repayment.[18]

In Thailand, the BAAC developed a flexible and successful strategy to extend loans to cooperatives, groups and individuals under different collateral requirements and loans terms (current average BAAC's loan size is reported to be US$1,300). The BAAC also offers a broad range of services, in addition to credit and savings, including remittances and insurance.

In the People's Republic of China, one of the essential lending businesses of the Agricultural Bank of China (ABC) is extending poverty-relieving loans to individual farmers or micro-enterprises. The Postal Deposit & Remittance Bureau, a governmental institution with a great number of branches within the reach of the posting service, undertakes no other financial businesses but deposits and remittances, serving most rural residents and many urban residents.

However, significant challenges remain in the APEC region, particularly among the developing economies. According to the World Bank's *2002 World Development Report* coping with the demand for financial services in rural areas involves not only effective access to credit and safer and more liquid savings, but also insurance—an area that even in industrialized economies is considered to have shown mixed results—[19] as a part of a general strategy to cope with agricultural risk that may also include the use of derivatives.

1.4 Gender considerations

Women are active agents of social and economic change.[20] Traditionally, women have been financially disadvantaged due to lower incomes, which in turn undermine their borrowing capacity given their consequently lower asset holding. As a result, women who do not have access to bank loans are frequently caught in a cycle of debt with loans either from finance companies or, as it is the case in many developing economies, from pawnbrokers, moneylenders, and other informal credit lenders.

---

[17] WB (2002b), pp. 39-43.
[18] WB (2002b), p. 41.
[19] WB (2002b), pp.39-43. For a more detailed discussion see the section on building more effective and accessible rural financial institutions.
[20] Sen (1999), chapter 8.

Access to financial services has been recognized as an efficient tool for enhancing women's rights and combating economic and social discrimination against them. For example, chapter 13 of the *United Nations Convention on the Elimination of All Forms of Discrimination Against Women* (CEDAW) mentions "the right to bank loans, mortgages, and other forms of financial credit" as part of the measures that economies shall take to eliminate discrimination against women in areas of economic and social life.

This has been recognized as a policy concern in some industrialized APEC economies such as New Zealand, where government efforts have been geared at empowering women by enhancing their access to financial services. Several programs have been implemented with women clearly considered as a target group, including some micro-lending schemes with ethnic considerations such as the Mäori Women's Development program (See Text Box 1.4.1 for further details).

A similar policy has been recently developed in Japan, where the number of women wanting to become self-employed has increased substantially. However, women face barriers to setting up and running a business, such as lack of necessary skills, know-how and useful business experience. To overcome this situation, the Japanese Government has implemented several programs aimed at providing both financial and technical assistance to women (See Text Box 1.4.2 for further details).

TEXT BOX 1.4.1: MICROBANKING GENDER PERSPECTIVE IN NEW ZEALAND

Women in New Zealand earn, on average, 84% of men's hourly earnings. Indigenous women, such as Mäori and Pacific women, earn 74% and 70% of men's hourly earnings, respectively. So far, progress towards closing this gender gap has been slow – there has been only an improvement of 5% over the last 17 years.

According to New Zealand's 2001 census, the average annual income for males was US$24,900, while females earned an average of US$14,500. Furthermore, the highest average annual income for females was in the 45 to 49-year age group at US$22,000, by contrast to males in the 40 to 44 year age group who had the highest average income at US$35,900.

Likewise a 2001 study found that the average incomes for households in which all the adults were women, were consistently lower than the average incomes of households in which all the adults were men or with adults of mixed genders, regardless of whether there were children or dependent young people in the household. This gap widened during the 1990's.

Given the aforementioned disparities, the government has recognized improving women's access to financial services as a policy concern, and has devoted significant efforts to:

- Providing more opportunities for women to access finance and financial planning for business development, retirement income, etc.
- Establishing greater control of bank facilities to eliminate subtle requirements that husbands / partners need to be consulted when women apply for finance, and
- Enhancing support for special funds such as the Women's Loan Fund—Wahine Putea, a charitable trust established in 1992.

Source: Dunlop (2002),

TEXT BOX 1.4.2: MICROBANKING GENDER PERSPECTIVE IN JAPAN

In 2001, only 14% of the new business starters were owned by women. In order to enhance the participation of women as new entrepreneurs, the Japanese government has recently established several programs including:

- Loan scheme for women and elder entrepreneurs

The loan scheme by the Japan Finance Corporation for Small Business and the National Life Finance Corporation offers low interest loans and exemption of mortgage. Women who have been running their own business for less than five years are eligible. The interest rate for this scheme is lower than standard. New businesses can receive the lowest interest loan. About 8,100 entrepreneurs utilized the Loan scheme between 1999 and March 2002.

- Support for “Small Office-Home Office” and “Tele Work”

The long-term, fixed and low interest loans provided by the Development Bank of Japan for “Tele Work” and “Small Office-Home Office” facilities encourage home-based business, and women can have more opportunities to start working.

- A school for business start-up

The School supports people who will start a new business. It is subsidized by the National Union for Commerce and Industry and the Chamber for Commerce and Industry and helps to develop business planning and provides practical skills and the knowledge needed to run a new business.

- Research program on support for women and elder people

The program develops practical approaches for women and the elderly who have a strong desire to start a new business and actively participate in the labour market.

- Support schemes for women farmers

    i. Support program for e-business of women entrepreneurs aimed at providing know-how and promoting networking in order to deal with highly developed technology that is important for agri-business management.

    ii. Loan scheme for women entrepreneurs who need funds for processing farm products and other original ideas.

    iii. Training abroad to encourage entrepreneurs to adopt new management practices and promotes active community based entrepreneurs

    iv. Loan scheme for women and older people who are engaged in gathering, farming and processing marine products.

- A seminar for women who want to start a new business

The Government supports women who want to start a new business and provides them with overall information on business management, including skills and knowledge on personnel management, through a seminar, an informative session with business people and a counselling program regarding business management. Furthermore, the government publishes guidebooks and provides the requisite information for starting up a business on Web site.

Source: Government of Japan (2002),

Aside from a developmental policy, offering financial services specifically to women can also be seen as a profitable activity for MBIs, since women have higher payback rates, are reputed to be better credit risks, are more inclined to use the income they control for investment rather than consumption, and have more unrealized entrepreneurial capacity when compared with men.

In Papua New Guinea, the Department of Social Welfare and Development has established support and promotion services for gender awareness with the aim of increasing the participation of women as both beneficiaries and agents in social, economic and political development. For this purpose, legislative reviews of domestic laws are conducted, as well as credit management training programs and reviews of governmental gender policies and procedures.[21]

In Australia, women earn 65.9 percent of total male earnings,[22] due to the differences between men and women in hours worked each week, types of jobs performed, and their occupational and industrial distribution.[23] In response to this situation, the Australian government has committed to increasing the range of resources available to women in business and several programs have been tailored particularly to women and their needs in business, including: the Women-in-Business Mentor Program, the Small Business Enterprise Culture Program and the Women in Business Program.

1.5 Community Empowerment

In addition to gender, discrimination in the form of rejecting otherwise qualified loan applicants can occur because of their race or ethnicity. In theory, if markets truly worked, there would not be any discrimination because other non-discriminating banks would see an untapped market and make loans to victims of bigotry. Barriers to entry, however, make it difficult for new banks to become chartered and cater to an underserved market. Information asymmetry can also lead to statistical discrimination, when aggregated data about a specific segment of the population is used to make a credit decision, instead of using an individual's credit history.[24] This can occur if a bank finds it cheaper to evaluate candidates based on their race rather than their personal credit histories. If a bank believes that race, ethnicity, or gender serves as a proxy for risk factors that are hard to determine, then it may deny loans based on those characteristics rather than perform an individual credit analysis.

In order to prevent potential discriminatory policies, the United States enacted the Community Reinvestment Act in 1977. This legislation requires all depository institutions in the US to take affirmative actions to meet the credit needs of their communities, particularly those located in low-income neighborhoods (See Text Box 1.5.1 for further details).

Along similar lines, microbanking activity in Malaysia has also been aim at supporting particular disadvantaged communities. This policy goes back to 1951, when the *Majlis Amanah Rakyat* was established as a government body with the objective of assisting the *Bumiputra* (indigenous people) through the provision of loans. Similarly, in 1973 the BPIMB (*Bank Pembamguan dan Infrastruktur Malaysia Berhad*), a specialized development bank, was established to accelerate the participation of Bumiputras in the national economy. Although its major activity is the financing of infrastructure projects, the BPIMB has undertaken microbanking activities in support of the Bumiputra population.

[21] Webpage of the Department of Social Welfare and Development of Papua New Guinea.
[22] Data as of February 2002.
[23] These data are seasonally adjusted. Australian Bureau of Statistics, 2002.
[24] Mellick (2002).

TEXT BOX 1.5.1: THE US EXPERIENCE WITH THE COMMUNITY REINVESTMENT ACT[1]

The Community Reinvestment Act (CRA), enacted in 1977, requires depository institutions in the United States to take affirmative actions to meet the credit needs of their communities, including low- and moderate-income neighborhoods. The CRA was created in response to concerns that banks were not meeting the credit needs of their communities.

The CRA requires each federal bank regulatory agency to assess each federally insured institution's record of helping to meet the credit needs of its entire community. If a bank is found to have discriminated or has not made sufficient efforts to lend to the credit-needy in their community, authorities have the ability to fine and assess penalties–for example blocking mergers and acquisitions, or prevent banks from opening or closing branches. The 1999 Financial Modernization Act further provides that all the subsidiary banks in a holding company must achieve at least a rating of satisfactory of higher in order for the holding company to expand its banking activities. Since 1990, the agencies must make each institution's CRA rating and evaluation available to the public.

In 2000, the Federal Reserve conducted a survey on CRA special lending programs.[2] Not surprisingly, home mortgage lending programs were found to make up 72% of the total, followed by small business lending programs, which comprised 8% of the total. Because small business lending involves such a small share of total lending compared to mortgage lending, much of the existing literature evaluating the CRA is dedicated to evaluating home mortgage lending rather than small business lending. Unlike mortgages, a well-developed secondary market for small business loans does not exist. Further complicating the analysis is that banks and thrifts did not gather or disclose information about small business lending to lower-income and minority communities until 1996. The data below are for financial institutions that have assets of US$250 million or more, or are subsidiaries of banks with US$1 billion or more in assets. Although these institutions about one-sixth of all commercial and savings banks, they account for about two-thirds of total small business lending by commercial banks and savings associations.

Table 1

Year	Total Small Business Lending (000s)	Total Loans to Small Businesses in LMI Areas (000s)	%
1996	146,980,484	31,644,155	21.50
1997	159,411,352	34,084,332	21.40
1998	161,343,498	33,119,240	20.50
1999	174,538,571	35,452,411	20.30
2000	179,056,204	35,867,877	20.00

Source: FFIEC.

Table 2

Year	Total Small Business Lending to Firms with Less than 1 million in Revenues (000s)	Loans to Firms with Less than $1 million in Revenues in LMI areas (000s)	%
1996	62,583,338	12,243,103	19.60
1997	67,032,425	12,556,070	18.70
1998	76,609,725	13,901,601	18.10
1999	84,699,622	15,279,990	18.00
2000	82,100,593	14,716,381	18.30

Source: FFIEC.

Lending to small businesses in low- and moderate- income (LMI) areas grew at 3.2% per year from 1996 to 2000, and 4.7% to businesses with less than US$1 million in revenues (See Table 1). However, total small business lending outpaced them both, growing at a 5.1% annual rate from 1996 to 2000. Total small business lending in low- and moderate- income areas as a percentage of total small business lending edged down each year, although the total decrease has been small.

As seen in Table 2, in the universe of firms with revenues of less than US$1 million, the percentage of loans to these firms located in LMI areas has hovered in the 18 to 19% range from 1996 to 2000.

- ***Evaluating the Effectiveness of the CRA***

The CRA has also been at the center of a controversy over whether there is discrimination in lending practices and if it is truly effective in increasing credit for the credit-needy. The Federal Reserve Board and various member banks have performed various studies on the issue of discrimination–a 1992 study found extensive discrimination against African-American and Hispanic mortgage applicants, a 1995 study challenged the 1992 results, finding that discrimination only existed against those with poor credit histories. A 2000 study of CRA loans by the Federal Reserve found that such loans were less profitable to banks than those made without government pressure. Some argue that because the CRA raises the costs of operating a bank in urban areas, the response to the regulation may be less entry by banks into these communities over time–an alternative would be to use explicit subsidies for certain kinds of lending instead of penalties imposed only on banks. Others argue that the CRA has improved credit flows to LMI areas, especially in mortgage lending, and regulation is necessary to encourage further credit flows.

[1] Based on Mellick *(2002).*
[2] Defined as any lending program that an institution uses to enhance its CRA performance.

The *Amanah Ikhtiar Malaysia* (AIM) was established in 1987, along the model established by the *Grameen Bank* in Bangladesh. Although it specifically targets poor and low-income groups, the AIM has worked primarily with Bumiputras, considering that this ethnic group comprises most of the poor population in the country. More than 97.3 percent of AIM's clients are located in rural areas. Following the Muslim tradition, the AIM levies 'service charges' rather than interest rates on loans.[25]

2. STATE OF MICROBANKING IN THE APEC REGION

This section is intended to assess the magnitude of microbanking activities in the APEC region, by reviewing the main characteristics of formal MBIs. For that purpose, the present chapter introduces a typology of intermediaries intended to summarize the existing MBIs in the region. It is worth noting that, as in any classifying exercise, there is a margin of error when interpreting the categories that correspond to each intermediary. At the end of this section, an assessment is provided in terms of the importance of the microbanking sector as a whole in some APEC economies.

As a result of the different national experiences with microbanking across the APEC region, the legal and institutional features of MBIs vary significantly from economy to economy. A typology of five kinds of intermediaries is hereby presented, including three key characteristics that differentiate them from each other 1) client base, 2) products and service, 3) sources of funding.[26]

2.1 Non Governmental Organizations

NGOs are non-profit associations funded primarily by donations that provide a wide range of services besides loans, such as micro-credit and technical assistance for developmental and social needs. NGOs generally focus on assisting marginalized groups such as women and indigenous people. Since NGOs are usually engaged in microbanking through informal arrangements,[27] information about their operations and follow up by national authorities are usually limited.

[25] If calculated as interest on the principal involved, however, these charges are well below rates in the Malaysian commercial banking sector. All this information was provided by the Government of Malaysia (2002).

[26] This typology is based on the one presented by Jansson (2001).

[27] There is a distinction between NGOs working on a formal or semi-formal basis—that is, as part or in association with broader government programs—and those working on an informal basis and relying exclusively on their own means. Indonesia and the Philippines are good examples of economies where NGOs have played an increasingly important role from a formal perspective.

Table 2.1 Typology of Microbanking Intermediaries

	Commercial Banks and Multipurpose Financial Institutions	Government Institutions and Agencies	Specialized Financial Institutions	Cooperatives and Credit Unions	Non Governmental Organizations
Strategy / purpose	New market, image, profitability	Social impact, sustainability, growth	Social impact, growth, profitability	Social impact, sustainability	Social impact, philanthropy
Legal form	Banks, finance companies	Development banks, government departments, programs and ministries	Banks	Cooperatives, credit unions	Foundations, associations
Clients	Various	Usually targeting specific economic and social sectors (i.e. agriculture, indigenous groups, etc.)	Individuals and micro-enterprises	Community-based, usually targeted at specific economic sectors (i.e. fishing, agriculture, etc.)	Usually targeting social sectors (i.e. women, indigenous groups, etc.)
Services	Various and sophisticated financial products.	Various; including technical assistance, funding, etc.	Loans, savings, insurance, credit guarantees, and others	Loans and savings	Microcredit and technical assistance
Sources of funding	Savings, national and international capital markets, commercial loans	Government funds, multilateral institutions	Commercial and soft loans, government funds, donations	Members funds´ in the form of deposits	Donations, concessional loans, and savings
Examples	Desjardins (Canada), Bank Rakyat Indonesia, City Commercial Banks (China)	Community Organization Development Institution (Thailand), Bansefi (Mexico), Postal Deposit & Remittance Bureau (China)	Sociedades Financieras Populares (Mexico), BAAC (Thailand) Agricultural Development Bank of China (China) Rural Banks (Indonesia)	Sociedades Cooperativas de Ahorro y Préstamo (Mexico), Rural and Urban Credit Cooperatives (China)	Bina Swadaya and YIS (Indonesia), AIM (Malaysia)

Source: Jansson (2001).

In Indonesia, there are at least 400 NGOs that have started micro-credit programs as part of numerous development projects by government agencies and international donors. A large number of the NGO programs are connected in some fashion with the government's social safety net program and parallel programs by governmental agencies. The more advanced NGOs (i.e., *Bina Swadaya* in Jakarta and YIS in Solo) have managed to upgrade their programs and are now considered part of the formal network of rural banks or *Bank Perkreditan Rakyat* (BPRs). All in all, the NGO contribution to microbanking in Indonesia remains relatively small, serving between 1 and 2 million clients[28] (see Table 2.1.1 for further details).

In the Philippines, NGOs have the widest outreach among all MBIs, due to the fact that they broke new ground on this field, nonetheless, the scale of operations in the country is still limited. These organizations started to provide credit services to the poor in the early 1980s, but their role expanded as the government initiated partnerships with them. In this economy, NGOs are considered to be the pioneers in terms of outreach, sustainability, and efficiency. Through a national coalition called the Micro-finance Council of the Philippines, NGOs have raised their voice and are recognized by the authorities as interlocutors.

NGOs in the Philippines offer credit and savings services to their clients. Working primarily with women, this type of MBI has been able to achieve a seemingly innovative objective of expanding

[28] Sukarno (1999), p. 11.

outreach among the poor, achieving high repayment rates, mobilizing local savings, and becoming financially sustainable.[29]

In Papua New Guinea, many non-governmental organizations hold various microbanking schemes. Some of the most important are the National Women Credit Program (NWCP), The Lik Lik Dinau Abitore Trust (LLDT), the Putim na Kisim scheme (PnK), and the North Simbu Rural Development Project (NSRDP). The oldest program is the NWCP, which started in 1988 in certain provinces in order to strengthen women's associations at district level. The LLDT program is the best-known and most-documented scheme where the NGO's involvement in microbanking is evident. It began its operations in 1994 with the objective to provide savings and credit services to organised women's groups in rural areas, replicating the Grameen Bank model. In 1995, the Lutheran Development Service established the PnK with AusAID funding the support of the Hanns Seidal Foundation of Germany and the Credit Union Foundation Australia. Its objective was to establish savings cells in the villages as the basis for the development of rural savings and loans societies. The NSRDP was established only 16 months ago. It targets women and employs a group approach with loans given to individual members of the group.[30]

In Malaysia, one of the dominant MBIs is an NGO: Amanah Ikhtiar Malaysia (AIM). As mentioned in the previous section, AIM has actively supported the financial needs of the Bumiputra, the indigenous Malay people. Similarly, in Chile, NGOs—along with savings and credit cooperatives are the second source of productive microfinance of the country.[31]

It should be noted that NGOs' microbanking activities are not limited to APEC developing economies. As mentioned in the previous section, specialized NGOs are primarily responsible for carrying out micro-enterprise development (MED) programs in the United States. Unlike in some developing economies, these are highly specialized organizations that do not accept deposits or operate as traditional banks. Their funding comes almost entirely from federal, state, and local governments, private corporations and charitable foundations.[32] NGOs can also be distinguished between multipurpose NGOs and NGOs specialized in microbanking, the later having made important strides in the industry by improving both outreach and sustainability.

Over time, NGOs might evolve into formal MBIs, given the desire to expand the range of financial services they are allowed to offer, and to be able to satisfy the vast demand they face and cannot meet with donor funding alone. Some NGOs have realized that within their operational milieu, a semiformal or NGO modality seriously limits their ability to respond to the demands of the target market on a significant scale—or efficiently and effectively. Some of these institutions have already transformed themselves into formal microbanking institutions and acquired a greater capacity to leverage funds in the market and offer relatively safer deposit facilities to their target groups. Although the transformations have not been easy, they have so far managed to deal with the challenges effectively.[33] This has been the case in Peru, where some NGOs have evolved into more sophisticated intermediaries known as small business and micro-enterprise development institutions or EDPYMES (*Entidad de Desarrollo para la Pequeña y Mediana Empresa*).

---

[29] Government of the Philippines (2002).
[30] Flora Carruthers (2002).
[31] José Miguel Zavala (2002b), p. 1.
[32] Mellick (2002).
[33] Fernando (2002), p. 7.

TABLE 2.1.1 NON GOVERNMENTAL ORGANIZATIONS

	Institutions	Number of Institutions	Total Number of branches	Number of Clients	Amount of Loans Outstanding (In Thousand US$)
Chile [/1]	N. A.	12	23	N. A.	N. A.
Indonesia[/2]	Bina Swadaya, Yis	400	N. A.	200,000	N. A.
Malaysia[/2]	AIM	1	60	78,312	29,800
Peru[/3]	N. A.	16	38	83,300	14,415
Philippines[/3]	N. A.	16	N. A.	217,024	17,340
Total		**445**	**121**	**578,636**	**61,555**

Source: Information provided by each economy.
N. A. Not Available.
[/1] As of June 2002.
[/2] As of year-end 2000.
[/3] As of year-end 2001.

2.2 Cooperatives and Credit Unions

Cooperatives and credit unions are non-profit community- or activity-based institutions, which receive deposits from their members, and extend relatively low-value credits. Members' savings are in the form of shares, which are then re-lent to them. Essentially, they are formal versions of ROSCAs. Although not exclusively oriented towards serving the poorest, cooperatives and credit unions do reach a large portion of the low-income population. Typically, this kind of intermediary targets groups devoted to a specific economic activity and they are usually grouped by federations.

Credit unions have an enormous potential to expand and grow, and in some industrialized economies, such as the United States and Canada, have consolidated their presence as quasi-banks. However, this has remained largely unrealized in many APEC economies because of the main weaknesses that characterize this type of intermediary, such as external dependency, poor public image, lax repayment discipline, and governance problems, among others. Additionally, since credit unions have a cooperative ownership and governance structure, they are often very small institutions with much lower levels of professionalism than banks or other sorts of MBIs, and they are geographically less diversified. The long-term sustainability of these institutions has also been questioned as most people join them to access cheap loans and not to use their deposit services.[34]

Nevertheless, cooperatives and credit unions have played a significant role in expanding financial services to the population in many industrialized economies. Indeed, the earliest financial cooperatives date back to the 19th century in England and Germany, with the latter developing the first modern credit unions as we know them today; that is, voluntarily-based organizations with a democratically-governed decision-making body, whose members have one vote each and are able to elect a board of directors.[35]

[34] Westley (2000).
[35] This definition is taken from the National Credit Union Administration (NCUA), (2002).

Among the APEC industrialized economies, Canada and the United States have had a strong and somehow related credit union movement, whereas in Australia and New Zealand credit unions have followed a different path.

Credit unions in the United States and Canada share not only historical roots, [36] but also a relatively similar development in terms of becoming vibrant MBIs, competing in some instances with commercial banking. This is certainly the case of the Desjardins *caisse populaires* in the Canadian province of Quebec, whose sophistication in terms of services, funding and client base has led it to exceed the traditional boundaries associated with typical credit cooperatives or credit unions (see Text Box 2.2.1 for further details).

In Australia, credit unions and "building societies"[37] played an important role in expanding financial services during the post-war era, particularly during the 1960s and 1970s. However, this type of MBI gradually lost its market share as the banking industry gained prevalence following a far-reaching financial liberalization reform. In 1999, Australian credit unions experienced further changes as a result of new regulatory dispositions. While transferring regulatory responsibility from state and territory governments to the Commonwealth, credit unions were granted the same license as banks, forcing them to compete directly with traditional banks, while being subject to the same national regulatory banner for all deposit-takers institutions.[38]

A similar story occurred in New Zealand, where credit unions have played a significant role in catering to the needs of small investors and borrowers. They are restricted in the nature of their operations, only being able to take in small deposits from their members (who are usually members of a union or occupational group, staff members of a company or residents in a particular area), and to lend to their members. Deposits with credit unions are generally of very small amounts with short maturities, and loans are also typically small and short-term in nature. Loans are usually extended on an unsecured basis and for personal consumption purposes. [39]

In East and Southeast Asia, there is a longstanding tradition of credit cooperatives and credit unions, although they are less developed.

In the Philippines, credit unions started to develop in 1906 and were the first institutions to provide financial services to the micro-enterprise sector in particular. However, as most of the credit cooperatives grew, they started to service the needs of professionals and salaried workers. Credit unions are mostly members of a national, regional or provincial federation. Cooperatives and credit unions offer credit and savings services, but do not provide insurance, remittance or other services to their members. [40]

In Thailand, the first financial cooperatives date back to 1916, when the government established them to serve the financial needs of local communities. Similarly, in Indonesia there are over 5,335 government-sponsored village unit cooperatives with saving and credit services (*Koperasi Unit Desa* or KUDs) established throughout the country. Nevertheless, they have been underdeveloped for several reasons, including repressive regulation and excessive government interference during the Suharto era.[41]

---

[36] Microbanking in Canada began in the late 1800's, with Alfonse and Doriene Desjardins' lobbying efforts against usury and their search for alternative credit models. In 1909, Alfonse Desjardins decided to help a group of Franco-American Catholics in Manchester, New Hampshire, to organize St. Mary's Cooperative Credit Association, creating what is considered the first credit union in the United States.
[37] Building Societies take mainly small deposits and provide loans secured against housing.
[38] Australian Treasury (2002).
[39] Credit unions are overseen by the Registrar of Friendly Societies and Credit Unions, a government appointed registrar. Information provided by Mortlock (2002).
[40] Government of the Philippines (2002).
[41] Sukarno (1999), p.11.

TEXT BOX 2.2.1: CREDIT UNIONS IN CANADA AND THE UNITED STATES

The Canadian credit union movement has a long-standing tradition, and it currently consists of 2,200 individual credit unions and *caisses populaires,* which are all considered cooperatives. Due to its autonomous local roots, the movement is primarily regionally-based, with the most active credit unions in Quebec and, to a lesser extent, in the Western provinces of Saskatchewan and British Columbia.

Membership to credit unions and *caisses populaires* totals about 10 million or about 33% of Canada's population. Membership is highest in Quebec, where 65% of the population is estimated to belong to the *caisses populaires*. In 1997, 26% of Canadians used a credit union or caisse populaire as their primary financial institution; this figure, however, varies greatly by region.

Outside Quebec, a large proportion of credit unions are members of one of the nine provincial central credit unions, and in turn, all nine provincial centrals belong to the Credit Union Central of Canada (CUCC). The provincial centrals provide capital for loans and investment, management services and access to Canada's payment system. However, each individual credit union maintains a separate identity and may compete for eligible members with other credit unions.

In Quebec, each caisse populaire was previously required to belong to one of eleven federations, which in turn belonged to the province-wide confederation, *Confédération des caisses populaires et de l'Économie Desjardins du Québec* (Desjardins). On December 4, 1999, member *caisses populaires* approved a plan to amalgamate their federations and the confederation into a single new federation, to which the 814 caisse populaires now belong. Currently, the single federation is divided into 16 regions and each of them has a representative in the regional council (Core). The new federation also has a management council with 21 members. The federation will hold a general congress every 5 years with the participation of 2000 delegates. Overall, the *caisses populaires* are somewhat more centralized than credit unions and operate under a single name. For this reason, Desjardins and its members are often regarded as a single financial institution.[1]

In the United States, the credit union movement began in 1909 in Manchester, New Hampshire.[2] That same year, the Massachusetts Credit Union Act was enacted and served as a basis for subsequent state credit union laws and for the enactment of the Federal Credit Union Act. Many years latter, in 1934, President Roosevelt signed the Federal Credit Union Act[3] into law, authorizing the establishment of federally chartered credit unions in all states.

Credit unions in the United States grew steadily during the post-war era, leading in 1970 to the creation of the National Credit Union Administration as a specialized body responsible for chartering and supervising federal credit unions. Additionally, a National Credit Union Share Insurance Fund (NCUSIF) was established to insure credit union deposits. Today, over 10,000 credit unions with over US$480 billion in assets serve close to 80 million people in the United States.[4]

Credit unions also represent and alternative for remittance services in certain markets. For example, in Durham, North Carolina, the Latino Community Credit Union, which opened in June 2000 to serve the area's Hispanic population, offers a remittance service that charges US$6.50 to US$10 for money transfers to Latin America. Another credit union initiative is IRnet, the World Council of Credit Unions, Inc.'s international remittance service, which facilitates credit unions' ability to transfer of money at reasonable prices to a large number of countries throughout the world.[5]

[1] Department of Finance, Canada, (2001).
[2] In 1909, Alfonse Desjardins decided to help a group of Franco-American Catholics in Manchester, New Hampshire, to organize St. Mary's Cooperative Credit Association, creating the first credit union in the country.
[3] The purpose of this law was in President Roosevelt's words "to make more available to people of small means credit for provident purposes through a national system of cooperative credit..."
[4] National Credit Union Administration, (2002).
[5] Mellick (2002).

In Chinese Taipei, credit departments of farmers' and fishermen's associations (FAs), which date back to the period of the Japanese colonial rule, serve the financial needs of their members and promote the economic development of farming and fishing communities.[42] Chinese Taipei's credit cooperatives have played an active role in community finance over many decades, and thus have occupied a place of considerable importance among local financial institutions.[43] However, these intermediaries are undergoing a far-reaching restructuring in the midst of financial liberalization and growing competition by commercial banks.[44]

In Korea, Mutual Credits were introduced in 1969 to promote savings and financial services among farming, fishing and forestry-oriented communities. A few years later, Mutual Savings and Finance Companies were established in 1972 to absorb small saver's funds and specialize in providing financial services to households and small businesses. Community Credit Cooperatives were also set up in 1972 based along urban and rural considerations. These intermediaries offer credit, savings, and remittance services.

In the People's Republic of China, rural credit cooperatives were initiated and promoted all over the country in 1952 for the purpose of restraining and striking usuries, while simultaneously relieving the difficulty in rural production. Urban credit cooperatives were formally promoted in 1986 by the People's Bank of China (PBC) to provide the more community-featured financial services required by the fast growing collective and private economy in urban areas.

Nowadays, cooperative financial institutions consist of both rural credit cooperatives—which operate in local rural areas on a town or village basis and have some credit unions at municipality (medium-sized cities), county and province levels—and urban credit cooperatives that operate in local urban areas on a community basis and have credit unions in some municipalities and counties.

APEC economies in Latin America also have a significant number of community-based MBIs. In Mexico, the origins of microbanking activity can be traced back to 1951, when local priests established *cajas populares* (savings cooperatives) as a grassroots movement inspired by the *caisses populaires* movement in Canada and the credit unions in the United States. This scheme was organized in cooperatives, federations and confederations, similar to the one Alfonse Desjardins developed in Quebec. By 1954, there were about twenty *cajas populares* and ten years later the first Confederation was formed.[45]

The government supported the creation of such cooperatives through different mechanisms, ranging from training and technical assistance to subsidies for the purchase of equipment and other necessary resources. In 1994, a new figure of financial cooperative was created—the *Cooperativas de Ahorro y Préstamo* (CAPs)—under the Cooperatives Associations General Law, allowing more flexibility for their operation but without including any regulatory or supervisory requirement.

In 2001, following some insolvency and management problems in a few financial cooperatives (*Sociedades Cooperativas de Ahorro y Préstamo*), the Mexican government decided to work on a new law aimed at setting a completely new regulatory and supervisory framework. As a result, the

---

[42] FAs handle not only savings and loans but also the marketing, distribution, and promotion of farm products and insurance services. Their purposes encompass a broad array of functions stretching right across the political, economic, educational and social realms. Their categorization as non-profit organizations means that their operations are tax-exempt, while their status as agricultural associations renders them exempt from deposit reserve requirements.

[43] As of year-end 2001, there were 260 credit departments of farmers' associations, with 883 branches, and 25 credit departments of fishermen's associations, with 44 branches.

[44] For further details of this process, see Section 4 of this study.

[45] In 1964, there were 500 cooperatives throughout the economy, serving the needs of 300,000 members.

current legislation streamlined MBIs to act either as cooperatives (*Cooperativas de Ahorro y Préstamo*) or finance companies (*Sociedades Financieras Populares*), while establishing clear guidelines for their regulation.

In Peru, microbanking activities began to develop in the 1950s with the creation of cooperatives of loans and savings that offered financial support to micro-enterprises. In 1954, the first cooperative, *Cooperativa San Juan*, was established outside Lima and was supported by the Catholic Church, which initially was the only institution backing these activities. By the mid-1950s the American Cooperative Movement, with financial assistance of USAID, started promoting the creation of more cooperatives nationwide. In 1959, the National Federation of Savings and Credits Cooperatives, FENACREP (*Federación Nacional de Cooperativas de Ahorro y Crédito del Perú*) was created.

TABLE 2.2.1 COOPERATIVES AND CREDIT UNIONS

	Institutions	Number of Institutions	Total Number of branches	Number of Clients	Amount of Savings/Deposits (In Thousand US$)	Average Savings/Deposits (US$)	Amount of Loans Outstanding (In Thousand US$)	Average Loan
Chile [/4]	Saving and Loan Cooperatives	78	N. A.	550,000	205,911.00	N. A.	287,625.00	700
People's Republic of China[/3]	Rural Credit Cooperatives	38,153	N. A.	N. A.	207,680,000	N. A.	144,640,000	N. A.
	Urban Credit Cooperatives	644	N. A.	N. A.	11,120,000	N. A.	6,890,000	N. A.
Chinese Taipei[/3]	Credit Cooperatives	39	373	N. A.	20,111,401	N. A.	11,265,709	N. A.
	FAs	285	927	N. A.	35,711,285	N. A.	19,830,664	N. A.
Indonesia[/2]	Kosipa	N. A.	1,164	3,050,000	24,809	7	69,996	104
	KUD	N. A.	8,279	3,050,000	5,822.42	2	45,060	15
Korea[/2]	Mutual Savings and Finance Companies	146	265	N. A.	14,900,000	N. A.	12,400,000	N. A.
	Credit Unions	1,317	1,317	N. A.	13,500,000	N. A.	8,100,000	N. A.
	Mutual Credits	1,466	1,466	N. A.	66,500,000	N. A.	41,500,000	N. A.
	Community Credit Cooperatives	1,817	1,817	N. A.	24,200,000	N. A.	11,700,000	N. A.
Malaysia[/2]	Cooperatives	451	N. A.	1,502,967	3,250	N. A.	130,000	N. A.
Mexico[/1]	Credit Unions	24	24	38,380	72,595	N. A.	152,227	N. A.
	SAPs	11	404	681,699	545,725	N. A.	372,816	N. A.
	CAPs	186	622	1,013,580	729,530	N. A.	591,095	N. A.
	Cajas Solidarias	220	3,990	220,626	31,124	N. A.	51,123	N. A.
	Cajas Populares	147	492	229,855	154,814	N. A.	131,199	N. A.
	Others	42	157	252,911	107,642	N. A.	92,583	N. A.
Peru[/3]	Cooperatives	175	195	348,551	151,625	N. A.	180,191	N. A.
Philippines[/3]	Credit Unions	12	N. A.	22,596	1,090	N. A.	2,140	N. A.
Thailand[/3]	Cooperatives, Credit Union, and Saving Society	8	6,606	7,475,542	3,429,190	N. A.	6,784,980	N. A.
	Cooperatives [/5]	6	5,700	7,212,683	3,374,480	N. A.	6,706,270	N. A.
	Credit Unions	1	675	225,261	52,510	N. A.	78,710	N. A.
	Saving Society	1	231	37,598	2,200	N. A.	N. A.	N. A.
Total		**45,229**	**34,704**	**25,912,249**	**402,615,003**	**4**	**272,002,389**	**273**

Source: Information provided by each economy.
N. A. Not Available.
[/1] As of year-end 1999.
[/2] As of year-end 2000.
[/3] As of year-end 2001.
[/4] As of June 2002.

[/5] Cclassified by types of Cooperatives in Thailand, namely, 1) Agricultural Cooperative 2) Fishery Cooperative 3) Land Settlement Cooperative 4) Consumer Cooperative 5) Service Cooperative and 6) Thriff and Credit Cooperative.

2.3 Specialized Financial Institutions

Specialized financial institutions (SFIs) are primarily shareholder-based and usually created to target a particular market niche. This type of intermediary involves a different management criterion from other MBIs, since it is specifically oriented towards a certain group of microbanking clients. SFIs offer a wide range of services and mobilize important amounts of savings.

In Latin America, relevant examples of SFIs include EDPYMES, *Cajas Rurales*, and MiBanco in Peru. *Cajas Rurales* are private institutions whose creation was promoted by the government in 1994. They are authorized to mobilize deposits and to finance the activities of micro-, small-, and medium firms in rural areas. MiBanco is a former NGOs converted into the first specialized commercial bank in 1998.

In the case of Mexico, the new legal framework introduced in 2001 allows former NGOs, producers financial organizations, small savings cooperatives, and private assistance institutions to evolve into finance companies or *Sociedades Financieras Populares*, which are SFIs allowed to provide savings services in addition to loan services.

In Asia, SFIs can be found in Thailand and Indonesia, in both cases involving government-owned institutions with a longstanding tradition of serving the financial needs of a specific market niche.

SFIs in Thailand include the BAAC and the Government Savings Banks. Both play a very significant role, holding around 60 percent of total assets controlled by MBIs and mobilizing 80 percent of the total savings mobilized in the country by this type of intermediaries. In Indonesia, SFIs are primarily in the form of rural banks or People's Credit Banks (*Bank Perkreditan Rakyat* or BPR), which are owned by domestic private parties, local governments or cooperatives. These are "secondary" banks, extremely small compared to the regular commercial banks can take deposits and make loans, but do not offer checking accounts or foreign exchange transactions.[46] Furthermore, BPRs do not have access to the payment system. The total number of BPRs is 2,420, with a combined balance sheet of Rp$3,220 billion which is equivalent to approximately 0.5 percent of commercial bank assets. In total, they provide services to approximately 4.2 million clients.[47]

Additionally, there are at least two other SFIs undertaking microbanking activities in Indonesia: The Village Credit Boards (*Badan Kredit Desa* or BKD) and the Rural Fund and Credit Institutions (*Lembaga Dana dan Kredit Desa* or LDKP). The BKD are credit-only MBIs which have been granted status of rural banks, providing services to 758,000 clients through a network of more than 5,000 branches.[48] By contrast, LDKPs are local government credit institutions that have a different status than rural banks.[49] The LDKP operates through 2,272 branches, providing services to 1.3 million clients.[50]

In the People's Republic of China, the Agricultural Bank of China (ABC) can be considered a SFI. One of the ABC's core missions has been extending loans to individual farmers or micro-enterprises. In 1979, rural credit cooperatives were transferred into the ABC's organization as skeleton units, in order to enhance the management of national agriculture supporting funds and meet the need of economic reform in rural areas.

---

[46] Until recently, the minimum capital requirement to open a BPR was Rp$50 million (approximately US$7,000), Sukarno (1999), p. 5.

[47] Figures on assets as of June 1999, Sukarno (1999).

[48] BKD are supervised and staffed by BRI Indonesia on behalf of Bank Indonesia (Central Bank).

[49] Under the 1992 Banking law, LDKP were given the opportunity to get a rural bank license, but few of them opted to do so.

[50] Sukarno (1999, 2000).

TABLE 2.3.1 SPECIALIZED FINANCIAL INSTITUTIONS

	Institutions	Number of Institutions	Total Number of branches	Number of Clients	Amount of Savings/Deposits (In Thousand US$)	Average Savings/Deposits	Amount of Loans Outstanding (In Thousand US$)	Average Loan
Chinese Taipei/2	Small and Medium Business Banks	5	293	N. A.	24,460,632	N. A.	22,445,460	N. A.
Indonesia/1	BPR	N. A.	2,427	4,233,000	235,029	57	285,382	142
	BKD	N. A.	5,345	758,000	2,553	4	18,723	25
	LDKP	N. A.	2,272	1,326,000	47,375	82	50,779	85
Peru/2	Mi Banco	1	27	78,748	24,210	N. A.	61,427	N. A.
	EDPYME	13	40	40,085	N. A.	N. A.	50,463	N. A.
	Financiera Solución	1	31	83,545	53,390	N. A.	67,728	N. A.
	Cajas Rurales	12	52	39,021	45,994	N. A.	69,571	N. A.
Philippines/2	Private-owned Banks	25	N. A.	76,825	1,990	N. A.	5,790	N. A.
Thailand/2	BAAC	1	587	2,678,918	4,880,500	N. A.	6,077,270	N. A.
	Government Savings Bank (GSB)	1	583	485,773	9,601,590	N. A.	3,380,340	N. A.
Total		**59**	**11,657**	**9,799,915**	**39,353,263**	**47**	**32,512,932**	**84**

Source: Information provided by each economy.
N. A. Not Available.
/1 As of year-end 2000.
/2 As of year-end 2001.

2.4 Government Agencies and State-Owned Institutions

These intermediaries include development banks, as well as government departments, programs and ministries, which usually target specific economic and social sectors, like agricultural and indigenous groups. Also included among these intermediaries are those owned by their municipalities and created to improve the access of low-income segments of the population to financial services. Government agencies provide a wide range of services, including technical assistance, and these are mostly funded by the government and multilateral institutions.

In Papua New Guinea, the Rural Development Bank (RDB) founded in 1968, is one of the government's financial instruments to promote development both in urban and rural areas. It maintains a small network with seven branches and 11 representative offices. There are three schemes that provide access to microbanking services for women, young people, and small businesses: the Women and Youth Mini Loan Scheme, the Small-Holder Agriculture Credit Scheme, and the Oro Business Credit Scheme. These programs were established in 1994, 1996 and 1997, respectively. It is important to mention that these schemes have had different problems associated with high transaction costs of loan supervision and lack of management and marketing skills, among others. In addition to the RDB, there is the Village Finance Limited (VFL), which was founded in 1998 as a wholly owned subsidiary of the Papua New Guinea Banking Corporation (PNGBC). It was established as a special financial institution that would deliver microfinance services to poor women in rural and urban areas.[51]

In Thailand, the government is directly involved in microbanking through one public organization, the Community Organization Development Institution (CODI), and two agencies, the Community Development Department and the Office of the National Village and Urban Community Fund.[52]

[51] Carruthers (2002).
[52] See Text Box 1.1.1 for further details on the National Village and Urban Community Fund.

In the People's Republic of China, the Postal Deposit and Remittance Bureau is a semi-governmental institution with a great number of branches within the reach of the posting service, undertaking only deposit and remittance, serving for the most part rural residents and immigrants in urban areas.

In Mexico, the government was directly involved in promoting the provision of savings services to a population lacking access to formal institutions through the Pahnal (*Patronato del Ahorro Nacional*), established in 1950 as an agency of the Ministry of Finance. As a result of the restructuring of the microbanking industry in 2001, Pahnal was transformed into a new Bank for National Savings and Financial Services (Bansefi). In addition to providing saving services and infrastructure development, Bansefi's main goal is to strengthen MBIs through financial and technical support.

In Chile, the government offers microbanking services through development banks such as BancoEstado, Bandesarrollo, and Banefe; and other institutions, like CORFO (Manufacturing Promotional Corporation), FOSIS (Solidarity and Social Investment Fund), INDAP (Institute of Agricultural Development), SERCOTEC (Technical Cooperation Service), and SENCE (National Training and Employment Service). For example, BancoEstado provides credit and guarantees to microentrepreneurs, as well as credit for watering works and agricultural credit and insurance, among others services. Similarly, CORFO provides credit and insurance to micro- and small-enterprises, for environmental, agricultural, commercial projects.

In Peru, the thirteen *Cajas Municipales de Ahorro y Crédito* are owned by their municipalities are present in 20 departments (out of the 23), and provide financial services through their 70 branches. The *Cajas Municipales* have been successful in providing deposit and credit services to low-income segments of the population while maintaining high levels of profitability.

In Malaysia, the government set up a statutory body named MARA (*Majlis Amanah Rakyat*) in 1951, with the objective of motivating, guiding, training and assisting the Malays and *Bumiputras* particularly in the rural areas, and to participate actively and progressively in commercial and industrial activities. Since it is not a financial institution, MARA can provide loans but cannot take deposits from its clients.

Another example of government agency in Malaysia is the BPIMB (*Bank Pembangunan dan Infrastruktur Malaysia Berhad*), which was appointed to do microbanking activities specifically for the *Bumiputra*. This development finance institution, which was incorporated under the Companies Act of 1965, is entirely owned by the Malaysian government. Additionally, the government launched the Entrepreneur's Group Economic Fund Program (TEKUN). More recently, in 1995 the Ministry of Entrepreneur Development in Malaysia began fostering microbanking services with the intention of establishing easy and quick accessibility to credit for small businessmen and petty traders.

In Korea, the government established two specialized banks in the early 1960s. Namely, the Industrial Bank of Korea, a state-owned bank providing financial services to small and medium-sized enterprises, and the Kookmin Bank, which extended loans to households and small businesses. The Kookmin Bank was later converted into a private commercial bank in its majority.

TABLE 2.4.1 GOVERNMENT INSTITUTIONS AND AGENCIES

	Institutions	Number of Institutions	Total Number of branches	Number of Clients	Amount of Savings/Deposits (In Thousand US$)	Amount of Loans Outstanding (In Thousand US$)
Chile[/3]	BancoEstado	1	69	63,000	N. A.	53,000
	INDAP	1	108	N. A.	N. A.	N. A.
	SERCOTEC	1	24	N. A.	N. A.	N. A.
	SENCE	1	13	N. A.	N. A.	N. A.
Korea[/1]	The Industrial Bank and the Kookmin Bank	5	1,406	N. A.	100,900,000	96,800,000
Malaysia[/1]	BPIMB	N. A.	13	552	None	8,600
Peru[/2]	Cajas Municipales	13	88	N. A.	182,343	232,692
Thailand[/2]	CODI	1	8,458	8,458/ groups	N. A.	12,160
	Poverty Reduction Program	1	18,634	1,426,371/ households	N. A.	186,050
	Saving Groups for Production	1	32,578	3,267,428	153,100	71,700
	Office of the National Village and Urban Community Group	1	79,754	79,754/ villages & urban communities	N. A.	1,530,683
Total		**26**	**141,145**	**3,330,980**	**101,235,443**	**98,894,885**

Source: Information provided by each economy.
N. A. Not Available.
[/1] As of year-end 2000.
[/2] As of year-end 2001.
[/3] As of June 2002.

2.5 Commercial banks and multipurpose financial institutions

Commercial banks and multipurpose financial institutions involved in microbanking are formal financial institutions that decide to access the low-income market, without abandoning their traditional market niches. This type of MBI is characterized by covering a broad range of clients, thus offering a full range of banking products, including sophisticated financial services. Typically, they also involve down scaling operations of commercial banks. They are funded by their clients' savings and commercial loans, as well as by national and international capital markets.

The involvement of this type of intermediary in microbanking across the APEC region is still relatively infrequent, particularly in developing economies. By and large, the most successful stories of this type of MBIs in the APEC region are that of Desjardins in Canada and Rakyat Indonesia's village-based units (BRI).

Originating along the lines of a credit union or a community-based financial cooperative, the Desjardins system of *caisses populaires* in the Canadian province of Quebec has gradually evolved through time. Nowadays, Desjardins is more than a cooperative network of caisses populaires. It provides a wide array of financial services, ranging from brokerage accounts to life and health insurance. As of March 2002, Desjardins had combined assets of C$86 billion, along with combined surplus earnings of C$192 million.[53]

[53] Desjardins (2002).

The Indonesian experience with BRI is quite singular since it is part of an overarching microbanking system. Considered as a commercial bank [54], BRI has a longstanding microbanking tradition through its specialized village units. The origins of these activities go back to the introduction of a popular credit system in the late 19th century, during the colonial Dutch rule. Through 3,700 village Units, BRI provides credit and savings services to close to 23 million clients.[55]

As seen in the table below, the BRI units reportedly serve the needs of the higher income segment of clients, with average loans in the range of Rp$2 million and average deposits of Rp$750,000. The lower income segments are covered by some of the SFIs previously mentioned (BPR and LKDP), as well as savings and credit cooperatives.

TABLE 2.5.1: Bri Units vs. Other Microbanking Intermediaries in Indonesia

MBI	Average Loan (in Rp$ thousand)	Average Deposit/Savings (In Rp$ thousand)	Total Deposits /Savings (In Rp$ thousand)
BRI Units	2,000	750	17,500,000
BPR	1,000	400	1,657,000
Savings & Credit Cooperatives (Kosipa)	820	55	169,000
LDKP	600	575	334,000
BKD	175	25	18,000
KUDs (Village Unit Cooperatives)	115	15	46,000

Source: Sukarno (1999), p.13.

In the People's Republic of China, some microbanking activities are undertaken by small and medium-sized joint-equity city commercial banks, all profit-oriented and operating on a city basis in urban areas. An example of this is the Yantai Housing Savings Bank.

Until very recently, commercial banks in Mexico were not engaged in microbanking, however, this has recently changed following the creation of *Banco Azteca* in April 2002. This bank was established to especially address the low-income segment of the population, and was the first commercial bank in Mexico to do so. In order to broaden its access to the financially excluded, this bank will have operations in the same establishments as a popular low-income store that it is known for transferring remittances from the United States to Mexico.

In Peru commercial banks involved in microfinance include Solución Financiera de Crédito, a subsidiary of the largest commercial bank in Peru (Banco de Crédito del Perú) that has 70 percent of its lending portfolio in micro loans, and Banco del Trabajo, which holds more than one third of its loan portfolio in micro and small loans. In Chile, commercial banks are the main source of microbanking services of the economy. There are banks, such as Banco Santander, that have developed a specialized division providing financial services to microentrepreneurs.

[54] The Indonesian Banking Act recognizes two different kinds of banks: (1) Commercial banks or primary banks, which have access to the Central Bank clearing system and offer a full range of banking products; and (2) People's Credit Banks (*Bank Perkreditan Rakyat,* BPR) or secondary banks, which are treated as SFIs for purposes of the typology presented in this paper.

[55] Sukarno (1999), p.14.

TABLE 2.5.2 COMMERCIAL BANKS AND MULTIPURPOSE FINANCIAL INSTITUTIONS

	Institutions	Number of Institutions	Total Number of branches	Number of Clients	Amount of Savings/Deposits (In Thousand US$)	Average Savings/Deposits	Amount of Loans (In Thousand US$)	Average Loan
Chile [/e]	Comercial private banks	2	243	57,500	N. A.	N. A.	57,500	905
People's Republic of China[/2]	Joint-equity Commercial Banks including Yantai Housing Savings Bank	109	N. A.	N. A.	81,510,000	N. A.	55,590,000	N. A.
Indonesia[/1]	BRI-Unit Desa	N. A.	3,694	2,474,000	2,398,514	106	844,799	284
Korea[/1]	Commercial Banks	17	4,709	N. A.	259,400,000	N. A.	187,700,000	N. A.

Source: Information provided by each economy.
N. A. Not Available.
[/e] Estimated by the Superintendency of Banks, 2002.
[/1] As of year-end 2000.
[/2] As of year-end 2001.

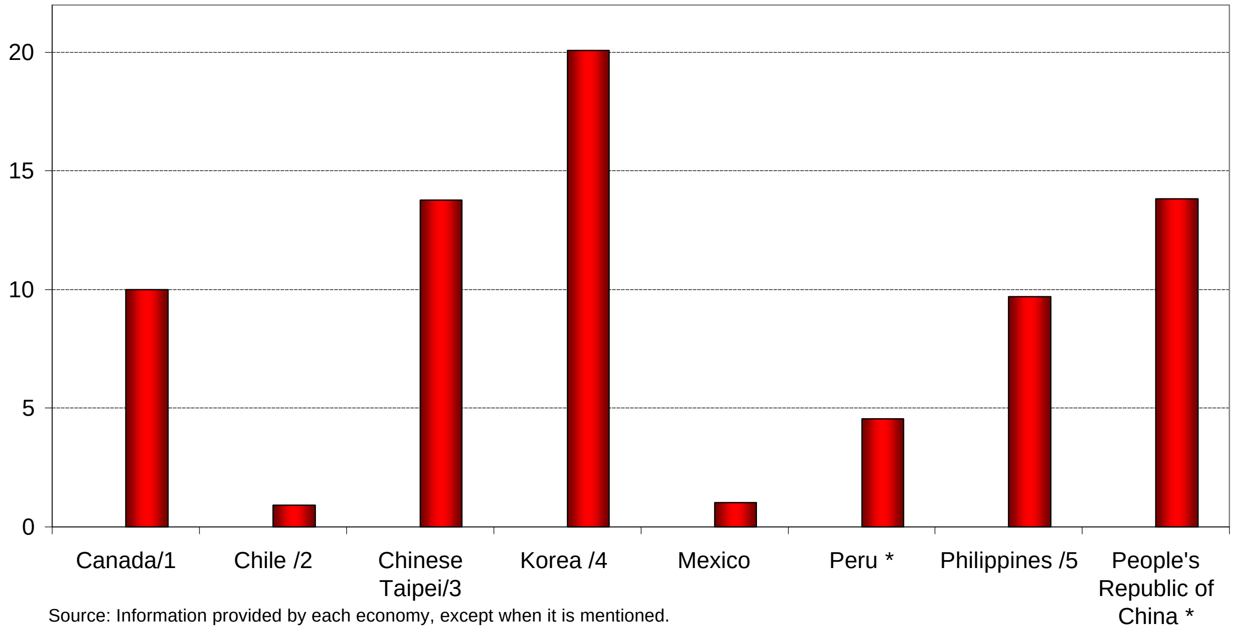
2.6 Size and magnitude of the microbanking sector[56]

The size of the microbanking sector varies from economy to economy: in Asian economies, microbanking assets represent an important percentage of the gross domestic product (GDP), while in Latin American economies, they are not relatively insignificant. The share of total microbanking assets in Korea as of year-end 2000 represented 50 percent of GDP, [57] while in the People’s Republic of China it amounted to 30 percent of GDP as of year-end 2001. In Thailand, the share of total microbanking assets stands for nearly 26 percent of GDP, in Peru 2.8 percent of GDP, and in Mexico 0.3 percent of GDP (as shown in Figure 2.6.1).

With the exception of Chinese Taipei, Peru, and the People’s Republic of China, the same pattern is reflected regarding the share of total microbanking assets as a percentage of the total financial sector assets as of year-end 2000. In Korea, this share represents approximately 20 percent of total financial sector assets, while in the People’s Republic of China and Chinese Taipei, total microbanking assets represent nearly 14 percent of the financial sector assets, and in Peru and Mexico this proportion is only 4.5 percent and 1 percent, respectively (as shown in Figure 2.6.1).

[56] The magnitudes reported here are derived from reporting by economies, and suffer from the difficulties previously discussed in section 1, footnote 8. There is possibly a conflation of 'small' and 'micro-' enterprise lending, leading to some overstatement of the relative significance of microbanking in some economies.
[57] The Korean microbanking sector encompasses the assets of the Industrial Bank of Korea, the Kookmin Bank, Mutual Savings & Finance Companies, Community Credit Cooperatives, and Mutual Credits. While these banks make some micro-oans, it may not be appropriate to classify all their lending as ‘micro’.

Figure 2.6.1 Share of Total Microbanking Assets as a Percentage of the Financial Sector Total Assets, as of year-end 2000



Source: Information provided by each economy, except when it is mentioned.
* As of year-end 2001.
/1 It includes deposit taking institutions.
/2 It includes saving and loan cooperatives and commercial banks and multipurpose financial institutions.
/3 As of November 30, 2001. It includes Small and Medium Business Banks, Credit Cooperatives and Farmers' & Fisherme's Associations.
/4 Considering only Mutual Savings & Finance Companies, Community Credit Cooperatives and Mutual Credits.
/5 Information from the ADB (2000). It includes thrift banks and rural banks.

3. REGULATION AND SUPERVISION OF MICROBANKING INTERMEDIARIES

As mentioned in the previous chapters, microbanking varies significantly from one APEC member to another. Differences arise not only regarding the categories of intermediaries involved and their complexity, but also the extent to which they are regulated and supervised. Despite these differences, there is growing consensus that some sort of regulatory and supervisory framework is needed, whether this is a part of a broader scheme for the entire financial system or an arrangement especially designed for microbanking activities.

This section presents a brief review on the rationale behind need for the regulation and supervision of microbanking activities, as well as some of the specific features that are commonly found in the industry. It will also review the extent to which APEC economies follow these patterns, in an attempt to identify current trends and prospects for the evolution of this sector in the region.

It should be noted that obvious differences will arise depending upon the level of financial depth and development of microbanking in each economy. Although this section includes information from most of the APEC economies, it focuses primarily on those economies where there is a recognized microbanking sector, as well as a reported interest of the authorities in developing some sort of regulation and supervision.

3.1 What is Understood by Regulation and Supervision of Financial Intermediaries?

In order to analyze the different approaches to regulation and supervision of MBIs and examine those that are applicable in APEC member economies, it is convenient to begin by defining what is understood by regulation and supervision of financial intermediaries.

Regulation is the set of principles, rules, and standards that affect the behaviour of agents in financial markets. The fundamental purpose of financial regulation is to promote effective and efficient capital accumulation and resource allocation while maintaining the safety and soundness of financial institutions that take deposits from the public.[58] Supervision of financial intermediaries consists of the examination and monitoring mechanisms through which the authorities verify compliance with and enforce financial regulation.[59]

Examples of such mechanisms include:[60]

- Registration and legal chartering of licensed entities
- Capital adequacy requirements
- Disclosure of ownership or control
- Reporting or publication of financial statements; norms for the content and presentation of such statements; accounting and audit standards
- Transparent disclosure of interest rates to consumers
- External audits
- Submission of names of borrowers and status of their loans to a central credit information bureau
- Assessments of loan portfolio and reserves for estimated loan losses
- Interest rate limits
- Exit mechanisms

[58] Jansson and Wenner (1997).
[59] Chaves and Gonzalez-Vega (1992), p. 5.
[60] Christen and Rosenberg (2000), p. 16.

3.2 Why have the Regulation and Supervision of Microbanking Activities Come to the Forefront of the Debate?

The regulation and supervision of MBIs have gained increasing importance over the last five years for a variety of reasons, which are associated with three main objectives:

a) **Protecting microbanking clients' savings**. The operations of some MBIs have grown significantly over the past decade, incorporating broad-based savings mobilization schemes. Considering the specific risk profile of deposit-taking MBIs and the fact that those savings usually come from extremely vulnerable segments of the population, national authorities have an interest in instituting a regulatory and supervisory framework for the operation of these MBIs in order to protect depositors.[61]

b) **Achieving a financially sound and efficient microbanking industry**. Weak and inefficient MBIs can hinder the growth and development of a national microbanking industry and potentially generate social and financial costs for national economies. The design and implementation of a flexible and adequate regulatory and supervisory framework is crucial for allowing mature and successful MBIs to evolve gradually into more sophisticated financial institutions. In other words, an effective regulation and supervision scheme should be aimed at promoting safe and sound intermediaries, while opening possibilities for innovation and expansion of financial services.[62] For their part, MBIs perceive clear advantages of becoming regulated and supervised, as they can expand their operations, funding options and in general achieve greater profitability.[63] Additionally, effective regulation and supervision are indispensable from the viewpoint of anti-money laundering and counter-terrorist financing, both of which are urgent priority issues in today's world.

c) **Securing the development of financial services for the unbanked segments of the population**. By regulating and supervising MBIs effectively, national authorities can promote the growth of safe and sound financial services for those segments of the population that have lacked access to the traditional banking system. In this sense, regulation and supervision can become an indirect tool for securing broader economic or social objectives such as micro-enterprise development, social safety nets, poverty reduction efforts, etc.[64]

3.3 Which Institutions should be Regulated?[65]

There seems to be a consensus that MBIs engaged only in credit operations only should not be subject to prudential regulation and supervision, basically because the objective of protecting depositors does not apply to those intermediaries. A possible exception to this principle would be if there were MBIs solely dedicated to credit that are large enough to threaten the stability of the financial systems in which they operate should they have a solvency or liquidity crisis.[66]

[61] Hannig and Braun, (2000).
[62] Fitzgerald and Vogel, (2000), p.2.
[63] Christen and Rosenberg, (2000), p. 1.
[64] We appreciate the comments from Tor Jansson of the IADB. He points to the conflict of interest arising from charging supervisors with the functions of both supervising and promoting MBIs. For this reason, it should be noted that this is an indirect effect stemming from effective rules and institution-building.
[65] An excellent reference for the question asked here is: Hennie Van Greuning, Joselito Gallardo y Bikki Randhawa: "A Framework for Regulating Micro finance Institutions". The World Bank, 1998. They offer a rich conceptual discussion about who should be regulated.
[66] Asian Development Bank (ADB), (2002b), p. 51.

It is also conventionally accepted that all intermediaries mobilizing deposits from the general public must be regulated and supervised, in order for authorities to maintain the soundness of these financial institutions and the safety of their clients by imposing restrictions on their risk exposure and operations, as well as by defining adequate accounting and reporting practices.[67]

Conversely, there are conflicting views on whether prudential regulation and supervision should apply to all MBIs mobilizing deposits from members, including savings and loans associations, credit unions, and cooperatives. Many specialists argue that MBIs that require members to deposit savings in order to obtain loans should not be subject to prudential regulation and supervision, given that obligatory deposits are part of the loan contract and that most members are net debtors.[68] For this type of institution, the risk of members losing their savings is relatively low, whereas the cost of regulating and supervising each intermediary may be extremely high. Other commentators note that prudential regulation and supervision may be appropriate to protect members' savings. Given the small size and large numbers of some of these categories of intermediaries, some experts have suggested the establishment of an explicit minimum limit—based on assets, number of members, or other indicators—below which institutions should not be regulated or supervised. Such a limit could vary from one economy to another.[69]

3.4 What Type of Regulatory Framework is Appropriate for Microbanking Intermediaries?

National authorities must consider that existing regulations for financial institutions with conventional client bases are not completely applicable to deposit-taking MBIs. This is a critical issue, since forcing MBIs to observe inappropriate regulation will not produce the intended reduction of risk, but will likely raise the cost of both supervision and financial intermediation.[70]

A regulatory framework for microbanking must incorporate the risks that are specific to MBIs, and distinguish them from those inherent to commercial banking (see Table 3.4.1 for further details). Whereas the latter are vulnerable to liquidity problems originated by overlapping debt maturities and operations in different currencies, for MBIs there are other risk factors that stem from their unique client base and lending models.

These different risk factors are systematically related to the different characteristics of micro-enterprises (potential clients of the microbanks) and those of SMEs and larger enterprises, which are more likely to be financed by commercial banks. These differences were recognized at the APEC High Level Meeting on Micro-enterprises in Acapulco on 18 July 2002[71].

---

[67] Jansson and Wenner, (1997), p. 5.
[68] ADB, (2000), p. 51.
[69] Christen and Rosenberg, (2000), p. 11.
[70] Jansson and Wenner, (1997), p. 5.
[71] See the Executive Summary of the High Level Meeting, Annex 2 of the Report of the 2002 Meeting of SME Ministers at Acapulco in August 2002.

Table 3.4.1: Differences between Traditional Banking and Microbanking

Category	Traditional Banking	Microbanking
Institutional Structure and Governance (of regulated institutions)	1) Profit maximizing institutional and individual shareholders 2) Centralized organization with branch offices located in cities	1) Mainly non-profit institutional shareholders 2) Decentralized set of small units in areas with weak infrastructure
Loan Portfolio	1) Fewer loans 2) Loans larger in size 3) Collateralized 4) Longer maturity 5) More stable delinquency	1) More loans 2) Loans smaller in size 3) Uncollateralized 4) Shorter maturity 5) More volatile delinquency
Lending Methodology	1) Based on collateral 2) More documentation 3) Less labour intensive	1) Based on character 2) Less documentation 3) More labour intensive

Source: Jansson and Wenner (1997), p. 9.

Considering the aforesaid features of the microbanking industry, the specific risks associated with it can be grouped into the following categories:[72]

a) **Loan portfolio risks.** Most MBIs lack the capacity to diversify their risk so their loan portfolios are highly specialized (short-term, uncollateralized loans), concentrated in a segment of the market (poor people and micro-enterprises) often in a circumscribed geographical area. It is also important to mention that MBIs serve clients whose business and family accounts are intermingled.

b) **Ownership and governance risks**. Whereas in commercial banks shareholders have their own funds at risk and therefore have strong incentives to verify that executive boards pursue profit-oriented policies, MBIs' investors and donors may be tempted to favour a socially-oriented approach over a commercial strategy, even though the latter ultimately would enhance the sustainability of the institution in the future.[73] Additionally, some MBIs do not have any member in their executive boards with the necessary training to design and implement sound governance policies.

c) **Management risks**. MBIs tend to have a decentralized operational structure that is more easily susceptible to fraudulent practices, especially in the absence of a frequent and uniform reporting system. MBIs in general have not paid sufficient attention to generating transparent financial information in a timely fashion to improve their operation.

d) **Operational risks**. These risks appear at two different levels: the technical (information systems, risk measures, etc.) and the organizational (reporting and monitoring of risk, as well as all relevant rules and policies).

e) **Incipient industry risks**. Since MBIs usually begin operating in markets where they face little if any competition, they tend to experience a drastic growth during their first years of operation that they will not necessarily be able to maintain, but which may distort their growth projections. Similarly, it is difficult to evaluate the commercial viability of new financial products which are designed based on models that cannot be adequately tested due to the lack of historic information.

[72] Berenbach and Churchill, (1997), pp. 34-36.
[73] Christen and Rosenberg, (2000), p. 6.

Fitzgerald and Vogel (2000) emphasize that the differences between microbanking and traditional banking arise in terms of risk profiles rather a set of specific risk factors. Indeed, for these authors both industries share four risks typically involved in financial institutions: credit risk, operational risk (including operating costs), interest rate risk and liquidity risk.[74] Under this approach, the difference lies therefore in the specific weight that each risk factor poses. For instance, whereas in traditional banking credit risk is higher than operational risks, in microbanking it is exactly the inverse.

3.5 What are the Main Areas of Regulation in Microbanking?

In order to develop an effective regulatory framework for microbanking, the following aspects have to be taken into account.[75]

a) **Licensing requirements and minimum capital requirement**. Entry requirements usually include minimum paid-up capital, asset size, and minimum number of members. The minimum capital requirement is essential for all financial institutions, yet since almost all MBIs rely on donor funds, they may find it extremely hard to fulfil this requisite.

b) **Capital adequacy standards**. This term refers to the ratio of assets to equity that a financial institution should maintain, or in Tor Jansson's words, "the extent to which a financial institution may leverage itself".[76] Standards in this regard are subject to debate, with some experts considering that Basle Accord standards (minimum capital of 8 percent of risk-weighted assets) are not relevant at all considering the enormous differences in risk profile between microbanking and traditional banking institutions. Beyond the definition of a clear capital adequacy standard, it is generally believed that MBIs should be subject to stricter capital adequacy standards than those applicable to more diversified financial institutions.[77]

c) **Liquidity requirements**. Liquidity management is an extremely important area, and in which MBIs tend to be weak. Some authors point out that an appropriate liquidity ratio depends largely on the particular circumstances facing the institution concerned (Christen and Rosenberg, 2000). Hence, liquidity management is less susceptible to regulation and supervision than some other management tasks.[78]

d) **Borrower's evaluation and credit risk monitoring**. The development of the microbanking industry has challenged the traditional belief that business information and collateral are crucial tools for assessing asset quality. Alternative measures might include the historical performance of portfolios, statistical sampling of arrears, adequacy of management information systems, capabilities and policies for dealing with arrears.[79]

e) **Portfolio diversification**. This is a critical task for MBIs, yet probably the most difficult to achieve. In order to diversify their portfolios, MBIs must develop their institutional capacity, expanding their presence to other geographical areas, as well as developing new products in order to satisfy the demand for financial services from a greater variety of clients.

---

[74] According to these authors, market risk and foreign exchange risk are the two other factors that are present in traditional banking but are practically non-existent in microbanking.
[75] Ledgerwood (1998).
[76] Jansson and Wenner (1997), p. 22.
[77] Nimal Fernando from the ADB seriously questions the relevance of using the Basle Accord as a reference for capital adequacy standards. However, analysts involved in rating assessments of microbanking tend to use it as a reference. See for instance, Wilhelm and Deimel (1999).
[78] ADB, (2000), p. 47.
[79] ADB, (2000), p. 44.

f) **Corporate governance and information disclosure**. Information disclosure on financial and operational aspects is increasingly relevant for all the stakeholders involved in microbanking, including the regulators. Information on financial statements, interest rates, portfolio quality, etc. should be reported on a regular basis, along with risk management schemes, providing managers and directors with accurate information about the magnitude of risks taken and with measures to monitor, limit and control those risks. In addition, accounting rules that are consistent and comparable among MBIs should be developed, together with corporate governance guidelines. The relevance of latter is increasingly acknowledged, as often the risks associated with these intermediaries derive from the lack of controls of management within each entity. Therefore, guidelines for internal controls and measures to promote sound operations, protect assets, and avoid conflicts of interest have been incorporated as key aspects of microbanking regulation.

3.6 What Type of Supervision is Appropriate for Microbanking Intermediaries?

Once national authorities have determined which intermediaries must be regulated and how, a specific institutional supervision scheme for MBIs should be devised. Broadly speaking, the areas of supervision mandated for MBIs do not differ significantly from those applying to traditional banking intermediaries. Following the 25 Core Principles developed by the Basel Committee on Banking Supervision, the following conceptual aspects are relevant for an effective supervision of the microbanking industry:

- Objectives, autonomy, powers and resources of the supervisory body.
- Clearly permissible activities subject to supervision and transparent criteria for licensing intermediaries.
- Compliance with prudential regulations and requirements, including capital adequacy, evaluation of credit policies and loan-loss provisioning, exposure limits, prevention of connected lending, internal control and audit systems, etc.
- Methods of on-going supervision, including on-site and off-site supervision, regular contact with the regulated institutions' management, validation of supervisory information, etc.
- Appropriate accounting information requirements.
- Formal powers of supervisory bodies, including adequate measures to bring about timely corrective actions when regulated institutions fail to meet prudential requirements, when there are regulatory violations, or where depositors are threatened in any other way.

In terms of the institutional setting, most experts agree that there are four basic supervision schemes.[80] They are:

a) **Direct supervision**. This term refers to the cases in which a national authority, usually the one that supervises the entire financial system, is responsible for overseeing microbanking institutions, including their monitoring and on-site inspection.

b) **Auxiliary supervision**. According to Paul Armbruster and Matthias Arzbach (2000), auxiliary supervision is understood as the scheme under which MBIs are supervised in the first instance by a federation or an independent entity, which limits its functions and practical tasks to off-site monitoring and on-site inspections and does not assume any legal responsibilities towards the national supervisory authorities or depositors. The powers for intervention and sanction of the aforesaid federation or independent entity remain quite restricted and the national authority retains the faculty for licensing, and sanctioning, and intervening in any MBI. Ultimately, MBIs remain subject to the regulation and supervision of national authorities because the state has responsibility for

[80] Christen and Rosenberg (2000), p. 35.

the soundness of the system. Therefore, this scheme does not imply delegating the responsibility for or the function of, regulation, nor does it fully replace supervision by national authorities.

c) **Delegated supervision.** This is when a national authority, be it the Ministry of Finance, the central bank, or another agency, holds responsibility for the supervised institutions, but delegates some specific tasks, mainly regular monitoring and on-site inspections, to a third party, which might be an MBI federation or an independent technical entity. The national authority retains the ability for license, and sanction, and intervene in any MBI. Alternatively, there may be a multi-tier system where intermediaries are grouped in federations, which in turn form confederations, and each tier oversees the immediately inferior one. In these cases, the supervisor must periodically test the reliability of the agent's monitoring, inspection, and reporting, and intervene should any problem emerge."[81]

d) **Self-supervision**. This scheme is consensually understood as the "arrangements under which the primary responsibility for monitoring and enforcing prudential norms lies with a body that is controlled by the organizations to be supervised—usually a member-controlled federation" [of MBIs].[82]

3.7 APEC Economies' Experience with Microbanking Regulation and Supervision

The microbanking regulatory and supervisory experience in the APEC region is vast and complex. An overview of current trends, considering the degree of comprehensive regulation for the sector, the main features subject to regulation, and the way MBIs are supervised is presented below.

3.7.1 Centralized versus Fragmented Regulatory Framework

A first distinction among APEC economies arises when examining the scope of the regulatory framework. There are three broad trends in the region (see Table 3.7.1 for further details). First, there is a limited group of economies where MBIs are subject to the same legal framework as applies to the financial system as a whole. A second and larger group of economies, albeit still limited, have specific regulatory guidelines for the microbanking sector as a whole or at least for a significant group of intermediaries. A third and last group presents a regulatory fragmentation along the different categories of MBIs, as well as across horizontal and vertical levels of government.

Australia is perhaps the best example of the first group, where no regulatory distinction is made between microbanking and the rest of the financial system. Since 1999, credit unions in Australia hold the same license as banks and are supervised on the same basis as banks, with the government having a single set of flexible prudential standards for all deposit-taking institutions.[83]

A relatively similar situation occurs in Peru, where all MBIs, with the exception of cooperatives and NGOs, are subject to the same Financial System Law *(Ley General del Sistema Financiero y de Seguros* No. 26702) that applies to banks. This law defines the operations and scope of regulation for several types of MBIs (*Cajas Muncipales*, *Cajas Rurales* and EDPYMES), while establishing less rigorous entry capital requirements than those applicable to banks. Furthermore, the law gives room for MBIs to gradually evolve into banks.[84] An essential aspect of the

---

[81] Christen and Rosenberg (2000), p. 20.
[82] Christen and Rosenberg (2000), p. 35.
[83] Australian Treasury (2002).
[84] In the case of EDPYMES, which are not allowed to mobilize deposits, the law allows them to expand their operations, including the mobilization of deposits from the public, once they approve a series of

regulatory framework in Peru is that it emphasizes the regulation of the microbanking activity, including a definition of micro-credit and specific norms for the supervision of microbanking, which apply equally to all institutions.

In contrast, in several other APEC economies regulation depends upon the specific institutional and operational features of each microbanking intermediary. However, the level of regulatory fragmentation, as well as the scope of regulation, varies from case to case.

Mexico provides one of the most comprehensive specific regulatory schemes under this category. Following new legislation enacted in 2001, Mexico introduced a more functional and inclusive regulatory scheme, covering practically the whole microbanking industry, replacing the highly fragmented previous regulation and regulating some categories of intermediaries for the first time.[85]

The Popular Savings and Credit Law makes a clear distinction between the microbanking sector and the rest of the financial system, while providing specific features for two broad types of MBIs: cooperatives and popular financial societies (i.e. SFIs). For each of these institutional features, four different “levels” of development are recognized, depending upon five key variables: (1) the amount of assets and liabilities, (2) the number of members or clients, (3) the number of branches, (4) the geographical scope and (5) the institutional capacities (technical and operational).

Other APEC economies have similar specific regulatory schemes, although significantly less comprehensive ones. In the United States, for instance, credit unions are clearly distinguished from the rest of the financial system and have a specific and strict regulation under the Federal Credit Union Act and the National Credit Union Administration’s rules and regulations. By contrast, in New Zealand regulation of credit unions is less strict, limited basically to the registration and overseeing by the Registrar of Friendly Societies and Credit Unions (a government-appointed registrar).[86]

In Korea, there is a specific legal framework for each type of microbanking intermediary, clearly distinct from the General Banking Act that regulates commercial banks. Similarly, in the People’s Republic of China and in Chinese Taipei MBIs have specific regulation depending upon their institutional features.

In Chile the central bank is responsible for issuing the rules governing the operations of commercial banks and savings and credit cooperatives (which are the most relevant categories of MBIs) and there is no explicit distinction between microbanking and other financial activities. Nonetheless, the General Banking Law regulates banks, whereas cooperatives are regulated by the General Cooperatives Law.

In Papua New Guinea, only NGOs are not subject to regulation or supervision, while all licensed banks and financial institutions that take deposits are supervised and regulated under the Banks and Financial Institutions Act 2000. The Savings and Loans Societies are licensed and regulated under the Savings and Loans Act. Both these Acts are administered by the central bank as the regulator and supervisor. The Department for Finance and Treasury supervises the Rural Development Bank.

---

specific evaluations and requirements, including internal control systems, risk management and risk rating. However, as of May 2002 none of the existing EDPYMES had “graduated” under this system. (Government of Peru, 2002)

[85] NGOs engaged exclusively in microcredit operations and commercial banks with microbanking operations are excluded form this law.

[86] Mortlock (2002).

Due to its federalist system, in Canada credit unions and *caisses populaires* are almost exclusively regulated at the province level for prudential soundness and market conduct. However, the Credit Union Central of Canada, which is the national trade association and central finance facility, is chartered and regulated by the federal government under the Cooperative Credit Associations Act. In addition, six provincial credit union centrals have chosen to register under federal legislation, while being regulated provincially.

Nevertheless, it should be mentioned that this regulatory structure could change in the near future as a result of recent legislative changes in Canada. In June 2001, the federal government reformed the regulatory framework governing the financial services industry through Bill C-8. This legislation seeks to address the structural fragmentation of credit unions as a potential entry barrier, allowing them to reorganize under a more national structure. [87]

In Indonesia commercial and rural banks are subject to the 1992 Banking Act as revised by Act No. 10 of 1998, with Bank Indonesia (Central Bank) being both the regulator and supervisor.[88] However, regulation for other type of intermediaries, such as the Rural Fund and Credit Institutions (LDKP) and the Savings and Loan Cooperatives (Kosipas), is fragmented along national and sub-national authority lines.

A similar case is that of Thailand, where regulation of MBIs is highly fragmented among several government ministries and offices. The Ministry of Finance, for instance, regulates the BAAC, but cooperatives fall under the jurisdiction of the Ministry of Agriculture and Cooperatives, while the Ministry of the Interior is responsible for other related microbanking activities carried out through the Community Development Program. However, it should be noted that this is expected to change, as the government is in the midst of drafting new regulation to govern all microbanking activities.

[87] Department of Finance of Canada (2002).
[88] Following the new Central Bank Act of 1999, this situation is expected to change as banking supervision is in the process of being transferred to a new banking supervisory agency.

Table 3.7.1: Regulation of Microbanking in APEC Economies

Economy	General financial System Regulation	Specific Regulation	Fragmented Regulation	Comments
Australia	X			Since 1999, credit unions have held the same license as banks and are subject to the same single set of flexible prudential standards for all deposit-takers.
Canada			X	Regulation of credit unions and *caisses populaires* involves primarily provincial governments, although the federal governments charters and regulates the Credit Union Central of Canada. The legislative and regulatory framework for these intermediaries generally parallels that of federal financial institutions, such as banks.
Chile	X			Each type of microbanking intermediary is regulated by its own specific law, the General Banking Law and the General Cooperatives Law.
People's Republic of China		X		All financial institutions are regulated by the People's Bank of China (Central Bank), but specific features apply depending upon each type of microbanking intermediary.
Indonesia			X	Commercial and rural banks are regulated under the Banking Act of 1992. However Rural Fund and Credit institutions (LDKPs) fall under subnational jurisdiction, while Savings and Loan Cooperatives (Kosipas) are regulated by the Ministry for Cooperatives and Small Enterprises.
Korea		X		Each type of microbanking intermediary is regulated by its own specific law, with commercial banks falling under the General Banking Act.
Malaysia		X		The Cooperative Act provides a specific regulatory framework for MBIs.
Mexico		X		Following the enactment of the Popular Savings and Credit Law in 2001, practically all deposit-taking fall under the same regulatory framework.
New Zealand		X		Credit unions are required to be registered and oversee by the Registrar of Friendly Societies and Credit Unions (a government-appointed registrar).
Peru	X			The Financial System Law (LGSF: *Ley General del Sistema Financiero y de Seguros* Ley No. 26702) regulates most of the MBIs. Credit cooperatives and credit-only NGOs are subject to their own regulatory framework.
Philippines		X		The National Credit Council in the Philippines is currently preparing a new and appropriate regulatory framework specifically for microbanking, although it will be based largely in the existing institutional set-up for the regulation of financial institutions.
Chinese Taipei		X		The Law Governing Credit Cooperatives, the Banking Law, the Fishermen's Associations Law, and the Farmer's Associations Law regulate community financial institutions.
Thailand			X	The BAAC and the GSB are regulated under their respective acts, whereas cooperatives and credit unions fall under the Cooperative Act. In addition, the Community Organization Development Institutions (CODI) stems from the Public Organization Act. However, the government is in the process of drafting regulations that will govern all microbanking activities.
United States		X		Credit unions are regulated by the Federal Credit Union Act and the National Credit Union Administration Rules and Regulations

3.7.2 Specific Regulatory Issues

- Licensing requirements

  i. Minimum paid up capital

Minimum paid-up capital requirements for MBIs in APEC economies are usually established depending upon the legal or operational features of each type of existing intermediary. An exception is Peru, where most MBIs (including *Cajas Rurales*, *Cajas Municipales* and EDPYMES) are required to have the same minimum paid-up capital requirement of US$240,000, regardless of their legal or institutional form. This is significantly lower than the US$5.295 million required for banks, because it corresponds to a more restrictive set of allowed operations (see Table 3.7.2.1 for further details).

By contrast, there are several cases, such as Korea and Indonesia, where regional considerations are taken into account as well. In Korea the minimum paid-up capital for mutual savings and finance companies is established along regional lines, with those intermediaries established in the capital city having higher requirements (US$4.5 million within Seoul) than those located in the rest of the economy (US$3.0 million within the metropolitan area and US$1.5 million elsewhere).[89] Similarly in Indonesia, the minimum paid-up capital for rural banks varies depending upon their location, with those located near the capital city being higher (Rp$2 billion in the Jakarta region) than those in the hinterland (Rp$1 billion in provincial capitals and Rp$500 million elsewhere).[90]

Mexico's recently enacted regulation combines the above-mentioned features by establishing a broad range of minimum capital requirements (from US$34,021 to US$8.5 million), based on operational rather than legal or institutional criteria.

---

[89] Bank of Korea (2002).
[90] These regulations were established in May 1999. In Sukarno (2000).

Table 3.7.2.1 MINIMUM PAID-UP CAPITAL

	Institutions		Minimum paid-up capital (in US$)
Chile	Commercial Banks		10,000,000
	Saving and Loan Cooperatives		Not required
	NGO's		Not required
People's Republic of China	Joint-equity Commercial Banks (including Yantain Savings Bank)		120,820
	Rural Credit Cooperatives		120,820
	Urban Credit Cooperatives		120,820
Indonesia	Rural Banks (BPRs)	Within Jakarta region	283,680
		Within Provincial Capitals outside Jakarta	141,840
		Other area	70,920
Korea	Commercial Banks		77,500,000
	Mutual Savings and Finance Companies	Within Seoul	4,500,000
		Within Metropolitan Area	3,000,000
		Other area	1,500,000
	Credit Unions		230,000
Mexico	Saving and Loans Cooperatives Associations and Popular Financial Societies	Level I	34,021
		Level II	170,106
		Level III	1,701,062
		Level IV	8,505,310
Peru	Mi Banco		5,295,000
	EDPYME		240,000
	Cajas Rurales		240,000
	Cajas Municipales		240,000
	Cooperatives		Not required
Philippines	NGOs		1,000
	Credit Unions		40
	Cooperatives		40
	State-owned banks		40,000
	Private-owned banks		40,000

Source: Information provided by each economy.

ii. Scope of operations

MBIs are usually subject to a strict regulation in terms of the type of operations in which they can engage. Flexibility and restrictions to vertical or horizontal integration, however, vary from case to case. Peru is among the cases where there is more flexibility. Although licensing clearly defines the authorized range of operations, it also allows intermediaries to eventually increase their sophistication so they can eventually become banks if they meet the additional capital requirements and appropriate standards and qualifications.[91]

Credit unions are usually restricted in their operations, but there are significant variations among APEC economies. For instance, whereas in New Zealand they can only take small deposits from members and extend low value loans, in Canada credit unions provide a wider variety of services, including consumer financing, mortgage lending and, more recently, the sale and distribution of mutual funds and insurance.

Additionally, in the People's Republic of China regulation differences arise depending upon the amount of assets of each institution. Rural Credit Cooperatives with total assets exceeding CNY$100 million or individual deposits of no less than CNY$5 million are regulated differently from those under that level. Similarly, in Chile the Superintendency of Banking and Financial Institutions (SBFI) regulates cooperatives whose minimum paid up capital reaches US$10 million and allows them to engage in operations such as issuing shares, bonds, and credit cards, among other services.

In Thailand, horizontal and vertical integration has to be approved on a case-by-case basis.

iii. Membership

Membership requirements typically apply among credit unions and cooperatives, although these restrictions vary significantly from economy to economy. For instance, whereas in Korea and Mexico credit cooperatives are requested to have a minimum of 100 members, in Thailand and the Philippines this requirement is significantly less strict (10 and 20 members, respectively).

In Mexico, the popular financial societies that are emerging as result of the new law are also subject to restrictions in terms of the shareholder structure. For instance, individuals and corporations cannot hold, directly or indirectly, more than 3 percent and 10 percent, respectively, of the institution's equity. Similarly, in Chile, no individual or corporation can hold more than 10 percent or 50 percent respectively, of the institution's equity.

In Peru MBIs are subject to the same shareholding restrictions applying to the rest of the domestic financial system: a major shareholder of a financial institution cannot hold more than 5 percent of the equity of another similar institution (see Table 3.7.2.2 for further details).

[91] This is the case of the EDPYMES, which are licensed for credit-only operations, but can eventually move into deposit-taking activities if meeting specific evaluations; Government of Peru (2002).

Table 3.7.2.2 MINIMUM NUMBER OF MEMBERS

	Institutions		Minimum number of members (if apllicable)
Chile	Commercial Banks		2
	Saving and Loan Cooperatives		50
	NGOs		Not required
People's Republic of China	Joint-equity Commercial Banks (including Yantain Savings Bank)		Complying with the requirements in the Corporation Law.
	Rural Credit Cooperatives		No less than 500
	Union of Rural Credit Cooperatives		More than 4 cooperatives
	Urban Credit Cooperatives		More than 50 of which no less than 10 entity members.
	Union of Urban Credit Cooperatives		More than 4 cooperatives
Korea	Credit Unions		100
	Community Credit Cooperatives		100
Mexico	Saving and Loans Cooperatives Associations	Level I	100
		Level II	200
		Level III	200
		Level IV	200
	Popular Financial Societies	Level I Level II Level III Level IV	Individuals and corporations can not hold, directly or indirectly, more than 3 and 10%, respectively, of institution's capital stock.
Peru	Mi Banco EDPYME Cajas Rurales Cajas Municipales Cooperatives		Microbanking intermediaries are subject to the same shareholder restrictions applying to the rest of the financial system: a mayor share holder of a financial institution is prohibited to hold no more than 5% of the capital stock of other firm of the same type.
Philippines	NGOs		5
	Cooperatives		20
Thailand	Cooperative		10
	Credit Union		15

Source: Information provided by each economy.

- Information disclosure and requirements

Most APEC economies include, to some extent, the obligation to report on a regular basis to the supervisory authority. Australia, Mexico, and Peru make no distinction between commercial banks and MBIs in terms of reporting financial and operational information.

In New Zealand, credit unions are required to file an annual return to the Registrar, setting out their financial statements and related information, while complying with standard prospectus disclosure requirements, and the disclosure requirements for investment products and credit contracts.[92]

In Canada, provincial governments require credit unions to engage external auditors to prepare their financial statements, and each provincial regulatory body conducts annual inspections of credit unions within their jurisdiction.

In Chile, an external auditing company must review the financial statements of banks and savings and loans cooperatives, and those which are supervised and regulated by the SBFI must release periodically some information about their clients, their interest rates, etc.

- Liquidity ratios

Several APEC economies maintain specific liquidity ratios for MBIs. In Canada, provincial regulators require credit unions and *caisses populaires* to maintain liquidity ratios from 8 percent to 10 percent of total assets, most of which is maintained in a liquidity pool at the provincial level.[93] Similarly, in Mexico Cooperatives and Financial Popular Societies are required to maintain at least 10 percent of their short-term liabilities invested in liquid assets.

In Peru, different liquidity ratios apply to all financial institutions depending on whether liabilities are denominated in local currency or in US dollars. In the former case, the current assets-to-current liabilities ratio is 8 percent, whereas in the latter it is 20 percent. Something similar occurs in Chile, where liquidity ratios apply depending on whether liabilities are short- or long-term.

In the People's Republic of China, rural and urban credit cooperatives are subject to a 3 percent reserve ratio (cash and balance due from Central Bank/balance of all deposits), while city commercial banks such as the Yantai Housing Savings Bank, are subject to a liquidity ratio of 25 percent (current assets / current liabilities).

- Corporate governance

In order to strengthen the soundness of MBIs, minimum standards of corporate governance have been established in several APEC economies. However, in most economies these guidelines have to do more with professional and educational requirements.

In Indonesia, the lack of appropriate management in rural banks prompted the authorities to enact a new set of provisions in May 1999, requiring them to hire managers with at least university degrees and a minimum of two years of banking experience. Similar specific guidelines have been developed in the People's Republic of China for cooperatives and city commercial banks (see Text Box 3.7.2 for further details).

---

[92] Mortlock (2002).
[93] Department of Finance of Canada (2002).

In Peru, directors of MBIs are required to show technical ability, moral integrity and creditworthiness, whereas in Mexico the regulatory framework established in 2001 introduced the figure of independent directors. The inclusion of these directors is not compulsory, but strict guidelines should be observed when electing independent directors in order to avoid conflicts of interest (a shareholder, donor, creditor, regulator, former employee or any related party is not allowed to act as independent director).

Text Box 3.7.2: Corporate Governance Guidelines in the People's Republic of China

Categories of existing intermediaries	Management Requirements	Board of Directors Requirements	Standards	Education Requirements
Rural Credit cooperatives Urban Credit cooperatives	More than 6 years experience in financial-related areas, or more than 9 years in economic sectors (including more than 3 years in financial sectors).	More than 6 years experience in financial sectors, or more than 9 years in economic sectors, (including more than 3 years in financial sectors).	Code of Democratic Selection in RCCs and UCCs	Not below the medium professional level of education*
City Commercial Banks (including Yantai Housing Savings Bank)	More than 8 years experience in financial sectors, or more than 12 years in economic sectors (including more than 5 years in financial sectors).	More than 8 years experience in financial sectors, or more than 12 years in economic sectors (including more than 5 years in financial sectors).	The Corporate Law, Direction on the Corporate Governance of Joint-equity Banks, Direction on the System of Independent Directors and External Directors in Joint-equity Banks	Not below the college level of education

* In the case of Unions of Urban Credit Cooperatives high level of education is required.

3.7.3 Supervision Features

Supervision of MBIs also varies considerably from one economy to another. In a very few cases it is the responsibility of the same institution that supervises the entire banking system. Nonetheless, some other economies display more complex supervision systems that combine direct supervision and delegated or auxiliary supervision, while in others supervision is fragmented across central and sub-national governments. (see Table 3.7.3 for an overview of the region)

Korea, Mexico and Peru are among those APEC economies where supervision of MBIs is carried out directly by the same agency responsible for the entire financial system, although in Mexico and Peru this co-exists with some sort of delegated or auxiliary supervision.

In Mexico, there is a system of auxiliary supervision in which the cooperative savings and loans Societies as well as the popular financial societies are directly supervised by their respect federations, which in turn are supervised by the National Banking and Securities Commission. Although in Peru most MBIs are subject to direct supervision by the Banking and Insurance Superintendency,[94] the credit cooperatives sector is an exception. Here there is a scheme of

[94] Although microcredit NGOs are not subject to regulation and supervision, a project of a self-regulatory framework was considered in 2002, with the Superintendency coordinating these efforts.

delegated supervision done through the National Federation of Savings and Loans Cooperatives (*Federación Nacional de Cooperativas de Ahorro y Crédito* or FENACREP).

A similar case is that of Chile, where the Superintendency of Banking and Financial Intermediaries (SBFI) supervises only those cooperatives whose minimum paid up capital amounts to US$10 million or more, whereas the rest of them are supervised by the Department of Cooperatives of the Ministry of Economy. Currently, Chilean Legislation is transforming to allow the adoption of a specialized supervision framework for each type of microbanking intermediary. Savings and loans cooperatives will be auxiliary supervised by the Federation of Savings and Loan Cooperatives (Federación de Cooperativas de Ahorro y Crédito or FECRECOOP).

Schemes of more complex and fragmented supervision in the microbanking sector are particularly evident in Indonesia. While the central bank supervises commercial banks such as the BRI (including its vast range of microbanking activities) as well as most rural banks, there is also some degree of delegated supervision since BRI supervises the network of smaller rural banks known as Village Credit Boards or BKD on behalf of the central bank. In the case of Rural Fund and Credit Institutions (LDKP), which were usually established by provincial or lower level governments, supervision is highly fragmented, with no systematic procedures and standards. Savings and Loans Cooperatives (Kosipa) in turn, are supervised by the State Ministry of Cooperatives and Small Enterprises.[95]

[95] Sukarno (2000).

Table 3.7.3 Supervision of Mbis in Selected APEC Member Economies

Economy	Direct supervision		Delegated or Auxiliary Supervision	Comments
	by the same institution that supervises the entire banking system	by a decentralized government agency specifically for their institutional form		
Australia	Australian Prudential Regulatory Authority			Credit unions hold the same license and are supervised on the same basis as banks.
Canada				All credit unions and *caisses populaires* are provincially incorporated. Consequently, the industry is almost exclusively regulated and supervised at the provincial level. The federal government does, however, play a regulatory role in the credit union movement through some of the centrals. The national central is chartered and regulated by the federal government.
Chile	Superintendency of Banking and Financial Institutions	Department of Cooperatives of the Ministry of Economy	Federation of Saving and Loan Cooperatives (FECRECOOP)	The Department of Cooperatives of the Ministry of Economy, which supervises small saving and loan cooperatives, has delegated some of its functions to the FECRECOOP.
People's Republic of China	People's Bank of China			Supervision is done through separate departments.
Indonesia	Bank of Indonesia (BI)	State Ministry for Cooperatives and Small Enterprises (Savings and Loans Cooperatives)	Bank Rakyat Indonesia	Bank of Indonesia (central bank) supervises commercial banks and most of the rural banks. However, some smaller scale rural banks are supervised by BRI on behalf of the Central Bank.
Korea	Financial Supervisory Commission			
Mexico	National Banking and Securities Commission (NBSC)		Federations	Federations may group two types of intermediaries: cooperative savings and loans societies and popular financial societies.
Malaysia		Department of Cooperative Development		
Peru	Superintendency of Banking and Insurance (SBS)		Federation of Savings and Loans Cooperatives (FENACREP)	With the exception of credit cooperatives which are supervised by the FENACREP, the BIS supervises the rest of microbanking intermediaries (including municipal savings and credit institutions, rural savings and loans institutions, Entities for the Development of Micro-Enterprises – EDPYME).
Philippines	Rural banks and thrift banks are regulated by the Bangko Sentral ng Pilipinas (BSP)	Credit cooperatives, on the other hand, will be under the regulatory authority of the Cooperative Development Authority (CDA)	Some credit unions are supervised by a federation	CDA is a government agency under the Office of the President and does not have any linkage nor delegated authority from the BSP to regulate, supervise and examine credit cooperatives. For now, the CDA, while legally mandated to regulate credit unions/cooperatives is not yet effectively implementing this function. The government, however, is currently reviewing CDA's functions with a view of strengthening its regulatory mandate.
Chinese Taipei	Ministry of Finance	Municipal and county government		MBIs are audited by the Central Deposit Insurance Corporation (CDIC)
Thailand	Ministry of Finance	Ministry of Agriculture and Cooperatives		The BAAC, the GSB, and CODIs operate under direct supervision of the Ministry of Finance. Cooperative and credit unions operate under direct supervision by the Ministry of Agriculture and Cooperatives.
United States		National Credit Union Administration (NCUA)		NCUA regulates and supervises all federal-chartered credit unions as well as some state-charted credit unions.

3.8 Interest Rates for Microbanking in APEC Member Economies

Contrary to what is seen in traditional commercial banking, interest rates vary significantly in the microbanking industry, depending, first of all, on whether or not they are controlled by the government, and then on the type of loan, the amount of savings, the number of monthly deposits made, etc. (see Table 3.8.1 for further details).

Several member economies do not set limits to deposit or loan interest rates, including Australia, Korea, Mexico[96], New Zealand, Peru, the Philippines, and the United States. Conversely, many other member economies control interest rates. In Thailand, loan and deposit rates are determined by the market, although the Ministry of Finance has set a ceiling of 19 percent per annum for SFIs, cooperatives, and credit unions. Similarly, in Papua New Guinea there is a 12 percent per annum ceiling on lending rates for Savings and Loans Societies.

The People's Bank of China (PBC) requires that the loan rates be set referring to the benchmarks set by the PBC, allowing it to impose a mark-up for certain borrowers. Since late 1998, MBIs have been permitted to charge up to 30 percent more than the base lending interest rates. (small and medium-sized borrowers)

In Malaysia interest rate controls may have played some part in keeping commercial banks out of microbanking. Bank Negara, the central bank, restricted the spread between base and maximum lending rates in the commercial banking system to 4.0 percent, less than would be required to cover the extra costs associated with microbanking lending. In the case of some loans guaranteed by the Credit Guarantee Corporation (CGC) the permissible spread was only 2.0 percent, reinforcing this effect.

[96] In Mexico, intermediaries adopt market-based interest rate policies. As of December 2001, it was found out that average deposit rates were around 8% annually (0.67% monthly), and average loan rates were close to 28% annually (2.34% monthly).

Table 3.8.1 MICROBANKING INTEREST RATES IN SELECTED APEC ECONOMIES

	Interest Rate Controls	Specifications
Australia	No	
Chile	Yes	Those imposed by the Superintendency of Banking and Financial Institutions, and they should not exceed the maximum conventional interest rate.
People's Republic of China	Yes	MBIs are permitted to charge up to 30% more than the base lending interest rates to small and medium-sized borrowers.
Chinese Taipei	No	
Indonesia	No	BRI-Unit Desa was charging between 10-18% annually over the last 18 months.
Korea	No	Every MBI can set interest rates on their own initiatives.
Malaysia	Yes	The Central Bank restrict the spread between base and maximum lending rates in the commercial banking system to 4%, less than would be required to cover the extra costs associated with microbanking lending; in the case of some loans guaranteed by the CGC the permissible spread was only 2%.
Mexico	No	Intermediaries adopt market-based interest rate policies. As of December 2001, average deposit rates were around 8% annually, and average loan rates were close to 28% annually.
New Zealand	No	
Papua New Guinea	Yes	Ceiling of 12% annually on lending rates for Savings and Loans Societies.
Peru	No	
Philippines	No	MBIs are encouraged to adopt market-based interest rate policy.
Thailand	No	There is no restriction to set a ceiling for deposit rate; MBIs reference deposit rate from the market rate.
	Yes	Ceiling of 25% annually on lending rates for Specialized Financial Institutions, cooperatives and credit unions.
United States	No	

N. A. Not Available.

Source: Information provided by each economy.

3.9 Final Considerations

Although experiences vary considerably from one member economy to another, evidence suggests that regulation and supervision of microbanking activities is necessary not only for securing sound and safe institutions, but also to allow the development of sustainable financial services to the poor.

Overcoming regulatory fragmentation and enhancing capacity building are significant challenges for several economies in the region, particularly those where microbanking has the greatest potential to develop due to relatively low financial depth.

The review included in this section suggests that microbanking needs a specific set of norms and institutions in order to be effectively regulated and supervised, despite the fact that there is no unique framework to follow. Most experts and national authorities agree in that the basic aspects of an appropriate regulatory and supervisory scheme would include liquidity, capital adequacy, asset quality and diversification, as well as corporate governance.

Additionally, it should be noted that adequate supervision for MBIs must be devised considering the relative importance of the sector, the number of participants in it, and their geographical dispersion.

4. RELEVANT TOOLS FOR THE STRENGTHENING OF THE MICROBANKING SECTOR

This section addresses other aspects of the microbanking sector or particular relevance for the regulation and supervision of the industry, especially in light of the need to develop stronger and more sophisticated intermediaries. Firstly, a brief overview of financial sustainability is presented, emphasizing the need to develop better financial indicators. Secondly, the issue of developing deposit insurance for MBIs is addressed considering the bankruptcy and insolvency risks associated with this financial activity. Then, the relevance of rating agencies and credit bureaus is discussed, along with their role in improving access to new funding by MBIs. The section concludes with a review of the existing trends in public policies geared at strengthening microbanking activities.

4.1 Financial Sustainability of Microbanking Activities

In contrast to what is commonly believed, microbanking can be a rather profitable activity. Indeed, this profitability has allowed some MBIs, particularly in industrialized economies, to eventually become fully integrated into the formal financial system by developing new products and services and by acting as quasi-banks. In other cases, the desire to enter the microbanking sector has led commercial banks to downscale operations in order to increase their outreach by targeting lower-income groups.

Assessing microbanking's financial sustainability in the APEC region is not an easy task due to the lack of a consistent approach across economies. It is widely believed that financial self-sufficiency should account for full coverage of all administrative costs, loan losses, and financing costs from operating income, after adjusting for inflation and subsidies and treating all funding as if it had a commercial cost.[97]

---

[97] This is the definition used by the IADB (2000), vol. 1, p. 10, which in turn is taken from the Consultative Group to Assist the Poor (CGAP) and the *Microbanking Bulletin*. It should be noted that these sources distinguish "financial self-sufficiency" from "operational self-sufficiency", with the latter accounting for all administrative costs and loan losses and separating this from operating income. However, for purposes of the discussion in this section the focus is only on "financial self-sufficiency".

There is no single indicator for measuring the sustainability of microbanking activities, although the use of indicators, such as return on average assets (ROA), return on average equity (ROE), gross financial margin, etc., are relatively widespread.[98] This has been a global problem, since there are currently more than 170 indicators to evaluate MBIs, according to some experts.[99] The existing discrepancies reflect a wide variety of cultures, practices, definitions, and calculation methods.

The microbanking industry in the APEC region still faces the challenge of developing measurable and relatively standard indicators of financial sustainability. Appropriate and reliable information systems, as well as widely agreed definitions and their indicators, are some of the most pressing needs faced by MBIs. The treatment of non-performing loans, in particular, has been mentioned as one of the most troublesome issues. The Consultative Group to Assist the Poor (CGAP) recommends that micro-enders report as a risk any loan with a payment overdue by 90 days, while some MBIs are said to report only loans overdue by one or two years.[100]

According to the Asian Development Bank, very few MBIs in Asia are self-sufficient, since most of them rely on subsidies from government or donor agencies.[101] CGAP has also found out that financial statements and reports are often weak or inaccurate.[102] Indeed, the lack of reliable financial information on MBIs has recently been under increased scrutiny, leading some analysts to even question some of the “models” or most often cited cases in the industry.[103]

Financial statements do not include sufficient information to allow a solid analysis of the state and prospects of the business. As a result of these weaknesses, managers may fail to identify operational problems and act promptly to properly overcome them. Therefore, board members are unable to focus efficiently on the core financial health of the company, undermining the expansion and growth of microbanking. Access to new funds provided by donors, investors, and commercial banks is thus hampered by the lack of reliable financial information.

Mexico, Thailand and the Philippines have reported similar financial problems regarding MBIs. Inefficient and heterogeneous information, weak accounting systems, inadequate risk management, higher administrative costs compared to other financial institutions, poor credit delinquency monitoring, and liquidity management problems have been mentioned as common problems in these economies.

In the Philippines, these problems have been clearly identified by national authorities and some policy actions are being undertaken. The National Credit Council (NCC), in coordination with the Cooperative Development Authority, has formulated a set of performance standards for assessing the financial viability and sustainability of credit cooperatives. The NGOs, on the other hand, have also adopted a set of performance standards, which is being reviewed to make it consistent

---

[98] A good reference for the discussion about measuring the sustainability of specialized microbanking institutions is: Jacob Yaron,. “What makes rural financial institutions successful?” *The World Bank Research Observer*, 1994. Yaron argues that the ROE and the ROA may not reflect the real capacity of the institution to generate profits, because they do not take into account the fact that MBIs commonly receive subsidies. A high value of ROA for a MBI highly dependent on subsidies may inaccurately indicate that the institution has the capacity to generate profits. Yaron proposed an indicator, today widely accepted, to assess the MBI´s sustainability: the Subsidy Dependence Index (SDI). Yaron´s SDI is defined as the percentual increase in the lending interest rate required to compensate for a complete elimination of subsidies.

[99] CGAP (2001a), p. 6.

[100] Pearl and Phillips (2001).

[101] ADB (2000b), Volume 1, p. 10.

[102] CGAP (2001b), p. 2.

[103] This has been the case of the Grameen Bank in Bangladesh. In addition to Pearl and Phillips (2001), see *The Economist* (2002), p.39.

with those of the credit cooperatives. In a draft regulatory framework for microbanking that was being formulated as of May 2002, the NCC was proposing the adoption of the following basic set of parameters:

- Portfolio Quality (portfolio at risk, past due ratio and provision for loan losses)
- Efficiency (administrative efficiency, operational self-sufficiency, and financial self-sufficiency)
- Stability (liquidity and net institutional capital)
- Outreach (growth of clients, growth of loan portfolio and growth of savings)

In sum, it has been found that this lack of standardized financial information makes reporting more difficult and costly for MBIs, which often have to tailor multiple reports for different stakeholders. Clarification and standardization of financial indicators remains a crucial challenge for the microbanking industry.

4.2 Solvency and Bankruptcy Problems: Is Deposit Insurance Relevant?

The lack of appropriate financial information may further endanger the sustainability of MBIs under particular circumstances, posing significant risks for the population and eventually prompting government action. High administrative costs, scarcity of funding sources, deficient information and technology development, as well as poor management and corporate governance structures, are reported to increase these risks.

With the exception of the Philippines and Chile, insolvency and bankruptcy episodes in the microbanking industry have been reported in several APEC economies, with government actions ranging from the development of deposit insurance schemes, to fostering increased consolidation among intermediaries.

In Thailand, for instance, the BAAC faced a critically low level of capital adequacy rate (CAR) during the 1997 financial crisis, forcing the government to inject more capital to solve the problem. Thai cooperatives were also affected by this crisis, although less than 1.0 percent faced bankruptcy. In this case, the government intervened through the Cooperative Promotion Department.

In Mexico, there have also been recent insolvency and bankruptcy problems associated with bad management practices. This was the case of "*Cajas Vallarta*", a deregulated loan and savings cooperative association, whose founder was charged for money laundering. This situation created a moral hazard problem, which was extended to other non-regulated savings and loans cooperatives, leading savers to withdraw their funds and causing a massive run against these institutions. In response, the government created a special fund to support insolvent loans and savings cooperatives and avoid major losses for their clients. In total, the Mexican government provided US$196.5 million to pay savers, and US$55 million to support and strengthen the associations and cooperatives that showed serious liquidity and insolvency problems.

In Peru, the microbanking system has not suffered any major solvency crisis, but in the past few years there have been some bankruptcies and insolvency episodes among *Cajas Rurales* and EDPYMEs. In the case of *Cajas Rurales*, inadequate evaluation and qualification of loans, poor monitoring of credit risks, and high concentration of their portfolio on agricultural loans have contributed to the poor quality of their loan portfolio, and to these having, on average, the highest rate of delinquency among local MBIs. Inadequate corporate governance and lack of a well-prepared technical staff worsened these problems. This led the government to intervene in the institutions and force their restructuring through mergers. [104]

An interesting case is Chinese Taipei, where MBIs have been forced to upgrade operations, merge and transform into commercial or agricultural banks in order to overcome financial weaknesses. Community-based financial institutions, such as credit cooperatives and the credit departments of farmers' and fishermen's associations (FAs), have underperformed due to cronyism in loan decision-making and poor risk management. Between 1995 and 2000, more than 30 FAs credit departments were reportedly hit by runs on deposits, while non performing loans escalated, threatening a systemic crisis. In response, the authorities established a US$4 billion resolution trust fund to clean up the insolvent institutions and foster its transformation. Many credit cooperatives have been merged, liquidated or taken over by commercial banks, while the most successful ones were transformed into commercial banks. FAs, in turn, are in the midst of becoming national or regional banks.[105]

Considering these problems, the issue of deposit insurance in microbanking becomes increasingly relevant. Traditionally, deposit insurance schemes were set up to protect the overall stability of the banking system, as well as safeguarding individual depositors.[106] Over the past few years, the issue of deposit insurance schemes for the banking industry has been subject to an intense debate and scrutiny, with a gradual shift from implicit to explicit schemes. In some cases, such as New Zealand, the authorities have even decided to eliminate deposit insurance, obliging depositors to take full responsibility for their investment decisions.

Deposit insurance in microbanking is not new. Indeed, the German loan and credit cooperative system—one of the largest and most successful in the world—has a longstanding tradition of deposit insurance for its clients.[107] Similar to what occurs with traditional banking, deposit insurance for MBIs can be explicit or implicit, while its funding varies from being primarily government-generated to exclusively privately-funded.

Explicit deposit insurance systems have become very popular because they appear as a direct and more cost-effective solution to the problem of financial panics and runs, while securing protection for small depositors. Indeed, deposit insurance schemes in the microbanking industry have been reviewed and upgraded as part of broader regulatory and supervisory reforms, stemming in some cases from insolvency and bankruptcy episodes.

Table 4.2.1: Recent Microbanking Insolvency and Bankruptcy Events in APEC Economies

ECONOMY	TYPE OF INTERMEDIARY	POLICY RESPONSE
People's Republic of China	Rural and Urban Credit Cooperatives, City Banks	On-going intervention by the central bank to restore financial and operational soundness
Korea	Mutual Savings and Finance Companies, Credit Unions	Authorities fostered exit and mergers as part of an overall policy for the domestic financial sector following the 1997 crisis.

[104] As of April 2002, the Peruvian authorities reported that four Cajas Rurales were in a process of reorganization to create a new entity to be called CORFINRURAL. One EDPYME was also reported to have had an intervention due to the loss of more than 50% of its tier capital.
[105] Government of Chinese Taipei (2002b).
[106] WB (2001b), p. 105.
[107] For further details on the German case see Fischer (2002).

ECONOMY	TYPE OF INTERMEDIARY	POLICY RESPONSE
Mexico	Savings and Loan Cooperatives (*Cajas Populares*)	In 1999–2000 bad management practices in some non-regulated cooperatives forced the government to intervene to avoid a massive run against these institutions.
Peru	Cajas Rurales and EDPYMES	Over the past few years, problems associated with poor risk management, and lack of technical capacity led authorities to intervene, forcing in some cases mergers among intermediaries.
Chinese Taipei	Credit Cooperatives and Credit Departments of Farmers and Fishermen's Associations (FAs).	Cronyism and poor risk evaluation affected the sector, leading to a high non performing loan ratio and poor portfolio quality. As a result, authorities have implemented broader reforms aimed at transforming credit cooperatives into commercial banks and FAs into commercial/agricultural banks.
Thailand	BAAC and Cooperatives.	In the aftermath of the 1997 crisis, the Bank for Agriculture and Agricultural Cooperatives (BAAC) faced a critically low level of capital adequacy rate (CAR), forcing the government to inject more capital. Thai cooperatives were also affected by this crisis, although less than 1% faced bankruptcy.

The experience among APEC economies varies significantly, with two broad types of insurance arrangement identified: explicit and implicit insurance schemes. In the former case, one can also distinguish between those schemes applying to the financial system in general from those *ad hoc* explicit arrangements developed especially for MBIs. (See Table 4.2.2 for further details.)

4.2.1 Explicit *ad hoc* Deposit Insurance Arrangements

A handful of APEC economies have developed explicit insurance arrangements geared specifically for some type of microbanking intermediaries. This is the case of the United States, Canada and Mexico.

In the United States, the National Credit Union Share Insurance Fund (NCUSIF) was established in 1970 as an arm of the National Credit Union Administration (NCUA). The fund, which is managed by NCUA under the three-person NCUA Board, insures all federal-chartered credit unions as well as those state-chartered credit unions that apply for and meet the standards. The insurance provided covers one or more accounts for up to US$100,000, in a similar way to the protection offered by the Federal Deposit Insurance Corporation (FDIC).[108] Insured credit unions in the United States are required to deposit and maintain 1.0 percent of their insured shares and deposits in the NCUSIF. Historically, deposit insurance funds strive for a ratio of equity to insured savings of at least 1.0 percent. The NCUSIF ratio of equity to insured shares and deposits is normally 1.25 percent to 1.30 percent.[109]

[108] NCUA (2000).

[109] In 1991 this ratio dropped to 1.23% and credit unions were asked to pay a premium. The National Credit Union Share Insurance Fund has three "fail safe" features: 1) Federal credit unions must maintain a one percent deposit in the Fund; 2) Premiums are levied by the Board if necessary; and 3) When the equity ratio exceeds 1.3% (US$1.30 on deposit for every US$100 insured), the Board sends a dividend to credit unions.

TABLE 4.2.2 DEPOSIT INSURANCE SHEMES IN APEC ECONOMIES

ECONOMY	SCHEME	SOURCE OF FUNDING	INDIVIDUAL AMOUNT INSURED (US$)	COMMENTS
Canada [/1]	Explicit	Private	39,606 - 165,025	Deposits of credit union members are protected by provincial stabilization funds and/or deposit insurance and guarantee corporations, with the amount of coverage varying by province. Nova Scotia, Labrador and Newfoundland have the highest maximun amount of deposit insurance of C$250,000, while Quebec, New Brunswick and Price Edward Island guarantee deposits to C$60,000- the same level as bank deposits.
Chile	Explicit	Government	2,677	This limit only applies to banks, and corresponds to the 90% of the total financial system. In addition, the Central Bank covers 100% of the deposits in current accounts, time, fixed and sight deposits, among others.
People's Republic of China	Implicit	Government	N. A.	Depositors are paid by the government when an MBI is closed.
Korea	Explicit	Private	38,000	Originally set up in 1996 exclusively for banks, as of 1998 the Korea Deposit Insurance Corporation (KDIC) also covers Mutual Savings and Finance Companies. for up to 50 million won (US$38,000) per depositor per institution.
Malaysia	Non existent	Private	N. A.	Partially applies to Amanah Ikhtiar Malaysian (AIM), which offers an insurance mechanism to cover loans disbursed to people who die.
Mexico	Explicit	Private	1,360-3,402	By law, MBIs mobilizing savings are required to have a fully privately-funded "Protection Fund" managed by Confederations, covering individual savings ranging between US$ 1,360 and US$ 3,402.
Peru	Explicit	Private	18,000	By law, MBIs mobilizing savings are required to pay a fee to the Deposit Insurance Fund that covers individual savings of the public (people and non-lucrative institutions) for up to the equivalent of US$ 18,000.
Philippines [/2]	Explicit	Private	2,000	The Philippine Deposit Insurance Corporation (PDIC), created in 1963, covers rural banks and thrift banks for up to 100,000 pesos per depositor.
Chinese Taipei [/3]	Explicit	Private	28,571	Following the 1999 amendment of the Deposit Insurance Act, MBIs such as credit cooperatives, credit departments and Small and Medium Business Banks are required to be insured through the Central Deposit Insurance Corporation. The maximum insured amount is NT one million.
Thailand	Implicit	Government	N. A.	Applies to all financial institutions in Thailand
United States	Explicit	Private	100,000	Federal and state chartered credit union deposits are insured through the National Credit Union Share Insurance Fund (NCUSIF).

N. A. Not Available.

[1 /] At an average exchange rate of US$1=C$1.51 prevailing in June 2002.

[2/] At an average exchange rate of US$1=$50 pesos prevailing in May 2002.

[3 /] At an average exchange rate of US$1=NT$35 at year end 2001.

In Canada, credit unions have diverse deposit insurance schemes depending on each province. Since credit unions are provincially-regulated, there are one or more organizations in each province responsible for protecting the deposits of credit union members. This organization can be a deposit insurance or deposit guarantee corporation or stabilization fund, corporation, board or central credit union. Deposit protection funds are built up and maintained at required levels primarily by premiums or assessments levied on individual credit unions. The amount of the contribution is usually set as a proportion of any of these parameters: shares and deposits; or shares, deposits and liabilities; or deposits and borrowings; or gross revenues or interest income; or total assets.[110]

Most credit union deposit protection organizations in Canada have powers beyond the collection of premiums and the payout of funds, giving priority to stabilization and prevention roles aimed at averting the potential payout of claims. These organizations monitor a credit union's financial performance closely, in addition to the independent audits or inspections by government or deposit protection organizations. They can intervene at the early stages of any potential difficulty. The insuring organization's powers extend to taking over the management, supervision, and ordering amalgamation or dissolution of a credit union that is judged to be unable to achieve regulated performance results.

In Mexico, an explicit deposit insurance scheme for the microbanking industry, and fully funded by the private sector, was adopted as part of the adoption of a new regulatory scheme in 2001. Under this scheme, a Protection Fund is set up by MBIs grouped in confederations, which in turn groups at least five federations composed of at least ten MBIs each. Depending on its level of operations, each intermediary pays a monthly quota to this protection fund. Each protection fund covers individual savings ranging between US$1,360 and US$3,402, depending on the operational level of each microbanking intermediary member. This fund is activated only after an intermediary is dissolved or liquidated.

4.2.2 Explicit Deposit Insurance Schemes

In Peru, all regulated MBIs are required to pay a fee to the Deposit Insurance Fund that covers individual savings of the public (people and non-lucrative institutions) for up to the equivalent of US$18,000. This limit is updated on a three-month basis.[111] Created in 1991 as a privately-run organization, this fund was originally capitalized with resources from the Central Bank of Peru, but now is primarily funded by the industry's members. The government participates indirectly through the management council, which is composed by one representative from the Banking and Insurance Superintendency acting as President, one from the Central Bank, another one from the Ministry of Economics and Finance, with the three remaining members coming from the financial system.

In the Philippines rural banks and thrift banks are insured through the Philippine Deposit Insurance Corporation (PIDC), created in 1963. The maximum coverage is 100,000 pesos (around US$2,000) per depositor. Similarly, following the 1999 amendment of the Deposit Insurance Act in Chinese Taipei, MBIs such as credit cooperatives, credit departments and small- and medium-business banks are required to be insured through the Central Deposit Insurance Corporation. The maximum insured amount is NT$1 million.

Along the same lines, in Korea mutual savings and finance companies are insured through the Korea Deposit Insurance Corporation (KDIC) established in 1996. Financial institutions insured by the KDIC are required to make a premium payment which is dependent upon each institution's financial position. The KDIC makes insurance claim payments in cases of the revocation of

[110] Credit Union Central Canada (2002).
[111] The deposit insurance mechanism does not apply to EDPYME, which are MBIs that do not mobilize savings deposit, or to NGOs, which are not regulated.

business license of an insured institution, a voluntary resolution to dissolve, or the declaration of bankruptcy by the court. The net amount of the insurance payment is paid up to 50 million won (US$38,000) per depositor per institution.

4.2.3 Implicit Deposit Insurance Schemes

In Thailand, all financial institutions enjoy full support from the government blanket guarantee. However, other types of MBIs do not have deposit insurance mechanisms at the moment. Similarly, in China there is an implicit deposit insurance scheme under which all depositors are paid by the government when a microbanking institution is closed.

4.3 The Role of Rating Agencies and Specialized Assessment Firms

Specialized assessment firms are relatively new in microbanking, with the first agency of this type established in 1996. Currently, there are five rating agencies (see Table 4.3.1) recognized by the CGAP of the World Bank, which are engaged in providing financial rating services for MBIs across the globe.[112] Additionally, several internationally recognized rating agencies have recently shown their interest in providing specialized assessment services to the microbanking industry.[113]

The factors that these agencies and firms evaluate to grant a credit risk grade or score are both quantitative and qualitative. The former includes capital adequacy, liability structure, liquidity and portfolio quality; whereas the latter are governance issues (i.e., quality of board of directors, management, etc.) and the adequacy of internal processes and organization as well as the overall credit policy consistency.

---

[112] Among the most recognized firms are MicroRate and ACCION CAMEL which focus on Latin America, PlaNet Finance which focuses on Africa, M-CRIL, which focuses mainly on Southeast Asia, and The World Council of Credit Unions (WOCCU) which focuses on credit unions in 29 countries around the globe.

[113] Some microbanking evaluators are forging strategic alliances with rating agencies such as Moody's, Fitch IBCA and Standard & Poor's. For instance, Moody's and Fitch IBCA are reportedly providing rating services for some MBIs in the People's Republic of China, while Standard & Poor's has recently been involved in evaluating MBIs in Latin America (specifically *BancoSol* of Bolivia in 2000) and has stressed the need to conduct assessments based on specific risk criteria, including competitiveness, legal structure, credit risk, and management. See Wilhelm (2002).

Table 4.3.1: Characteristics of Five Specialized Assessment Firms for Microbanking Intermediaries

	ACCION INTERNATIONAL CAMEL	WOCCU PEARLS	PLANET RATING GIRAFE	MICRORATE	M-CRIL
Regional Outreach	Latin America	Credit unions in 29 countries	Africa	Latin America	Southeast Asia
Type of clients	ACCION affiliates, bank supervisors, and second-tier institutions	Affiliated credit unions, leagues, and credit union regulators	Donors, investors, creditors, NGOs, and MBIs	Donors, MBIs, and investors	Lenders, donors, MBIs, private banks and investment firms
Objective of the evaluation	* Internal tool for management, board, and network	* Performance monitoring by management and external supervisors	* Measurement and control of risk	* Evaluate MBIs credit risk for potential investors and creditors * Influence MBIs behavior * Compare MBIs performance	* Measure and evaluate MBIs credit risk for potential investors and creditors * Provide inputs that influence MBI behavior * Generate a database with verified information on MBI performance for benchmarking purposes
Quantitative approach	8 indicators in 5 areas: capital adequacy, asset quality, earnings, and liquidity management	45 indicators in 6 areas: protection, effective financial structure, asset quality, rates of return and costs, liquidity, and signs of growth	12 indicators in 4 areas: risk analysis, assets including loan portfolio, funding, and efficiency and profitability	2 major areas: lending operations and portfolio quality and financial performance	Financial performance including credit performance and asset quality, mobilization of funds, profitability, etc.
Qualitative approach	13 indicators in management area including governance, human resources, processes, controls, and audits, information technology system, etc.	No qualitative evaluation	14 indicators in 3 areas: governance and decision making, information and management tools, and internal control	Organization and management information systems	2 major areas: organizational and governance aspects, and managerial and resource strength
CGAP opinion	Strong on management profitability, and benchmarking practices	Strictly financial (includes comprehensive financial analysis), no qualitative evaluation	Strong on management, governance, and best practices, it relies on external consultants which increases the risk of misinterpretation of the assessment criteria	Strong on financial track record, and benchmarking against peers, it gives relatively little judgmental input	Strong on capacity constraints based on specific issues

Source: Authors elaboration, with information provided from Consultative Group to Assist the Poor (2001a).

Rating agencies allow both regulators and intermediaries to improve the efficiency of microbanking operations. By disclosing information to the public, MBIs not only improve their transparency and accountability to clients, but also increase their access to new funding in an easier and efficient manner. In fact, donors and investors have become increasingly concerned with measuring the financial performance of MBIs. According to a leading expert, this stems from the fact that "donors want to make sure their assistance is creating sustainable institutions, while investors want to see if the institutions offer real investment opportunities."[114]

Among APEC economies, the use of rating agencies is still relatively underdeveloped, while its methods and implementation vary significantly across the region.

Thailand is one of the few APEC economies where most MBIs are required to be rated. However, the responsibility for conducting these assessments varies depending upon the type of intermediary. Through the Thai Rating and Information Service (TRIS), the Ministry of Finance evaluates the performance of SFIs. In addition, the Bank of Thailand conducts its own risk assessments for SFIs. In the case of cooperatives and other public agencies involved in microbanking, the ratings are usually done internally through special committees set up by the management and boards of directors. The Thai authorities have found these assessments very useful, as they provide reliable and high quality information for the regulators.

In Mexico, MBIs are not required to be rated. However, the National Banking and Securities Commission (CNBV), which has been recently granted the responsibility of overseeing MBIs, is currently designing an internal rating scheme as a preventive supervision tool.

In Peru, authorities do not require MBIs to be rated, but an institution's rate is one element determining the fee to be paid to the Deposit Insurance Fund (DIF). A MBI without a rating automatically receives a C rating for the purpose of the DIF fee. Thus, those MBIs that can get a better rating than C have an incentive to voluntarily hire a rating agency and submit a rating to the DIF.

In China authorities do not require MBIs to be rated either, but rating agencies are active there and their work is geared towards donors, investors, and the institutions themselves.

4.4 The Role of Credit Bureaus

Traditionally, asymmetric information in credit markets arises when information on potential borrowers and their investment projects is typically only partly or not at all, disclosed to lenders, introducing adverse selection into the credit market. Once a loan is made, lenders face the possibility that borrowers may try to avoid repaying the loan or take actions that increase the risk of the investment project. Asymmetric information between borrowers and lenders in turn leads to higher interest rates and more credit rationing than would be the case if information sharing were optimal.[115]

The problem of asymmetric information is particularly acute in microbanking given the nature of its operations. With most of the clients lacking physical collateral to secure a loan, credit history information becomes crucial for overcoming information asymmetries while providing regulators with a useful tool for overseeing the portfolio quality of MBIs. In its absence, the MBIs must offset risks by relying on solidarity group lending, collateral, and uniformly high pricing or fees.

The existence of credit bureaus providing information on the history of repayment of past loans by individual clients is therefore a crucial aspect for strengthening MBIs. Typically, credit bureaus can collect information on all borrowers, or only those with loans exceeding a certain

[114] Jansson (2001).
[115] IADB (2001), p. 81.

size. In principle, credit bureaus could be established by third-party providers that make information available not just to members of an exclusive industry group but to any creditor willing to pay a service.

In addition to allowing microbanking clients to improve their access to cheaper and more extended credit, credit bureaus can become effective tools for the supervision of MBIs. Credit bureaus help to assure the safety and soundness of MBIs by giving supervisors a valuable tool to oversee the quality of MBI's portfolios. Concrete benefits offered by credit bureaus include:[116]

- *Lower transaction costs*. As MBIs spend less time evaluating loan applications, the cost of providing credit is reduced.
- *Reduced risk.* MBIs are better equipped to assess borrower risk and therefore can to price their services more effectively, together with better management of loan portfolios and risk-adjusted reserves
- *Greater transparency.* MBIs can gain better knowledge of their liabilities, especially if these involved the use of non-standardized accounting procedures.
- *More competition.* Credit histories foster competition among MBIs as they look for clients with a better profile history, with the latter benefiting from more favourable terms.
- *Better incentives to repay.* By letting borrowers know that they risk being locked out of credit markets, credit bureaus enhance discipline among borrowers in terms of payment delays or defaults.

Additionally, credit bureaus are effective instruments for the supervision effort. Credit bureaus can be publicly or privately run. Government-controlled bureaus—also known as credit registries—are believed to have some limitations. According to some experts (Haider, 2000), these limitations stem from some bank secrecy laws, which prevent them from including many transactions from non-regulated entities, ones which typically involve microbanking activity (i.e. consumer finance companies).[117] Due to this reason, privately managed bureaus have become increasingly relevant. Due to the economies of scale involved, some of these bureaus have developed after a public credit registry has been functioning for some time.

Among APEC economies, the People's Republic of China has a credit bureau run by the central bank. In Peru the Superintendency of Banking and Insurance has developed one of the most sophisticated and effective credit bureaus for the microbanking industry. This development was prompted by the authorities' decision to report to the credit bureau every loan worth more than one *sol*, equivalent to around 30 US cents.[118] All MBIs, except cooperatives, must report their credit portfolio on a monthly basis.

In the People's Republic of China, credit bureaus have become increasingly important as part of broader efforts aimed at extending the provision of financial services to the population. This process began in 1996 with the establishment of a firm-level credit bureau within the central bank. In addition, a system of "joint-guarantees" among rural households was introduced to increase the credit rating of individual farmers. In 1999 a credit bureau for individuals was initiated by the central bank's Shanghai branch and by 2002 a nationwide credit bureau system was established under the aegis of the central bank.

In Mexico, a privately run credit bureau is limited to commercial banks and no requirements have been established for expanding their service to MBIs. However, the new Popular Savings and Loans Law considers that MBIs grouped in federations and confederations could consolidate their own databases in order to have a credit history of all their clients. A similar scheme of self-managed credit bureaus is found in Thailand.

---

[116] Haider (2000), p. 5.
[117] Haider (2000), p. 7.
[118] Jansson (2001), p. 13.

In Chile, the Superintendency of Banking and Financial Institutions (SBFI) has a risk-control central that receives information regarding all the people who have liabilities with microbanking intermediaries. The SBIF classifies and releases that information to the public and to the financial intermediaries.

4.5 Access to New Funding Sources

All the above-mentioned aspects can contribute to expanding microbanking sources of funding. Broadly speaking, one can distinguish four main funding sources: donors, public savings, banks, and domestic and international investors.

Although donors still account for a significant share of microbanking funding, their overall importance has steadily declined over the past few years. Donor resources are not keeping up with the overall growth of the market, while it has been found that non-monetary conditionality attached to it hampers microbanking operations. Moreover, criticism has arisen regarding the role of donors in fostering sounder and more viable MBIs. By relying extensively on subsidies, donor funds can distort the market, while undermining the growth of a more sustainable microbanking industry.[119] [120] Donors would therefore be particularly useful in the early stages of microbanking development or in those cases where there are small and weak MBIs.

Public savings are the most abundant and cheapest source of funding in comparison to the it cost to borrowing from local banks. However, their effective mobilization requires the development of more sophisticated and better managed and regulated MBIs – a significant challenge under the existing conditions in many APEC economies.

Access to bank funding might also prove a difficult task, although it is a growing trend in those APEC economies where there is a more developed microbanking industry. By contrast, domestic and international investors have become an increasingly attractive funding source for MBIs unable to mobilize public savings on a wider basis or tap commercial banking funds.

Private investors are increasingly interested in microbanking as this is seen as a sound and profitable activity, leading some investors to establish dedicated funds to support the microbanking industry.[121] However, in order to effectively tap these resources, MBIs need to overcome the abovementioned constraints of lack of standardized and credible financial information and accessing to reliable credit risk assessments.

In practice, the funding experience in the APEC region differs significantly from economy to economy. In most cases, the government provides funding through different arrangements, while donors remain a key source of funding. In Mexico, Peru, Thailand and the Philippines authorities have noted the importance of having access to commercial funding from local banks. However this is still very limited, with the Philippines being one of the few economies reporting commercial bank funding for microbanking.

In Mexico, *Compartamos*, a former NGO transformed into a fully profitable financial institution, has recently been able to obtain wholesale money from leading financial institutions, including Deutsche Bank and Merrill Lynch. *Compartamos* also made a public offering of a US$10 million bond issue in the local capital markets. Even though many of its 110,000 borrowers are poor rural

---

[119] Lombard and de Schrevel (2001).
[120] The Report of the 2002 APEC SME Ministerial Meeting, 24-25 August 2002, (see footnote 18, section 2, above) notes that Ministers agreed to 'limit microfinance subsidies to activities that disseminate information, develop financial tools, and train managers and staff.'
[121] LaCif is a private investment fund for Latin America based in Lima, Peru.

women, it was awarded a local currency credit rating of A+ by Standard & Poor's, reflecting the high quality MBIs' portfolios can attain when they are properly managed.[122]

4.6 Microbanking Development Policies

In addition to improving financial information, developing credit rating agencies and credit bureaus, as well as expanding new sources of funding, microbanking can benefit from concrete public policy actions. In general, one can distinguish between direct and indirect policy interventions.[123] Most APEC economies surveyed in this study have reported both types of activities, with the dividing line at times blurred.

Nevertheless, it is important to note that government's reliance on generalized subsidies can end up undermining sustainable microbanking. For this reason, particular attention should be paid into the way government actions are implemented, emphasizing those policies aimed at developing linkages between microbanking and the rest of the domestic financial system.

4.6.1 Direct Intervention

These activities are usually associated with credit guarantees, participation in the capital and management of institutions, priority sector lending, differential interest rates, preferential discount rates and facilities, and setting credit/deposit ratios for rural branches of banking institutions. Additionally, government ownership of banks can also be considered a developmental activity. [124]

Central banks in APEC Asian economies have traditionally played a significant role in providing developmental support. An example of this is the People's Bank of China (PBC), which has assumed a very active role in enhancing microbanking through several measures, including:

- Increasing funds to provide loans to rural and urban credit cooperatives as well as city commercial banks[125]. Savings retained through the Postal Deposit and Remittance Bureau have also been mobilized for this purpose. Similarly, controls on interest rates charged by these MBIs have been gradually eased.
- Providing preferential treatment to MBIs with respect to loan interest rates, rediscount rates and loans from the PBC when extending credit to small and medium-sized enterprises.
- Enhancing credit to individual farmers through rural credit cooperatives. In December 2001, the PBC promulgated new guidelines for this objective.
- Fostering restructuring in the microbanking sector through legal reforms and in some cases providing facilities to increase equity capital. This is the case of the urban credit cooperatives, which are seen as a vehicle to expand coverage to niches left behind by traditional banking as that sector further concentrates its activities in the biggest and richest areas of the economy.

In the Philippines, the central bank has also opened a rediscount window for financing MBIs, while the government has set up the People's Credit and Finance Corporation, with the purpose of providing loanable funds to MBIs.

In terms of priority lending policies, Korea and Chinese Taipei have relied extensively on this policy to support SMES. In Korea several financial institutions, including MBIs such as mutual savings and finance companies, are obliged to extend a certain proportion of their loan portfolio

[122] Hanrath (2002)
[123] The ADB (2000b) refers to developmental and promotional activities, respectively.
[124] ADB (2000b), p. 15.
[125] As of 2001, the PBC increased the credit ceiling on RCCs from CNY$35 billion (approximate US$4.23 billion) to CNY$70 billion (approximate US$ 8.46 billion).

for this purpose. This lending ratio, however, has been gradually eased as financial liberalization in recent years has been deepened.

Table 4.6.1.1: Lending to Small and Medium Enterprises in Korea

FINANCIAL INTERMEDIARY	LENDING RATIO
Nationwide commercial banks	45% (increase basis)
Local banks	60% (increase basis)
Merchant banking corporations	25% (balance basis)
Mutual Savings and Finance Companies	50% (balance basis)
Lease Companies	30% (annual execution basis)

Source: Bank of Korea (2002)

A similar situation occurs with the small and medium business banks in Chinese Taipei. Established in 1975 by the Banking Law, these banks are required to apportion at least 60 percent of their total lending as loans to SMEs. In 2001, five such banks remained in operation.[126]

4.6.2 Indirect activities

These activities can be associated with broader measures that generate externalities and reduce transaction and information costs. They might include pilot projects for innovative microbanking schemes, collection and publication of data, advocacy and training, among other activities.

Several APEC economies are reported to have governmental agencies providing technical assistance to MBIs. The Philippines is particularly active on this regard, with the Cooperative Development Authority (CDA) providing assistance to credit cooperatives. Also, the government has enacted a law that creates the People's Development Trust Fund (PDTF). This is a trust fund whose earnings will be used to fund capability-building activities of MBIs.

In Mexico, the newly created government-owned Bank for National Savings and Financial Services Bank (Bansefi) also provides technical assistance as part of its core mission. This includes providing a technological infrastructure for microbanking activities, as well as specialized training to intermediaries. Similar activities by government agencies are also reported in Thailand.

In Peru, the *Corporación Financiera de Desarrollo* (COFIDE) is a government-owned entity that is actively involved in promotional activities. These include policies aimed at improving credit technology, investment management, and promotion of new financial products, among other activities. Similarly, the current work of COPEME (*Proyecto Iniciativa Microfinanza*) includes efforts to promote a system of self-regulation among NGOs, which will contribute to their institutional strengthening by inducing them to adopt the concepts and parameters of prudential regulation, similar to those contained in the actual regulatory framework for microbanking.

A different modality was implemented in the United States in late 2001. Through the implementation of the "First Accounts" Program, the US government provides grants to support projects for expanding the use of formal financial services among the un-banked population. (See Text Box 4.6.2.1).

---

[126] As of the end of November 2001 their total assets amounted to NT$1,230.1 billion, which accounted for 4.85% of the total assets of all banking institutions in Chinese Taipei. Their total deposits stood at NT$843.1 billion and their total loans extended at NT$773.7 billion, accounting for 4.58% and 5.24% respectively of the aggregate deposits and loans of all banking institutions in the domestic market. Taken from Ministry of Finance of Chinese Taipei (2002a).

An additional policy for supporting microbanking among some APEC economies has to do with preferential or special tax regimes. In the Philippines, credit cooperatives with accumulated reserves and undivided net savings of no more than 10 billion pesos shall be exempt from all national, city, provincial, or municipal taxes of whatever name and nature. They shall also be exempt from customs duties, advance sales or compensating taxes on their importation of machinery, equipment and spare parts used by them and which are not available locally (as certified by the Department of Trade and Industry).

Similarly, in Chinese Taipei credit cooperatives and the credit departments of farmers and fishermen's associations are subject to tax exemption. In Thailand, clients who use the BAAC's Thawisin Card Deposit or buy Savings Premium Certificates from the Government Savings Bank are tax-exempt. Interest paid to members of financial cooperatives are also tax exempt.

TEXT BOX 4.6.2.1: THE US TREASURY "FIRST ACCOUNTS" PROGRAM

On 27 December 2001, the Treasury Department issued a Notice of Funds Availability (NOFA) for the "First Accounts" program, which seeks to increase the number of Americans who receive basic account services from insured financial institutions. Official sources estimate that up to 40 million Americans do not use mainstream banking services.

The amount available is approximately US$8 million to fund projects that can serve as models to connect unbanked low- and moderate-income individuals to mainstream financial services. A wide variety of entities are eligible to apply for the grants - such as employers, financial services electronic networks, insured depository institutions, labor organizations, local governments, non-profit organizations, and states.

The paramount goal of First Accounts is to move a maximum number of unbanked low- and moderate-income individuals to a banked status with either an insured depository institution or an insured credit union through the development of financial products and services that can serve as replicable models in meeting the financial services needs of such individuals. Additional goals include the provision of financial education to unbanked low- and moderate-income individuals to enhance the sustainability of the new financial relationships. We will also undertake research to evaluate the success of the funded projects and to understand what products, services, educational initiatives, marketing techniques or incentives are needed.

According to Treasury Assistant Secretary for Financial Institutions, Sheila Bair, there are at least three benefits to being banked:

> "First, increased safety and security - Carrying large amounts of cash is dangerous. Keeping cash at home is risky.
>
> Second, lower financial transaction costs - The costs of financial transactions outside the banking system are high. Recent Treasury research indicates that a minimum wage worker can pay an average of US$18 per month for cashing paychecks at a check casher. A Social Security recipient would pay an average of US$9 to US$16 a month to cash his or her risk-free government check.
>
> And, third, the opportunity to build a promising future - It is difficult to participate in the mainstream economy without a checking account. It is more difficult to establish a sound credit record, qualify for a car loan, obtain a home mortgage, and receive a small business loan. Bank accounts can help families to save and manage their money."

Sources: Bair (2002) and Fisher (2002).

A valuable lesson on which indirect government policies are appropriate can be drawn from the case of the Philippines. There, authorities focused on the creation of an enabling policy environment and legal and regulatory framework for the establishment and growth of sustainable MBIs.

Interest rate deregulation in the early 1980s and relaxation of bank entry and branching in the early 1990s stimulated an increase in the number of rural banks whose locations, small sizes, and lower minimum capital requirements made them well suited to provide microbanking services. This rapid expansion of the banking system led to the introduction of innovative financial products and expanded the outreach of financial institutions to include untapped smaller clients.

Gradually, government financial institutions were transformed to wholesale lending institutions using private financial institutions (including banks, credit cooperatives, and financial NGOs) as retail conduits. The government also boosted MBIs operations by enabling them to avoid undue competition through the abolition of subsidized credit programs.[127] Executive Order No. 138 (issued in 1999) transferred all credit programs to government financial institutions by 2002, mandated the use of market interest rates in pricing loans, and directed the optimum use of private retail outlets as conduits. In 2002, the General Banking Act was amended, providing a more appropriate regulatory and supervisory framework for micro-finance activities.

CONCLUSIONS

As seen in this study, experiences of APEC member economies with microbanking are rather heterogeneous, especially in terms of the complexity and outreach of existing intermediaries, the regulatory and supervisory frameworks in place, and the current issues facing the business in each economy.

However, for all economies considered, regardless of how developed they are, microbanking activities are or have been significant, whether as part of an integral national strategy for poverty reduction and social safety net building (China, Indonesia, Mexico, Peru, Philippines, and Thailand), or as a mechanism to address the needs of specific economic or social sectors of the population (Korea, Malaysia, Papua New Guinea, and United States). In most APEC industrialized economies, microbanking has evolved over time and it is now a substantial component of the domestic financial system (Australia, Canada, Chinese Taipei, New Zealand and the United States). However, the financial exclusion resulted from the withdrawal of conventional banking services from some geographic areas or social groups in developed member economies calls for the application of some of the well-established models of microbanking to improve the situation.

In many of the less-developed APEC economies, microbanking has truly gained relevance in recent years as a tool to abate poverty. The number of governmental agencies and institutions engaged in microbanking activities across the region has grown steadily over the past few years, coupled with increased activity by the non-governmental development community.

A striking feature common to virtually all economies considered is the presence of a long-standing, albeit in some cases neglected, microbanking sector, typically composed of credit unions and financial cooperatives, some of which date as far back as the nineteenth century. However these institutions have followed very different paths in each member economy, primarily depending upon how successful the industry has been in achieving long-term sustainability, as well as how effective the authorities have been in creating linkages with the rest of the financial system.

For this reason, major differences arise when comparing a given category of microbanking intermediaries across economies. In Canada, and the United States, for instance, credit unions and cooperatives serve large number of clients and compete on equal grounds with commercial banks. Conversely, in developing member economies, such as Indonesia, Mexico, Peru, and the

[127] Gil Beltrán, (2002).

Philippines, credit unions and cooperatives are still engaged in small-scale financial operations without having truly developed as a competitive financial intermediary.

The need for an effective regulatory and supervisory framework for microbanking activities has become a crucial issue for most economies. A number of them are currently in the process of reforming their regulatory and supervisory frameworks in order to foster the microbanking sector. Among these Chile, Indonesia, Mexico, Papua New Guinea, and the Philippines stand out. However, fragmentation and a lack of consistent strategies are currently commonly observed in the less developed economies, although it is not a problem exclusive to them.

Considering the different institutional paths existing in each APEC economy, there is no single approach on how to enhance the effectiveness of the regulatory and supervisory framework. However, there is agreement that government action should be aimed at creating an enabling policy environment and a legal and regulatory framework for the growth and expansion of sound and sustainable microbanking intermediaries, fostering their gradual and full integration into the domestic financial system. Hence, it is particularly relevant that the strategy for developing microbanking intermediaries is inscribed within a broader set of policies for the financial system. In this sense, financial authorities should participate actively in devising appropriate policies for this sector.

In order to face these challenges, authorities are pressed to move from direct interventions through subsidies and financial repression—which have consistently failed to achieve long-term sustainability—to more subtle indirect interventions aimed at addressing market imperfections and setting an appropriate institutional infrastructure. They would includes, for instance, improving credit bureaus, fostering the adoption of best practices, improving risk management through the use of rating agencies and specialized assessment firms, developing deposit insurance schemes, etc.

Microbanking institutions, in turn, face the need to improve the way they have been operating over their past few years, without continuing to rely extensively on subsidies and donors' funds for their survival. Microbanking has proven to be an attractive industry for many individual and institutional investors, so tapping into new private funding has become a crucial aspect for microbanking.

In sum, the experience reviewed in this study shows that the APEC region is at the forefront of the microbanking industry. Whether as an integral part of the financial system in the most industrialized economies, or as an incipient industry with great potential among the less developed economies, the vast array of microbanking experiences in the APEC region offer a formidable lesson of how relevant the industry has become for economic development, and ultimately for improving living standards in our societies.

This richness and variety of experience in microbanking suggests the value of increased attention to information exchange and collaboration within the processes of APEC, wherever there are opportunities for synergy. Thus at the recent SME Ministerial Meeting in Acapulco, 'Ministers instructed the SMEWG to coordinate, through its new sub-group, work with all APEC fora and sub-fora involved in issues pertaining to micro-enterprises development…' Issues of financing were among those noted by Ministers as appropriate for collaboration.

Further, the APEC High Level Meeting on Micro-enterprises, on 18 July 2002 in Mexico, concluded that '[a] number of APEC Committees and Working Groups could be invited to give specific attention to the role of micro-enterprises in their respective areas of activity. There are evident links to the Economic Committee's preparation of a chapter on 'specialised' financial institutions' in the *2003 APEC Economic Outlook*. The financial sector work could be expanded, to the benefit of developed economies, to include the study of financial institutions designed to overcome the financial exclusion of the poor in such economies.

BIBLIOGRAPHY

Abdullah, Burhanuddin, 2001. “Central Bank and its Place in Microfinance Development. A case of Indonesia.” Paper presented at the plenary session of The Asia Pacific Microcredit Summit Meeting, New Delhi.

Asian Development Bank, 2000a. “Finance for the Poor. Microfinance Development Strategy”, online, Asian Development Bank, internet, July 7th, 2002.

__________, 2000b. *The Role of Central Banks in Microfinance in Asia and the Pacific. Overview*, Asian Development Bank.

Australian Bureau of Statistics, 2002, Average Weekly Earnings, Australia, February 2002.

Australian Treasury, 2002. *Credit Unions in Australia*. Paper submitted for the APEC Policy Paper on Microbanking Development, Regulation and Supervision, Sydney.

Bair, Sheila C., 2002. “Remarks for Financial Institutions before Multilateral Investment/Inter-American Development Bank.” Second Regional Conference on Impact of Remittances as a Development Tool, Washington, D. C.

Bank of Korea, 2002 “Answer to the Template for the APEC Policy Paper on Microbanking Development, Regulation and Supervision”, Seoul.

Bansefi/CNVB (National Savings and Financial Services Bank/National Banking and Securities Commission), 2002 “Answer to the Template for the APEC Policy Paper on Microbanking Development, Regulation and Supervision.” Mexico.

Berenbach, Shari and Craig Churchill, 1997. “Regulation and Supervision of Microfinance Institutions: Experience from Latin America, Asia, and Africa”, Occasional Paper, No. 1, Microfinance Network, Washington, D. C., cited by Joanna Ledgerwood, 1999. *Manual de microfinanzas. Una perspectiva institucional y financiera*, Washington, D. C.: Banco Mundial.

Carruthers, Flora, 2002. “The Case of Papua New Guinea.” Presented at the 2002 APEC Economic Committee Symposium on Microbanking Development, Regulation, and Supervision in the Asia Pacific Region, Mexico.

Conroy, John, 2000. “Indonesia,” in The Role of Central Banks in Microfinance in Asia and the Pacific: Vol. 2, Country Studies, Asian Development Bank.

Consultative Group to Assist the Poor, 2001a. *Resource Guide to Microfinance Assessments,* Focus Note No. 22. Washington, D. C.

__________, 2001b. *Focus on Financial Transparency: Building the infrastructure for a microfinance industry*, Focus Note No. 22. Washington, D. C.

Christen, Robert Peck and Richard Rosenberg, 2000. “The Rush to Regulate: Legal Frameworks for Microfinance.” *CGAP Occasional Paper,* No. 4. Washington, D. C.

Credit Union Central Canada, 2002. “Deposit Insurance.” “[http://www.cucentral.ca/Public/whycu/insurnce/content/insurnce.htm]

Cunningham, Gord, 2000. “Microfinance: Flavor of the Month or Practical Development Alternative?” Conference presented at the Yukon Economic Forum: Ideas Summit, Whitehorse, YT.

Desjardins, 2002, *Financial Results for the First Quarter of 2002*, Press Release.

Department of Finance of Canada, 2000. “Canada's Credit Unions and Caisses Populaires. The Canadian Financial System.”[http://www.fin.gc.ca/toce/
2000/ccu_e.html#Overview]

Department of the Treasury of the United States, Office of Public Affairs, 2002.

Department of Social Welfare and Development of Papua New Guinea’s webpage, http://www.pngfamilies.gov.pg/ngo.html

Dunlop, Celia, 2002, Strategic Communications Advisor, Ministry of Women’s Affairs, New Zealand, March 2002.

Else, John, 2001. “Microenterprise Development in the U. S.: Is there a case for Public Support? In The Role of Microenterprise Development in the United States. Association for Enterprise Opportunity: Arlington, Virginia.

Fernando, Nimal, 2002, “Trends in the Asian Microfinance Industry”, Finance for the Poor, Quarterly Newsletter of the Focal Point for Microfinance, Vol. 3, No. 2, Regional and Sustainable Development Department, Asian Development Bank, June 2002.

Fischer, Klaus P., “Deposit Insurance and Moral Hazard in Financial Cooperatives”, March 2002.

Fisher, Peter R., 2002. “Remarks Before the Credit Union National Association’s 2002 Governmental Affairs Conference Enhancing Financial Understanding.” Washington, D. C.

Fitzgerald, Thomas and Vogel, Robert, “Moving Towards Risk-Based Supervision in Developing Economies”, Consulting Assistance on Economic Reform II, *Discussion Paper* No. 66, May 2000.

Goetz, A. M. and R. S. Gupta, 1996. “Who Takes the Credit? Gender, Power, and Control Over Loan Use in Rural Credit Programs in Bangladesh,” *World Development* 24(1): 45-63, Washington, D. C.

Government of Chile, 2002. “Answer to the Template for the APEC Policy Paper on Microbanking Development, Regulation and Supervision.” Santiago.

Government of The People’s Republic of China, 2002. *Microbanking in China*. Paper submitted for the APEC Policy Paper on Microbanking Development, Regulation and Supervision, Beiging.

Government of Japan, March 2002.

Government of Malaysia, 2002. “Answer to the Template for the APEC Policy Paper on Microbanking Development, Regulation and Supervision.” Kuala Lumpur.

Government of Peru, 2002. “Answer to the Template for the APEC Policy Paper on Microbanking Development, Regulation and Supervision.” Lima.

Government of the Philippines, 2002. “Answer to the Template for the APEC Policy Paper on Microbanking Development, Regulation and Supervision.” Manila.

Government of Chinese Taipei, (2002a), Microbanking in Chinese Taipei.

Government of Chinese Taipei, (2002a), “The Reform of Chinese Taipei’s Community Financial Institutions”.

Haider, Elinor, 2000. “Credit Bureaus: Leveraging Information for the Benefit of Microenterprises.” *Microenterprise Development Review* 2(2): 1,5-8, Washington, D. C.

Hanning, Alfred and Gabriela Braun, 2000. “How to regulate and supervise microfinance?” In Alfred Hannig and Edward Katimbo-Mugwanya, eds., *How to regulate and supervise microfinance? Key issues in an international perspective*. Kampala: Bank of Uganda - German Technical Co-operation Financial System Development (FSD) Project.

Hanrath, Alexander, “Banks see a Big Future for Micro-Finance”, *Companies & Finance International*, Financial Times, June 25th, 2002.

Inter-American Development Bank, 2001. *2001 Report Economic and Social Progress in Latin America Competitiveness: The Business of Growth*, Washington D. C. Inter-American Development Bank.

Jansson, Tor F. and Mark Wenner, 1997. *Financial Regulation and its Significance for Microfinance in Latin America and The Caribbean.* Inter-American Development Bank, Washington, D.C.

Jansson, Tor F., ed., 1998. “Microfinance Guarantees: Is There Another Model?” *Microenterprise Development Review* 1(2): 1-4, Washington, D. C.

Jansson, Tor, 2001. *Microfinance: From Village to Wall Street*, Washington, D. C.: Inter-American Development Bank.

Ledgerwood, Joanna, 1998. *Microfinance handbook: an institutional and financial perspective (Sustainable banking with the poor)*, Washington D. C.: World Bank.

Lombard, Cédric and Jean-Philippe de Schrevel, 2001 “Obstacles met by a commercial investor in micro-finance”, presented at the IV Inter-American Forum on Microenterprise, Washington, D. C.

Lucano, Fernando and Miguel Taborga, 1998. *Tipología de Instituciones Financieras para la Microempresa en América Latina y el Caribe*, Washington D. C.: Inter.-American Development Bank.

Mayo, Ed and Andy Mullineux, 2001. *Bootstraps or Braces? The Regulation of Community Development Finance Institutions*, United Kingdom: University of Birmingham.

Mellick, William, 2002. *U.S. Regulation of Microenterprise Development (MED) Programs*, U. S. Council of Economic Advisor, Washington, D. C.

Ministry of Finance of Canada, 2001. “Caisse Centrales Desjardins.” Presentation prepared by the Ministry of Finance of Canada.

Ministry of Finance of Chinese Taipei, 2002a. *Microbanking in Chinese Taipei.* Paper submitted for the APEC Policy Paper on Microbanking Development, Regulation and Supervision, Taiwan.

__________, 2002b. *The Reform of Chinese Taipei's Community Financial Institutions.* Paper submitted for the APEC Policy Paper on Microbanking Development, Regulation and Supervision, Taiwan.

Ministry of Finance of Thailand, 2002a. *Microcredit/Microbanking for Economic Development: Thailand's Experience.* Paper submitted for the APEC Policy Paper on Microbanking Development, Regulation and Supervision, Bangkok.

__________, 2002b. "Answer to the Template for the APEC Policy Paper on Microbanking Development, Regulation and Supervision." Bangkok.

Mortlock, Geof, 2002. *Microbanking: Some Perspectives from New Zealand,* Economics Department, Reserve Bank of New Zealand.

National Credit Union Administration, 2000, *Your Insured Funds*, Washington, D.C., 2000.

__________, 2002. "National Credit Union Share Insurance Fund." [http://www.ncua.gov/about/ncusif.html].

Pearl, Daniel and Michael Phillips, 2001. "Grameen Bank, which pioneered loans for the poor, has hit a repayment snag," *The Wall Street Journal*, November 27.

Ratcliffe, Robin, 2002. "Empowering woman." Article excerpted from the Meet the Challenge Sessions entitled "Adopting Policies that Ensure Microcredit Programs Empower Women, both Staff and Clients." [http://www.microcreditsummit.org/newsletter/best5.htm]

Rogaly, B, T. Fisher, and Ed Mayo, 2000. *Poverty, Social Exclusion and Microfinance in Britain*, New Economics Foundation.

Sen, Amartya, 1999. *Development as Freedom*. New York: First Anchor Books Edition.

Sukarno, Imam, 1999. "The Case of Indonesia." In Alfred Hannig and Edward Katimbo-Mugwanya, eds., *How to regulate and supervise microfinance? Key issues in an international perspective*. Kampala: Bank of Uganda - German Technical Co-operation Financial System Development (FSD) Project.

__________, 2000. "Policy and the Regulatory Environment for Microfinance in Indonesia with Special Reference to Rural Banks (Bank Perkreditan Rakyat)." Paper presented at the Regional Workshop on Microfinance for East Asia and the Pacific, Manila.

The Economist, (2002). "Microcredit in Bangladesh," May 11th.

Von Stauffenberg, Damian, 2001. "How Microfinance Evolves: What Bolivia Can Teach Us," *Microenterprise Development Review* 4(1): 1-7, Washington, D. C.

Westley, Glenn D., 2000. "Reform and Rehabilitation of Credit Unions, A Way to Expand Microfinance," *Microenterprise Development Review* 2(2): 1-5, Washington, D. C.

__________, 2001. *Can Financial Market Policies Reduce Income Inequality?* Sustainable Development Department Best Practices Series, Washington, D. C.

Wilhelm, Ursula, 2002. Identificando los Principales Riesgos en las Microfinanzas, Standard & Poor's, América Latina, México.

Wilhelm, Ursula and Tomas Deimel, 1999. Thomas, "BancoSol, S.A.", *Análisis de Calificación de Bancos*, Standard & Poor's.

World Bank, 2001a. *World Development Report 2000/2001:Atacking Poverty*, New York: Oxford University Press.

__________, 2001b. *Finance for Growth. Policy Choices in a Volatile World*. Policy Research Report. New York: Oxford University Press.

__________, 2002a. "The Development of Sustainable Microfinance in East-Asia and Pacific (EAP)" 28 June. [http://www.worldbank.org/devforum/forum_mfi.
html]

__________, 2002b. World Development Report 2002: *Building Institutions for Markets*, New York: Oxford University Press.

Zavala, José Miguel, 2002a. "La Experiencia Microcrediticia Chilena." Presented at the 2002 APEC Economic Committee Symposium on Microbanking Development, Regulation, and Supervision in the Asia Pacific Region, Mexico.

__________, 2002b. Comments to the draft of the Structural Chapter for the APEC Economic Outlook. Paper submitted for the APEC policy Paper on Microbanking Development, Regulation and Supervision, Chile.

APPENDIX AI

INDICATORS OF A KNOWLEDGE-BASED ECONOMY

Introduction

This chapter presents sets of quantitative indicators in an attempt to capture the general stage of development of APEC member economies relative to a fully developed knowledge-based economy (KBE) and the economies current potential to become a KBE.

A set of such indicators was presented in the Economic Committee's report *Towards Knowledge-based economies in APEC* of November 2000 (the "KBE report"). That report recommended that "KBE Status Indicators (KSIs) be included in the annual APEC Economic Outlook publication". APEC Ministers encouraged the Economic Committee to pursue this recommendation. This chapter therefore presents updated data for the indicators used in the KBE report.

What is a Knowledge-Based Economy?

The term "knowledge-based economy" refers to essentially the same thing as the wide sense of "new economy" used in the Economic Committee's report *The New Economy and APEC*, of October 2001.

A *knowledge-based economy* is an economy in which the production, distribution, and use of knowledge is the main drivers of growth, wealth creation and employment across all industries. In this context, being a KBE means more than simply having a thriving "new economy" or "information economy" somehow separate from a stagnant "old economy". In a true knowledge-based economy, all sectors have become knowledge-intensive, not just those usually called "high technology".

Recent work by the OECD[1] confirms that economic growth is most sustainable for those economies strong in the four policy dimensions identified in *Towards KBEs in APEC*. 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 private sector institutions whose activities and interactions initiate, import, modify, and diffuse new technologies and practices).

2. *Human resource development*
   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 ('life long learning').

3. *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 enterprises operating in the economy.)

Presentation of Indicators

The characteristics of a range of APEC member economies relating to their KBE status are summarised here through the economy charts in Figure A.1. Charts are presented for all those

---

[1] OECD , *The New Economy- beyond the hype* (Paris, 2001)

economies for which a reasonably high proportion of these indicators are available (17 economies in all). Details of the indicators used are given in Table A.1 and Table A.2. For all the indicators used, bigger values are "better" (economy is more like a KBE).

The indicators are divided into groups corresponding to the four key dimensions of a KBE listed above, namely business environment, ICT infrastructure, innovation system, and human resource development. This presentation emphasises the overall message of a group of related complementary indicators, such as those for innovation systems. While each indicator in the group gives only a partial impression of an innovation system, the group as a whole gives an overall impression which is appropriate for the qualitative comparison between groups of countries, which is the focus of this study.

In the charts, each indicator is scaled against a reference value for that variable, so that the disparate numerical values can all be fitted onto a common scale. The reference value is in fact the OECD average value for that indicator, so that the value 1.0 represents the OECD average value for each indicator.[2] The hatched bar(s) in the chart represent values greater than 2.0, as indicated on the chart; symbol "X" represents a missing value (as distinct from a numerically small value).

With one exception, the data is for the latest year for which comparable data is available across APEC economies. Table A.2 shows the year in which each variable was measured (as distinct from published) and the reference value (so that readers can work back to the numerical values)[3]. Most of the data is for 2000 or 2001, and thus gives a reasonable comparative representation of the present situation. The exception is in ICT, where uptake rates are especially rapid. To give some measure of this, one measure (internet access) is shown for 1999 and 2001, with the same reference value being used for both years, so that the relative size of the two bars reflects actual growth.

Choice of indicators

As discussed in the KBE report, the indicators were chosen to give a roughly equal number of indicators in each dimension. Within each dimension there is an attempt to represent the four phases of knowledge creation, acquisition, dissemination and use, so that the indicators complement rather than duplicate each other.

However, the choice of indicators is somewhat constrained by the availability of data – especially in a form comparable across APEC economies. The principal sources of such publicly collated data are the World Bank, the World Competitiveness Yearbook (WCY) and the OECD. Both the first two obtain many of their indicators already collated by specialist UN agencies such as UNESCO. Although the OECD compiles a wide range of indicators relating specifically to KBEs [4], they do not cover all APEC countries. Survey data such as that in the WCY have limitations due to sample selection and size, and are not officially endorsed by APEC economies. However, it is a useful and accessible source of comparable data.

We have *not* attempted to calculate a single composite index of "KBE status", because we believe that the differing pictures created by the various groups of indicators (which do not always correlate tightly with one another) gives more valuable insights than a single index for which

[2] The reference value shown on the charts is the simple (unweighted) average across all (or most) OECD countries, not only those which are also members of APEC. It is intended as a reference value, one which is independent of the sample set.
[3] Tables of numerical values are available on request from the APEC Secretariat.
[4] Particularly pertinent OECD publications are *Science Technology and Industry Scoreboard* (every two years, latest edition is 2001) and *Education at a Glance* (annual, latest edition is 2001).

characteristics need most attention by particular economies. Also, it is not at all obvious when weightings should be given to the various partial indicators in constructing a composite index.

Comment

The broad picture of the KBE status of APEC economies that emerges from the data presented here is similar to that presented in the KBE report of 2000 (which uses data mostly from 1997), although the ICT dimension has evolved more rapidly than the others.

All of the most developed members of APEC are already well on the way to being knowledge-based economies, as indicated by the proportion of current economic activity in those economies that is in some sense “knowledge intensive”. Over 30 percent of their workforce can be classed as “knowledge workers”[5] and over 30 percent of their GDP comes from “knowledge-based industries”[6]. The US is by far the largest economy in APEC and is still one of the most thriving “new economies”, even after the collapse of the “dot-com boom” (though the data here mostly antedate that collapse). On several indicators it ranks way above the reference level (the OECD average).

The indicators for the other more developed economies (including the high performing Asian economies) mostly cluster around the OECD average (1.00 on the vertical scale). This is closely related to the explicit and well resourced national strategies of Korea, Singapore and Chinese Taipei to become KBEs, a “natural” evolution from the industrial strategies they have successfully pursued. The experience of the High Performing Asian Economies suggests that wider and deeper education is the key precondition before the other aspects can take off.

The indicator profiles of the asian fast-growing economies and the Latin American Economies in Figure A.1 are broadly similar to each other, but markedly different from the most developed economies and the high performing Asian economies. In particular, they lag behind significantly in ICT infrastructure, human resource development and in indicators of the innovation system. Malaysia’s ICT indicators are notably higher than any other country in either group, reflecting a strong policy thrust in this field.

The indicator “Exports of high technology products” is particularly high for Philippines, Thailand, Mexico, Singapore and Korea. However, this is somewhat deceptive since only in the latter two economies is substantial value added to these electronic products.[7] Foreign direct investment (FDI) is particularly high in both Singapore and Chile, as a consequence of conscious policy decisions to put the relevant framework policies in place.

In many economies, three business environment indicators, namely “financial institutions’ transparency” and “openness to domestic and international competition” have improved markedly

[5] As in the KBE report, we classify as a ”knowledge worker” anyone whose occupation is reported to the International Labour Organisation (ILO) as falling into any of the following categories: managers and senior government officials, professional workers, or “associate professionals”. This definition is identical to what OECD (*Technology, Productivity and Job Creation*, 1998) refers to as “skilled white-collar workers”. A major advantage of this indicator is that ILO Statistical Yearbooks yield a data set which gives reasonably comparable and readily available information for most APEC (and other) economies over several decades. See Appendix 2 of the KBE report for further detail.

[6] Following OECD *Science Technology and Industry Scoreboard* (2001) we group high-tech and medium-high-tech manufactures, together with health and education, financial and other business services, and communications services as “knowledge-based industries”. This definition is more refined (i.e. narrower) than that used by OECD in earlier work, and in particular than that taken across to the APEC KBE report of 2000.

[7] For this reason, value-added or net exports of “high technology” manufactures would be a better measure, but is not readily available.

since the 1997 survey reported in the KBE report, although there is still scope for improvement in several economies.

Table A.1: Specification of Indicators for the Economy Scorecards.

Indicator	**Significance for KBE**	**Details**
Business environment		
KBIs	Indicates current status as a KBE	Value added by "knowledge-based industries" as percentage of GDP. (KBIs as defined by OECD 2002 Scoreboard - see text). Not available for all countries. *(a)*
Exports of Services	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 services)	As percentage of GDP. Commercial services includes transportation, travel, other private services and income. Data are not always fully comparable across countries. *(b)*
High Tech Exports	Indicator of knowledge intensity of manufacturing.	As percent of GDP. World Bank data give percentage of mfg exports. Converted to percentage of GDP using UN Trade data. "high tech" covers any product from certain sectors (similar to but not identical to those called "high tech" by OECD). *[c]*
Foreign Direct Investment (FDI)	Indicates investor confidence in economy. Also indicate of openness to outside influence (and knowledge).	As a per cent of GDP. *(d)*
Government Transparency (Rating)	Indicates clarity of policy and (to lesser extent) absence of cronyism - both needed by a KBE	WCY Survey. Scale 1-10. "The government communicates its policy intentions clearly" = 10. *(e)*
Financial Institutions' Transparency (Rating)	Without reasonably high rating, outside investment is deterred	WCY, scale 1-10. (10= "financial institutions provide adequate information about their activities") *(e)*
Competition Policy (Rating)	Competition encourages innovation	WCY. (10= " govt policy prevents unfair competition in this economy") *(e)*
Openness (Rating)	Openness to outside goods and services indicates openness to outside ideas	WCY Survey. Scale 1-10. "National protectionism does not prevent foreign products and services from being imported" = 10. *(e)*
ICT infrastructure		
Mobile Telephones (per 1,000)	Indicator of new technology take-up.	Number of mobile telephones in use per 1,000 inhabitants. *(f)*
Telephone Mainlines (per 1,000)	Primary indicator of domestic telecommunications capacity	Number of telephone mainlines in use per 1,000 inhabitants, *(f)*
Computers per capita	Indicates take-up of new ICT by business and broader community	Number of computers (PCs, mainframes, etc) per thousand inhabitants *(g)*
Internet users p.c.	Indicates take-up of new ICT by business and broader community. Indicative of ability to engage in e-commerce & modern information collection and dissemination.	Number of internet users, per 1,000 inhabitants *(g)*.
E-commerce	Indicates extent to which traditional industries are adapting to the digital economy	Internet commerce (B2B +B2C) as a percentage of total commerce (WITSA)

Indicator	Significance for KBE	Details
Innovation system		
Researchers p.c.	Indicates potential to create new (technical) knowledge	Stock of researchers per million of the population. *(h)*
GERD/ GDP	Indicates current effort to create new (technical) knowledge	Gross annual expenditure on R&D, i.e. BERD + public expenditure on R&D (as percentage of GDP). (*h*)
BERD /GDP	Commitment by enterprises to knowledge creation	Business annual expenditure on R&D as a percentage of GDP. *(h)*
Patents awarded in US p.a., p.c.	Industries which patent extensively mostly do so in US (a major technology market) as well as at "home"	Number of US Patents awarded in specified year to residents of specified economy (per million population). *(i)*
Intercompany co-operation (rating)	Partial indicator extent of knowledge networks	WCY survey. Scale 1-10 (10="technological co-operation is common between companies") *(e)*
Company-university co-operation (rating)	Partial indicator extent of knowledge networks	WCY survey. Scale 1-10. (10="knowledge transfer is sufficient between companies and universities*") (e)*
Human resource development		
Secondary Enrolments	Potential for skilled workforce in the future	This UNESCO figure is the total enrolment, regardless of age, divided by the population of the official age group which corresponds to a specific level of education. *(h)*
"NSE" Graduates, *per annum, per capita*	Indicates flow of high-level technical skills into the economy	Number of new graduates in natural sciences and engineering in year specified (per million population) *(h)*
Percentage "knowledge workers"	Indicates current status as a KBE	As percentage of the labour force. Based on ILO occupational statistics - see text for details. *(j)*
Human Development Index	Broad indicator of social development; KBE cannot develop unless all components of HDI are 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 enrolments) and GDP per capita at purchasing power parity. (max value =1.000) *(k)*

Sources:

(a) OECD *Science Technology and Industry Scoreboard*
(b) WTO Annual report
(c) World Bank Development Report
(d) IMF Statistics Yearbook
(e) World Competitiveness Yearbook
(f) International Telecommunications Union
(g) World Information Technology and Services Alliance (WITSA), *Digital planet 2002 - the global information economy*
(h) UNESCO Statistical Yearbook
(i) US Patents Office
(j) Calculated from International Labour Organisation (ILO) Labour Statistics - see text (esp footnote 5)
(k) UNDP World Development Report

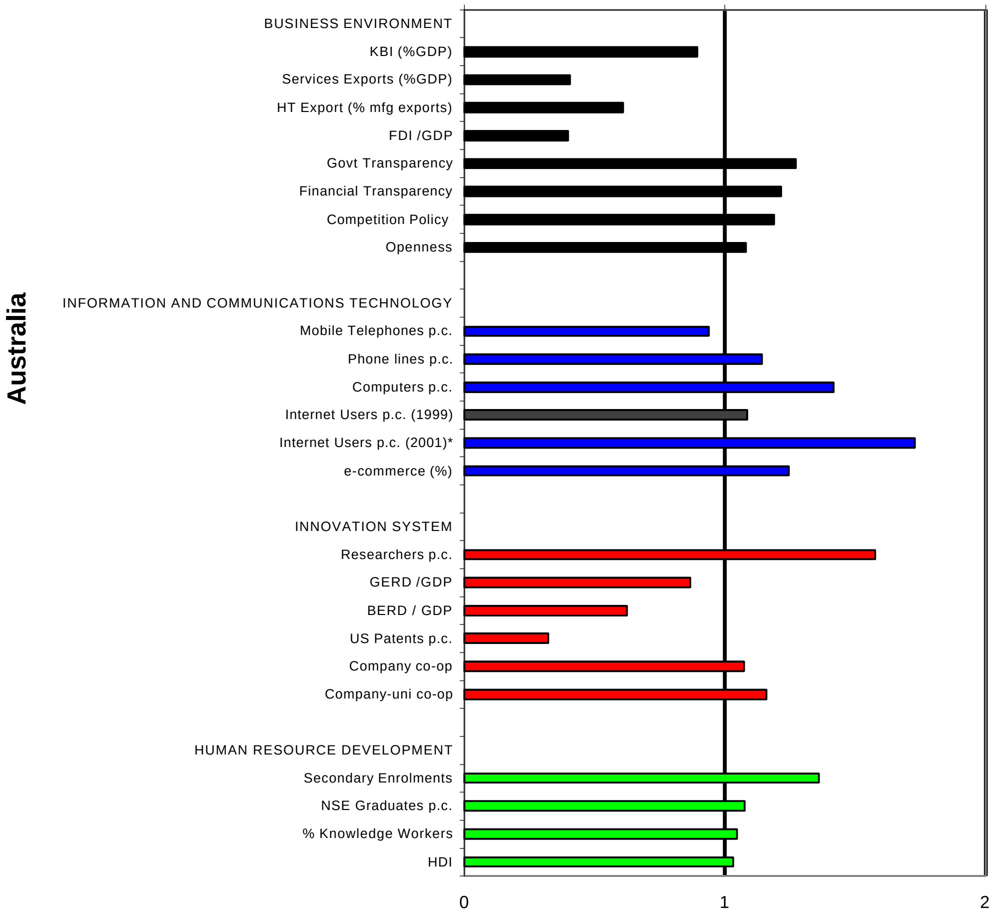
Table A.2 Data Status and Reference Values for the Charts

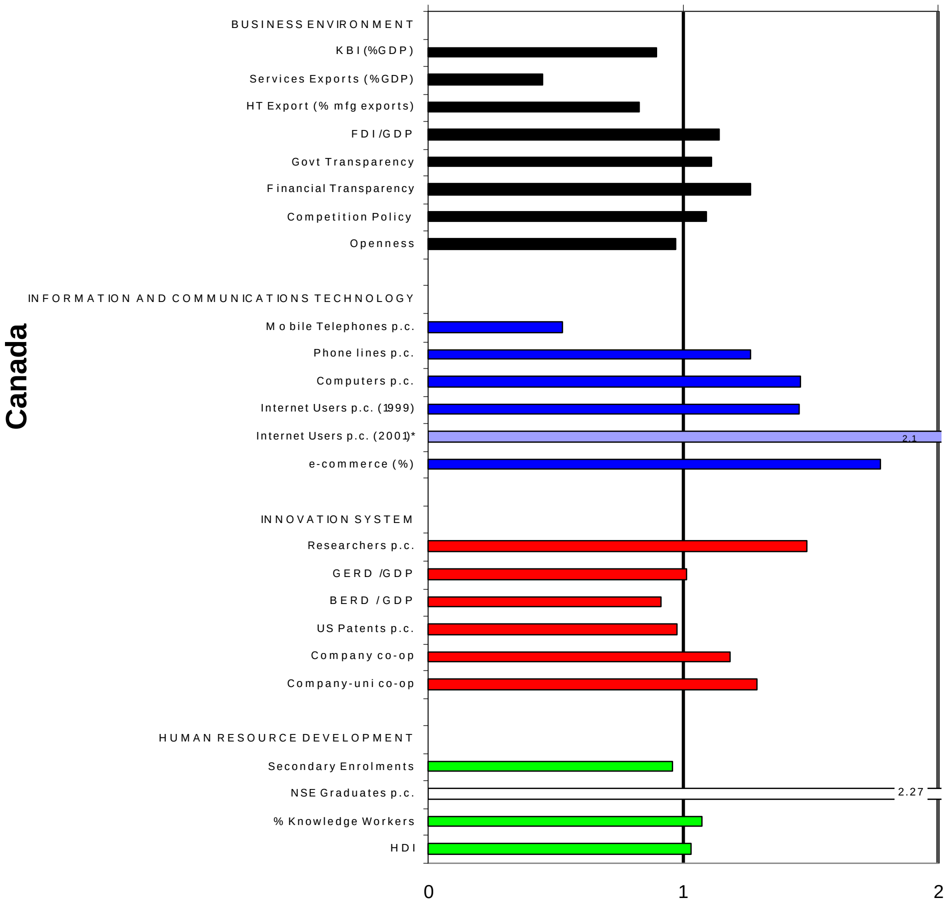
Indicator	Year	Ref.val.
Business Environment		
KBIs (% business sector VA)	1998 #	37.22
Service exports (% GDP)	2000	11.62
High Tech exports (% mfg exports)	1999	18.10
FDI/GDP (%)	2000	0.076
Government Transparency (rating/10)	2002	5.53
Financial Institutions' Transparency (rating /10)	2002	6.42
Competition Policy (rating/10)	2002	6.18
Openness (rating/10)	2002	6.98
ICT infrastructure		
Mobile phones (per '000).	2001	650
Phone lines (per '000).	2001	551
Computers (per '000)	2001	412
Internet users (per '000).	1999	26.80
Internet users (per '000).	2001	26.80
E-commerce (%)	2001	0.57
Innovation system		
Researchers (per mn)	2000	3.1
GERD/GDP (%)	2000	1.79
BERD/GDP (%)	2000	1.14
US patents (per mn)	2000	114
Inter-Company co-operation (rating/10)	2002	5.87
Company-University co-operation (rating/10)	2002	4.69
Human Resource Development		
Secondary enrolments (% of age group)	1996, #	108.7
Natural Science Graduates (per mn)	1997, #	1564
Knowledge workers (% of labour force)	Mostly 2000, some 1999	0.36
Human Development Index (max=1.00)	1999	0.91

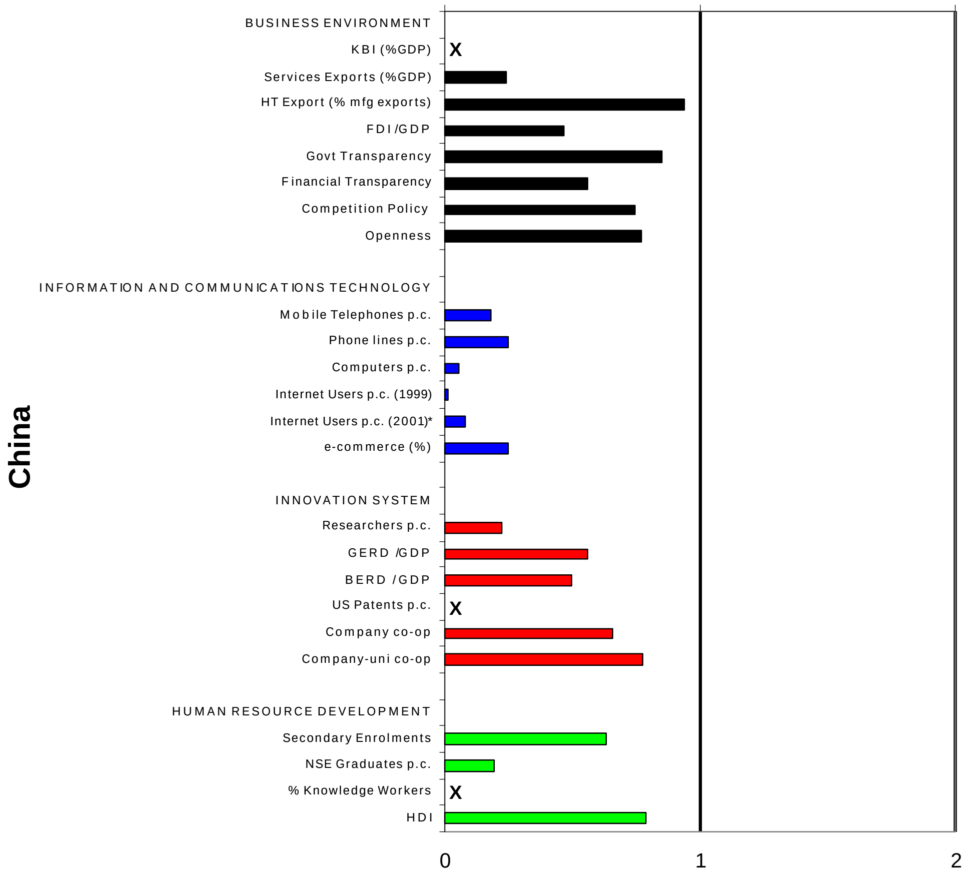
* Chart bars for "internet users (2001)" are normalised with same reference value as for 1999, so as to show growth from 1999.
# Values for Secondary Enrolments (1996) and Natural Science Graduates (1997) in Hong Kong, China have been directly supplied by that economy. Values for Secondary Enrolments and Natural Science Graduates in Chinese Taipei have been directly supplied by that economy for 2000 and 2001.

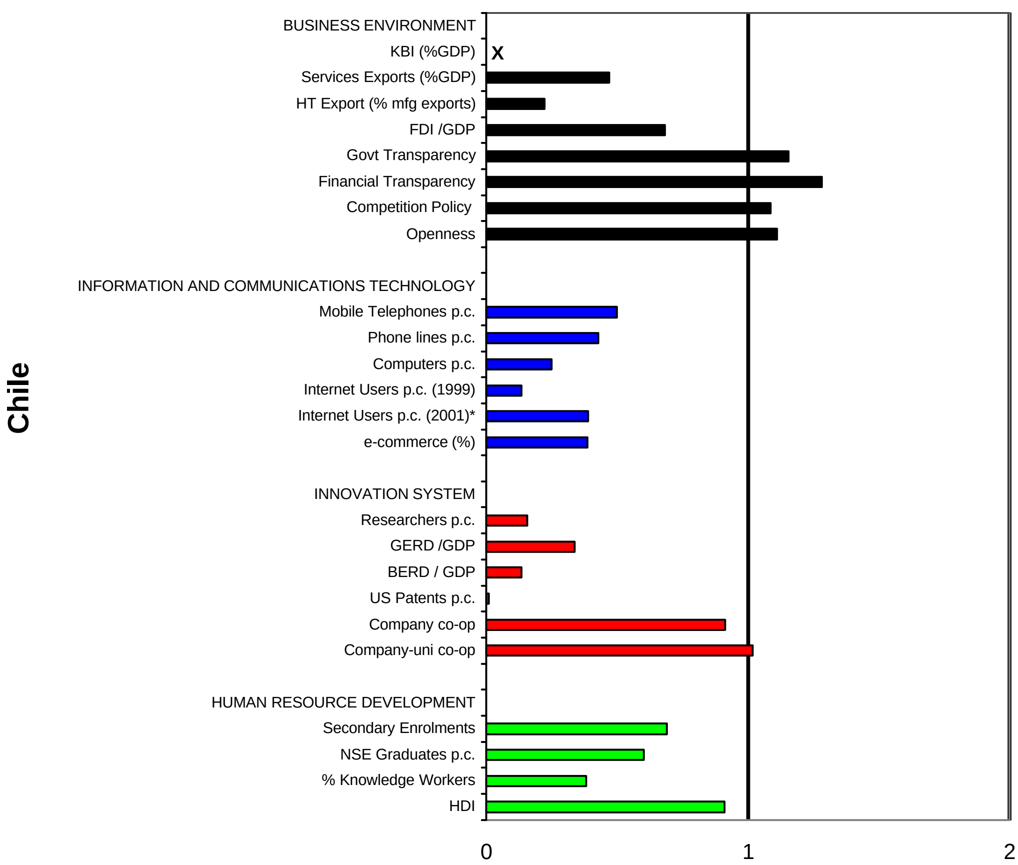
Figure A.1: KBE indicators for Selected APEC Economies (in alphabetical order).

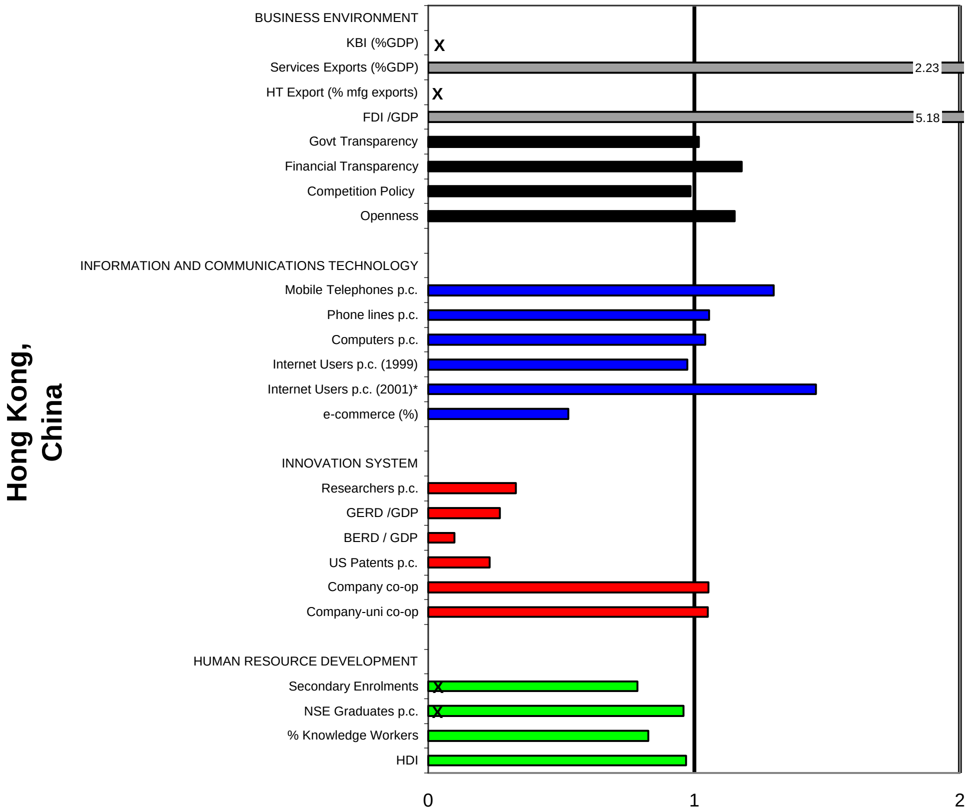
The indicators are divided into groups corresponding to the four key dimensions of a KBE described in the text, namely business environment, ICT infrastructure, innovation system, and human resource development. Each indicator is scaled against a reference value for that variable; the value 1.0 (vertical line) represents the OECD average value for that indicator. (See text and Table A.2). The hatched bar(s) in the chart represent values greater than 2.0, as indicated on the chart; symbol "X" represents a missing value (as distinct from a numerically small value). See Table A.1 for further details of indicators used.

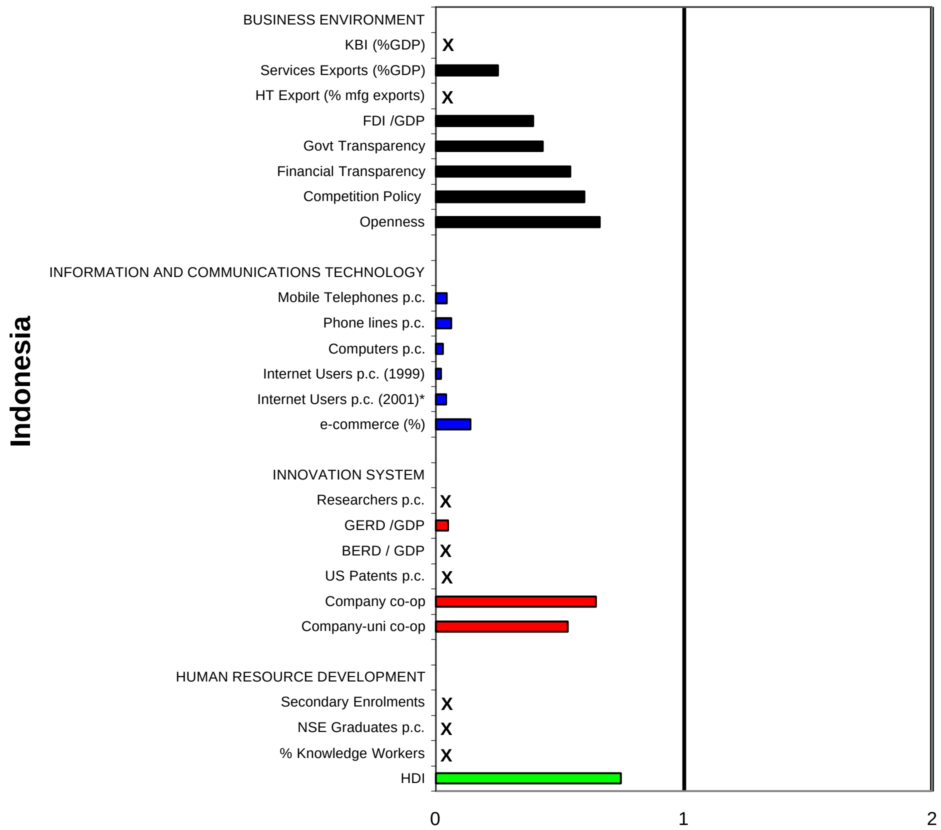

Australia
BUSINESS ENVIRONMENT
KBI (%GDP)
Services Exports (%GDP)
HT Export (% mfg exports)
FDI /GDP
Govt Transparency
Financial Transparency
Competition Policy
Openness
INFORMATION AND COMMUNICATIONS TECHNOLOGY
Mobile Telephones p.c.
Phone lines p.c.
Computers p.c.
Internet Users p.c. (1999)
Internet Users p.c. (2001)*
e-commerce (%)
INNOVATION SYSTEM
Researchers p.c.
GERD /GDP
BERD / GDP
US Patents p.c.
Company co-op
Company-uni co-op
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
NSE Graduates p.c.
% Knowledge Workers
HDI
0
1
2

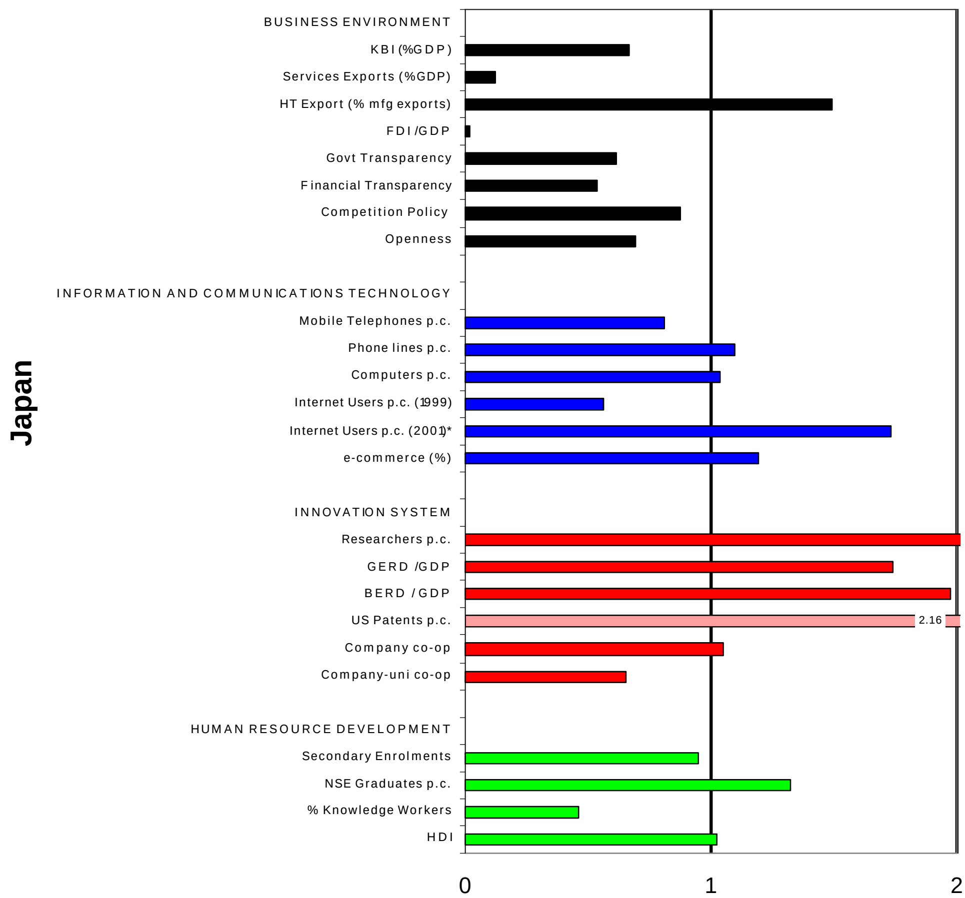

Canada
BUSINESS ENVIRONMENT
KBI (%GDP)
Services Exports (%GDP)
HT Export (% mfg exports)
FDI /GDP
Govt Transparency
Financial Transparency
Competition Policy
Openness
INFORMATION AND COMMUNICATIONS TECHNOLOGY
Mobile Telephones p.c.
Phone lines p.c.
Computers p.c.
Internet Users p.c. (1999)
Internet Users p.c. (2001)*
2.1
e-commerce (%)
INNOVATION SYSTEM
Researchers p.c.
GERD /GDP
BERD /GDP
US Patents p.c.
Company co-op
Company-uni co-op
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
NSE Graduates p.c.
2.27
% Knowledge Workers
HDI
0
1
2

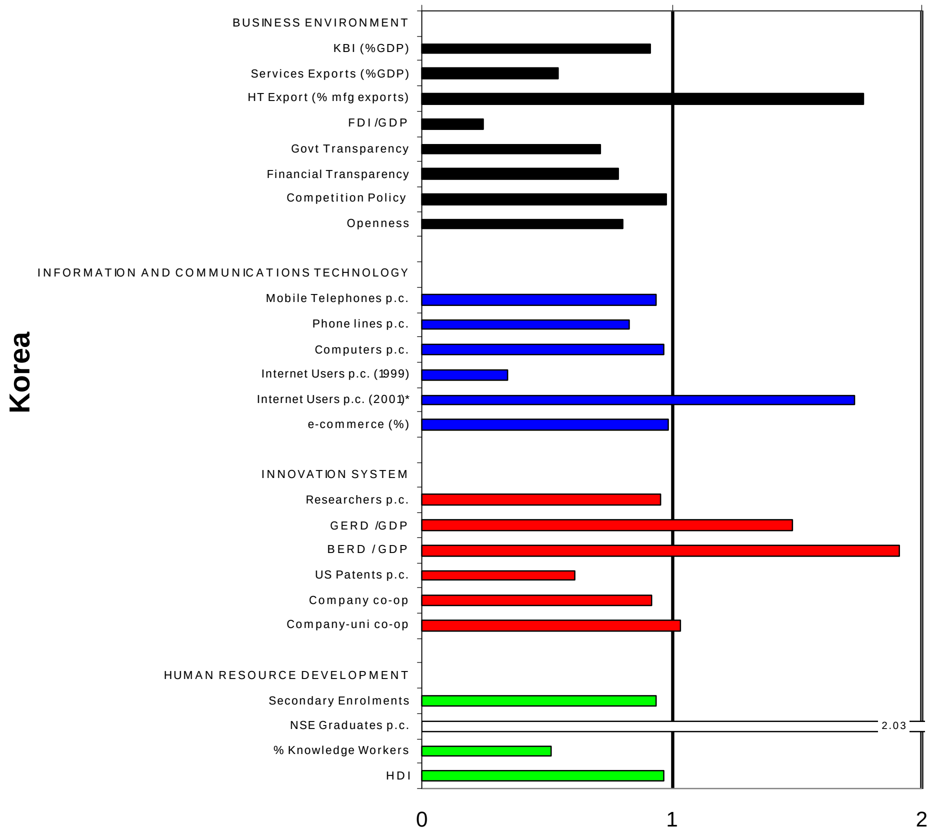

China
BUSINESS ENVIRONMENT
KBI (%GDP)
X
Services Exports (%GDP)
HT Export (% mfg exports)
FDI /GDP
Govt Transparency
Financial Transparency
Competition Policy
Openness
INFORMATION AND COMMUNICATIONS TECHNOLOGY
Mobile Telephones p.c.
Phone lines p.c.
Computers p.c.
Internet Users p.c. (1999)
Internet Users p.c. (2001)*
e-commerce (%)
INNOVATION SYSTEM
Researchers p.c.
GERD /GDP
BERD /GDP
US Patents p.c.
X
Company co-op
Company-uni co-op
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
NSE Graduates p.c.
% Knowledge Workers
X
HDI
0
1
2

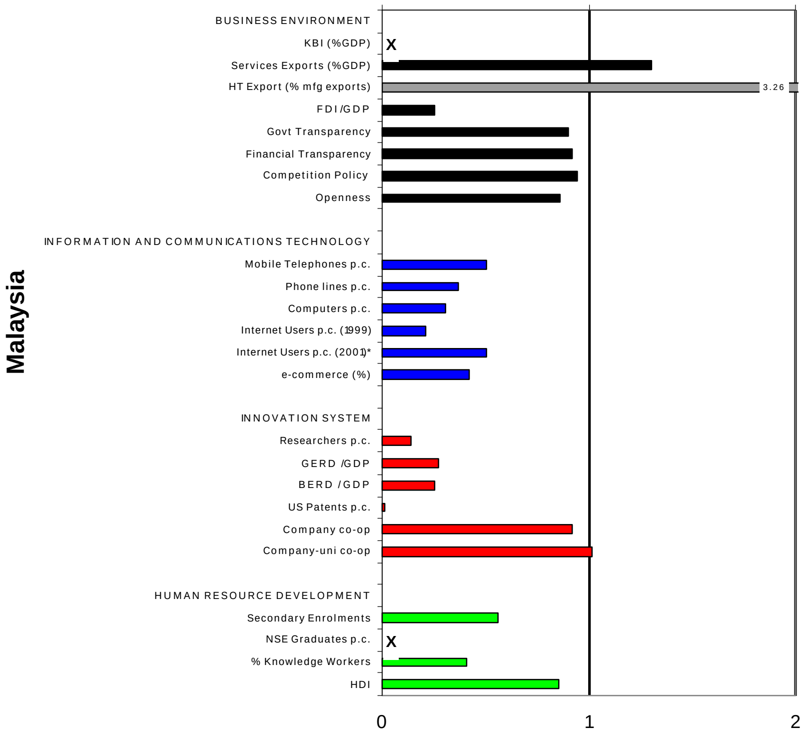

Chile
BUSINESS ENVIRONMENT
KBI (%GDP)
X
Services Exports (%GDP)
HT Export (% mfg exports)
FDI /GDP
Govt Transparency
Financial Transparency
Competition Policy
Openness
INFORMATION AND COMMUNICATIONS TECHNOLOGY
Mobile Telephones p.c.
Phone lines p.c.
Computers p.c.
Internet Users p.c. (1999)
Internet Users p.c. (2001)*
e-commerce (%)
INNOVATION SYSTEM
Researchers p.c.
GERD /GDP
BERD / GDP
US Patents p.c.
Company co-op
Company-uni co-op
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
NSE Graduates p.c.
% Knowledge Workers
HDI
0
1
2

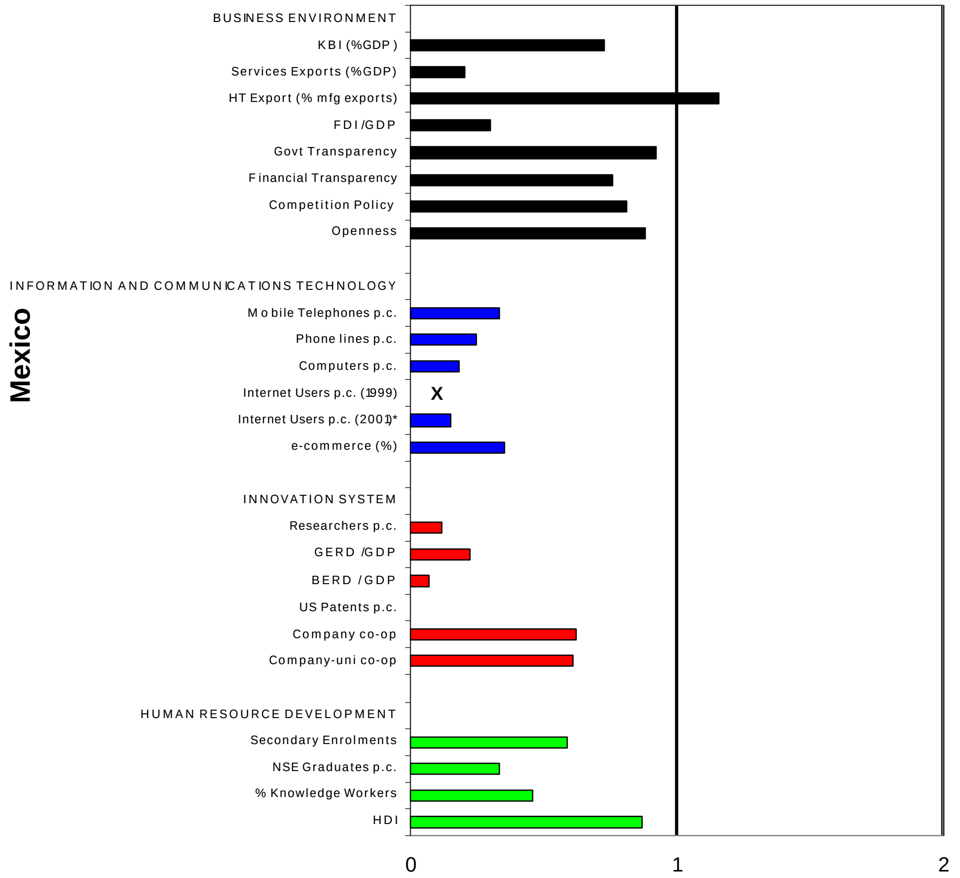

Hong Kong, China
BUSINESS ENVIRONMENT
KBI (%GDP)
X
Services Exports (%GDP)
2.23
HT Export (% mfg exports)
X
FDI /GDP
5.18
Govt Transparency
Financial Transparency
Competition Policy
Openness
INFORMATION AND COMMUNICATIONS TECHNOLOGY
Mobile Telephones p.c.
Phone lines p.c.
Computers p.c.
Internet Users p.c. (1999)
Internet Users p.c. (2001)*
e-commerce (%)
INNOVATION SYSTEM
Researchers p.c.
GERD /GDP
BERD / GDP
US Patents p.c.
Company co-op
Company-uni co-op
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
X
NSE Graduates p.c.
X
% Knowledge Workers
HDI
0
1
2


Indonesia
BUSINESS ENVIRONMENT
KBI (%GDP)
Services Exports (%GDP)
HT Export (% mfg exports)
FDI /GDP
Govt Transparency
Financial Transparency
Competition Policy
Openness
INFORMATION AND COMMUNICATIONS TECHNOLOGY
Mobile Telephones p.c.
Phone lines p.c.
Computers p.c.
Internet Users p.c. (1999)
Internet Users p.c. (2001)*
e-commerce (%)
INNOVATION SYSTEM
Researchers p.c.
GERD /GDP
BERD / GDP
US Patents p.c.
Company co-op
Company-uni co-op
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
NSE Graduates p.c.
% Knowledge Workers
HDI
X
0
1
2

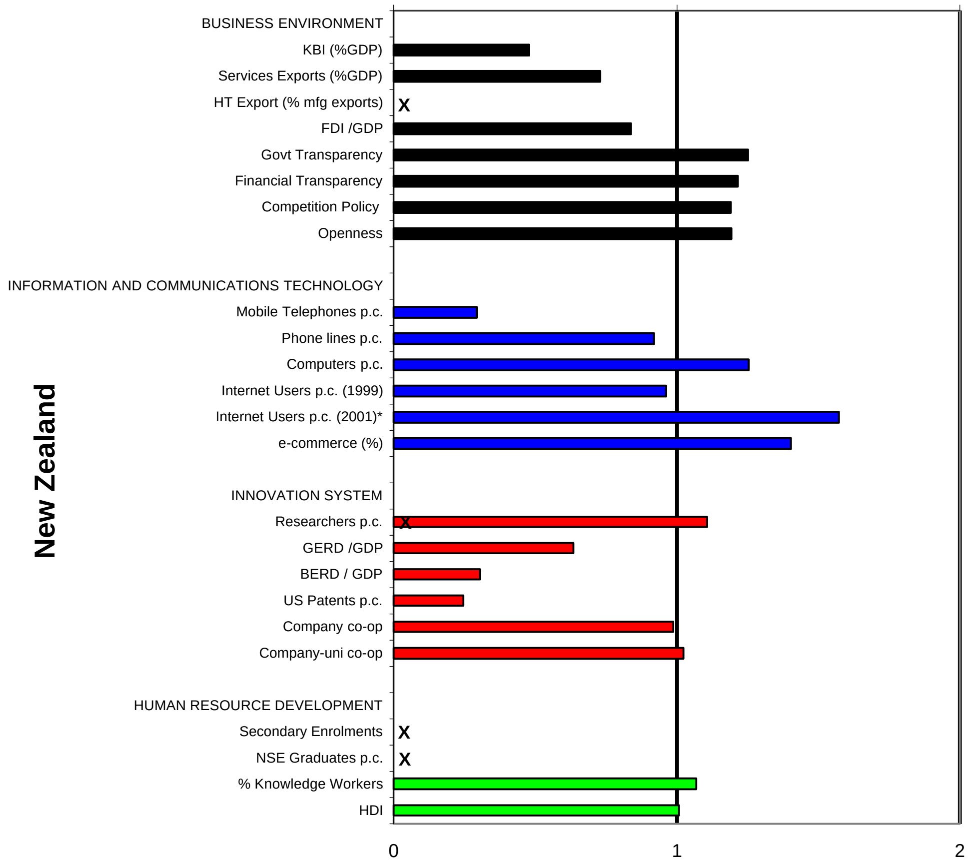

Japan
BUSINESS ENVIRONMENT
KBI (%GDP)
Services Exports (%GDP)
HT Export (% mfg exports)
FDI /GDP
Govt Transparency
Financial Transparency
Competition Policy
Openness
INFORMATION AND COMMUNICATIONS TECHNOLOGY
Mobile Telephones p.c.
Phone lines p.c.
Computers p.c.
Internet Users p.c. (1999)
Internet Users p.c. (2001)*
e-commerce (%)
INNOVATION SYSTEM
Researchers p.c.
GERD /GDP
BERD /GDP
US Patents p.c.
2.16
Company co-op
Company-uni co-op
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
NSE Graduates p.c.
% Knowledge Workers
HDI
0
1
2


Korea
BUSINESS ENVIRONMENT
KBI (%GDP)
Services Exports (%GDP)
HT Export (% mfg exports)
FDI /GDP
Govt Transparency
Financial Transparency
Competition Policy
Openness
INFORMATION AND COMMUNICATIONS TECHNOLOGY
Mobile Telephones p.c.
Phone lines p.c.
Computers p.c.
Internet Users p.c. (1999)
Internet Users p.c. (2001)*
e-commerce (%)
INNOVATION SYSTEM
Researchers p.c.
GERD /GDP
BERD /GDP
US Patents p.c.
Company co-op
Company-uni co-op
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
NSE Graduates p.c.
% Knowledge Workers
HDI
2.03
0
1
2

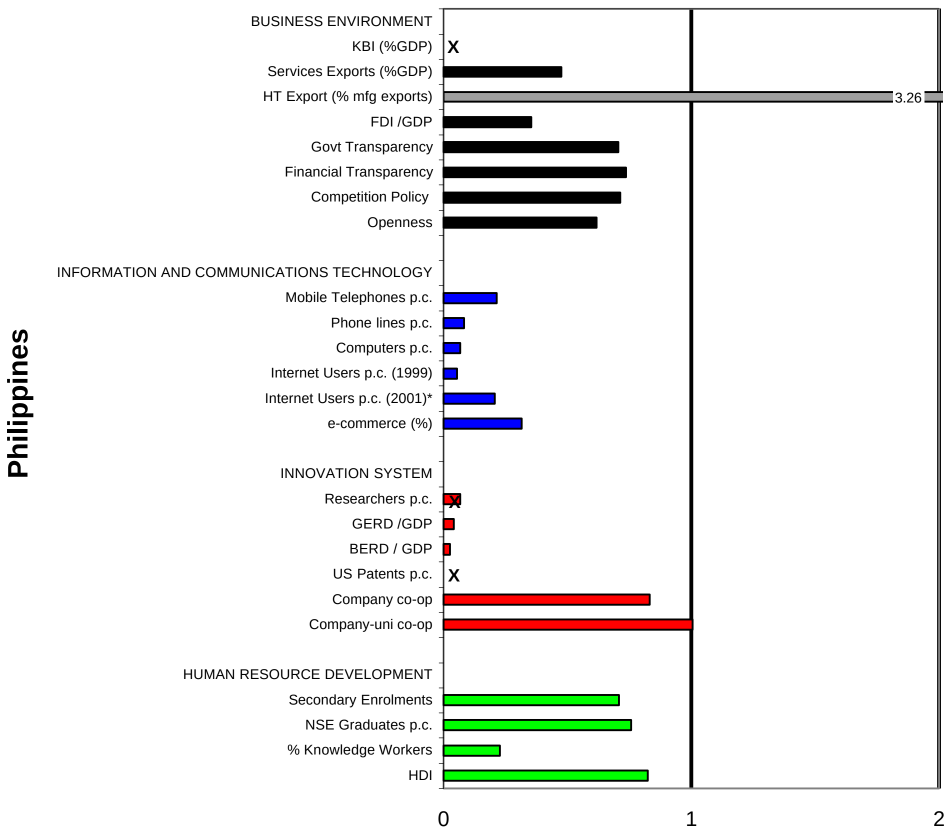

Malaysia
BUSINESS ENVIRONMENT
KBI (%GDP)
Services Exports (%GDP)
HT Export (% mfg exports)
FDI /GDP
Govt Transparency
Financial Transparency
Competition Policy
Openness
INFORMATION AND COMMUNICATIONS TECHNOLOGY
Mobile Telephones p.c.
Phone lines p.c.
Computers p.c.
Internet Users p.c. (1999)
Internet Users p.c. (2001)*
e-commerce (%)
INNOVATION SYSTEM
Researchers p.c.
GERD /GDP
BERD /GDP
US Patents p.c.
Company co-op
Company-uni co-op
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
NSE Graduates p.c.
% Knowledge Workers
HDI
X
X
3.26
0
1
2

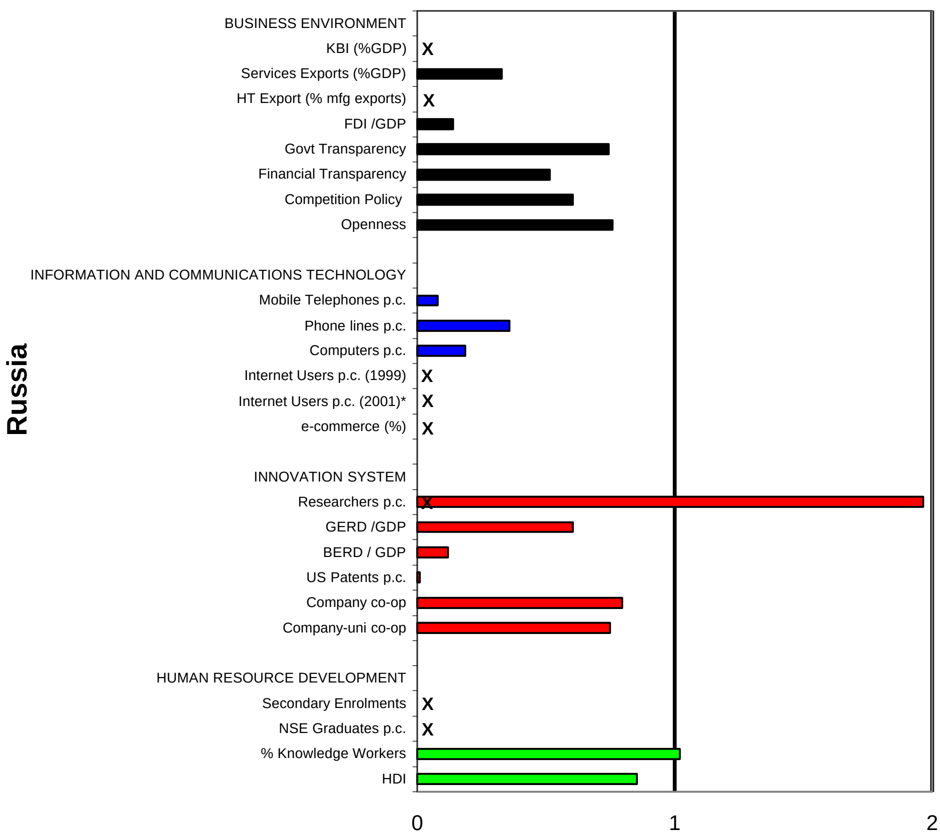


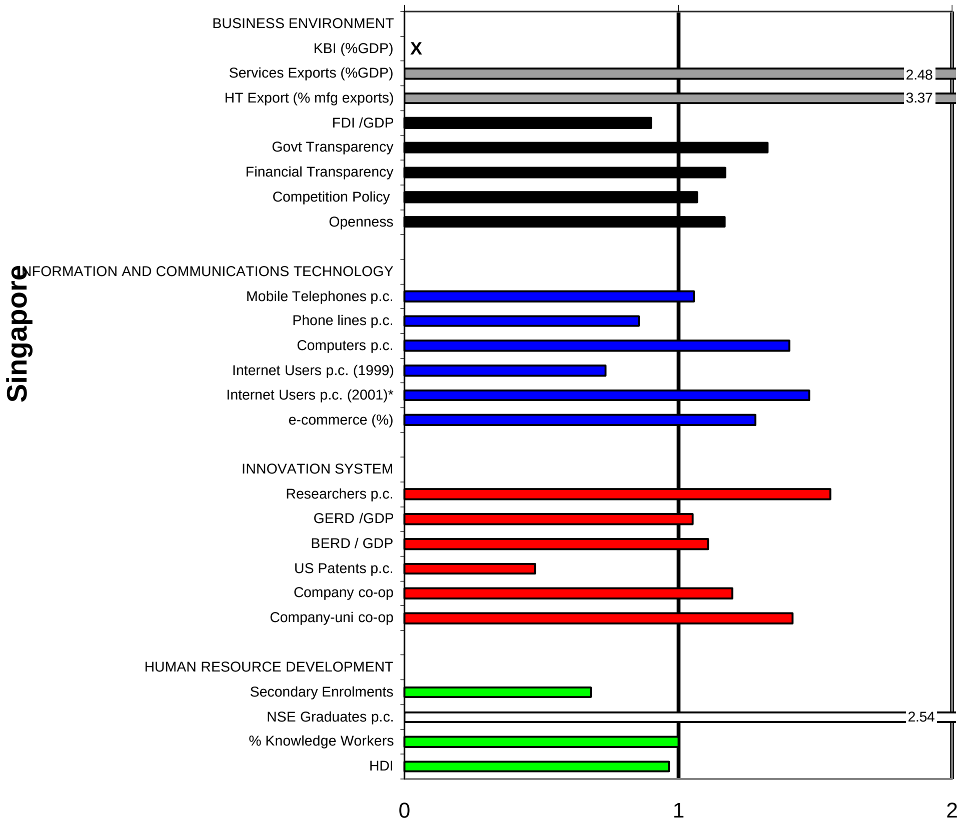
Mexico
BUSINESS ENVIRONMENT
KBI (%GDP)
Services Exports (%GDP)
HT Export (% mfg exports)
FDI /GDP
Govt Transparency
Financial Transparency
Competition Policy
Openness
INFORMATION AND COMMUNICATIONS TECHNOLOGY
Mobile Telephones p.c.
Phone lines p.c.
Computers p.c.
Internet Users p.c. (1999)
X
Internet Users p.c. (2001)*
e-commerce (%)
INNOVATION SYSTEM
Researchers p.c.
GERD /GDP
BERD / GDP
US Patents p.c.
Company co-op
Company-uni co-op
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
NSE Graduates p.c.
% Knowledge Workers
HDI
0
1
2

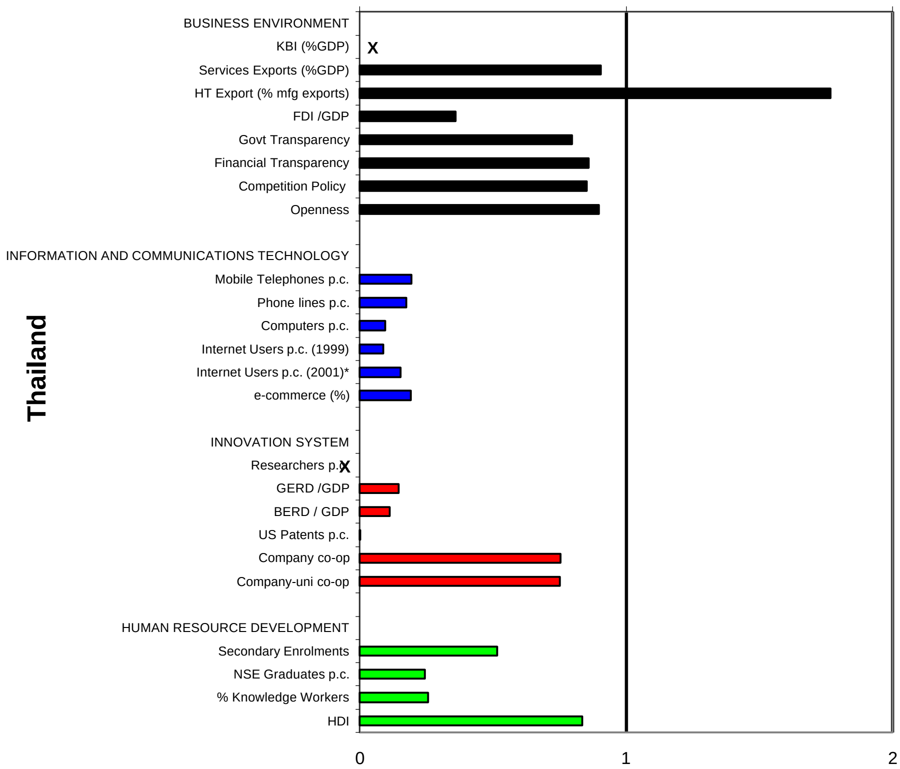


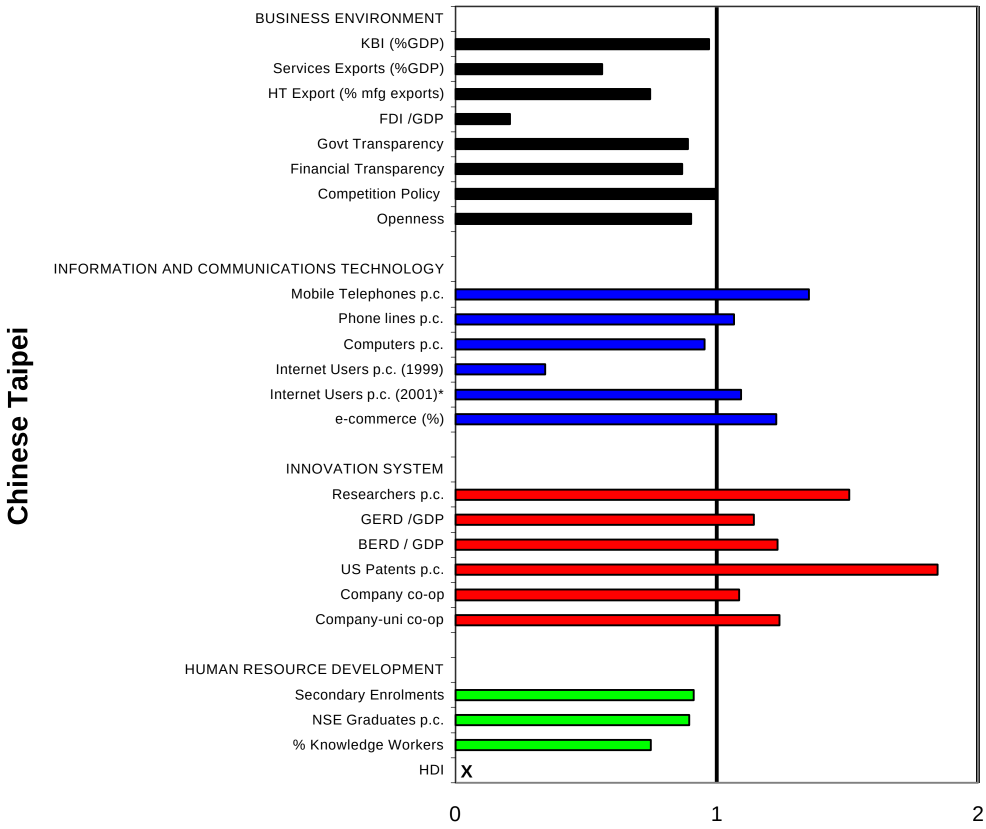
New Zealand
BUSINESS ENVIRONMENT
KBI (%GDP)
Services Exports (%GDP)
HT Export (% mfg exports)
X
FDI /GDP
Govt Transparency
Financial Transparency
Competition Policy
Openness
INFORMATION AND COMMUNICATIONS TECHNOLOGY
Mobile Telephones p.c.
Phone lines p.c.
Computers p.c.
Internet Users p.c. (1999)
Internet Users p.c. (2001)*
e-commerce (%)
INNOVATION SYSTEM
Researchers p.c.
X
GERD /GDP
BERD / GDP
US Patents p.c.
Company co-op
Company-uni co-op
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
X
NSE Graduates p.c.
X
% Knowledge Workers
HDI
0
1
2

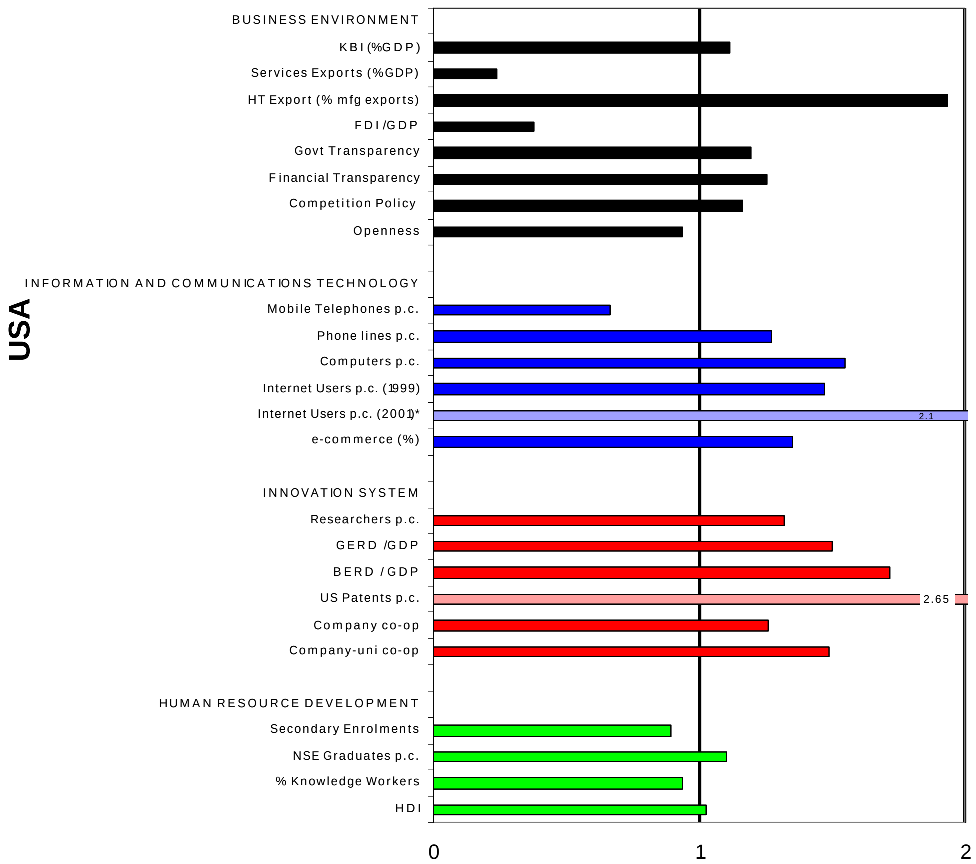

Philippines
BUSINESS ENVIRONMENT
KBI (%GDP)
Services Exports (%GDP)
HT Export (% mfg exports)
FDI /GDP
Govt Transparency
Financial Transparency
Competition Policy
Openness
INFORMATION AND COMMUNICATIONS TECHNOLOGY
Mobile Telephones p.c.
Phone lines p.c.
Computers p.c.
Internet Users p.c. (1999)
Internet Users p.c. (2001)*
e-commerce (%)
INNOVATION SYSTEM
Researchers p.c.
GERD /GDP
BERD / GDP
US Patents p.c.
Company co-op
Company-uni co-op
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
NSE Graduates p.c.
% Knowledge Workers
HDI
X
X
X
3.26
0
1
2


Russia
BUSINESS ENVIRONMENT
KBI (%GDP)
Services Exports (%GDP)
HT Export (% mfg exports)
FDI /GDP
Govt Transparency
Financial Transparency
Competition Policy
Openness
INFORMATION AND COMMUNICATIONS TECHNOLOGY
Mobile Telephones p.c.
Phone lines p.c.
Computers p.c.
Internet Users p.c. (1999)
Internet Users p.c. (2001)*
e-commerce (%)
INNOVATION SYSTEM
Researchers p.c.
GERD /GDP
BERD / GDP
US Patents p.c.
Company co-op
Company-uni co-op
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
NSE Graduates p.c.
% Knowledge Workers
HDI
X
X
X
X
X
X
X
X
0
1
2


Singapore
BUSINESS ENVIRONMENT
KBI (%GDP)
X
Services Exports (%GDP)
2.48
HT Export (% mfg exports)
3.37
FDI /GDP
Govt Transparency
Financial Transparency
Competition Policy
Openness
INFORMATION AND COMMUNICATIONS TECHNOLOGY
Mobile Telephones p.c.
Phone lines p.c.
Computers p.c.
Internet Users p.c. (1999)
Internet Users p.c. (2001)*
e-commerce (%)
INNOVATION SYSTEM
Researchers p.c.
GERD /GDP
BERD / GDP
US Patents p.c.
Company co-op
Company-uni co-op
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
NSE Graduates p.c.
2.54
% Knowledge Workers
HDI
0
1
2


Thailand
BUSINESS ENVIRONMENT
KBI (%GDP)
X
Services Exports (%GDP)
HT Export (% mfg exports)
FDI /GDP
Govt Transparency
Financial Transparency
Competition Policy
Openness
INFORMATION AND COMMUNICATIONS TECHNOLOGY
Mobile Telephones p.c.
Phone lines p.c.
Computers p.c.
Internet Users p.c. (1999)
Internet Users p.c. (2001)*
e-commerce (%)
INNOVATION SYSTEM
Researchers p.c.
X
GERD /GDP
BERD / GDP
US Patents p.c.
Company co-op
Company-uni co-op
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
NSE Graduates p.c.
% Knowledge Workers
HDI
0
1
2


Chinese Taipei
BUSINESS ENVIRONMENT
KBI (%GDP)
Services Exports (%GDP)
HT Export (% mfg exports)
FDI /GDP
Govt Transparency
Financial Transparency
Competition Policy
Openness
INFORMATION AND COMMUNICATIONS TECHNOLOGY
Mobile Telephones p.c.
Phone lines p.c.
Computers p.c.
Internet Users p.c. (1999)
Internet Users p.c. (2001)*
e-commerce (%)
INNOVATION SYSTEM
Researchers p.c.
GERD /GDP
BERD / GDP
US Patents p.c.
Company co-op
Company-uni co-op
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
NSE Graduates p.c.
% Knowledge Workers
HDI
X
0
1
2


USA
BUSINESS ENVIRONMENT
KBI (%GDP)
Services Exports (%GDP)
HT Export (% mfg exports)
FDI /GDP
Govt Transparency
Financial Transparency
Competition Policy
Openness
INFORMATION AND COMMUNICATIONS TECHNOLOGY
Mobile Telephones p.c.
Phone lines p.c.
Computers p.c.
Internet Users p.c. (1999)
Internet Users p.c. (2001)*
2.1
e-commerce (%)
INNOVATION SYSTEM
Researchers p.c.
GERD /GDP
BERD / GDP
US Patents p.c.
2.65
Company co-op
Company-uni co-op
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
NSE Graduates p.c.
% Knowledge Workers
HDI
0
1
2

APPENDIX AII

INDIVIDUAL ECONOMY REPORTS

AUSTRALIA

The Australian economy strengthened as 2001 progressed, in sharp contrast to the weakening seen in most of the rest of the world. Gross Domestic Product (GDP) grew by 4.2 percent through the year to the December quarter 2001. Unemployment remained low and signs of improvement were visible in the December quarter 2001, while ongoing inflation remained within the Reserve Bank of Australia's target range over 2001.

REAL GROSS DOMESTIC PRODUCT

Real GDP increased 2.6 percent in 2001 (in year average terms) following growth of 3.1 percent in 2000. The slowing in the rate of growth in the first half of 2001 reflected the abatement of transitory factors such as the Sydney Olympics stimulus and the introduction of The New Tax System (TNTS). In the second half of 2001 Australia's growth rebounded strongly, despite weakness in the world economy. Nonetheless, over 2001 Australia was one of the strongest developed economies.

- Household consumption rose solidly in 2001. The high growth in household consumption in 2001 is likely to have reflected the effect of lower fuel prices, low interest rates and strong growth in household wealth.

- Dwelling investment grew strongly in the latter half of 2001, bolstered by the Government's more generous First Home Owner's Scheme and historically low interest rates. Although in year average terms dwelling investment fell in 2001, this follows a strong peak in activity in 2000 and is, in part, a consequence induced by consumers bringing forward construction ahead of the introduction of TNTS.

- Business investment grew solidly over the second half of 2001, although total business investment fell over the year. Olympics-related construction unwinding and the impact on confidence due to various factors (domestic and international) in the early part of the year, contributed to this outcome.

- Public final demand (abstracting from private sector net purchases of second-hand public sector assets) rose by 0.7 percent in 2001 after rising 3.6 percent in 2000. Slower growth in public final demand in 2001 reflected the unwinding of the previous strong growth in public consumption.

- The external sector had a positive impact on growth over the course of 2001. Net exports contributed 1.2 percentage points to GDP growth in 2001, after contributing 0.5 percentage points to GDP growth in 2000.

INFLATION

The Australian Consumer Price Index (CPI) increased by 3.1 percent through the year to the December quarter 2001. Various one-off factors added to inflation over that period. The price of meat, seafood, fruit and vegetables increased substantially through the year. In addition, some price effects have resulted from the events of September 11, the collapse of a major Australian insurance firm (HIH) and the second largest Australian airline (Ansett). These upwards price movements were offset somewhat by a significant decline in petrol prices over the year due to a fall in global oil prices.

EMPLOYMENT

Employment grew by 1.0 percent in 2001, while the unemployment rate increased steadily over most of the year to peak at 7.0 per cent in October 2001, before declining slightly to 6.7 percent in December 2001.

Wages, as measured by average weekly ordinary-time earnings for full-time working adults and average weekly earnings (all employees), rose 5.7 percent through the year to the December quarter 2001. In contrast, the wage cost index rose by 3.4 percent through the year to the December quarter 2001.

CURRENT ACCOUNT

The current account deficit fell to A$17.7 billion or 2.6 percent of GDP in 2001, down from A$26.3 billion or 4.0 percent of GDP in 2000.

Exports at current prices increased 8.5 percent in 2001, while export volumes increased 0.76 percent in 2001. Imports increased 1.3 percent at current prices in 2001, while import volumes fell 4.6 percent in 2001. The terms of trade increased 1.6 percent in 2001, following a 5.4 percent rise in 2000. The trade balance improved by A$10.2 billion in 2001 to record a trade surplus of A$2.9 billion.

EXCHANGE RATE

Since 1983, Australia has had a floating exchange rate. The Reserve Bank of Australia may undertake foreign exchange market operations when the market threatens to become excessively volatile or when the exchange rate is clearly inconsistent with underlying economic fundamentals. These operations are invariably aimed at stabilising market conditions rather than meeting exchange rate targets.

During 2001, the Australian dollar appreciated (in nominal terms) 4.9 percent against the Japanese yen. It depreciated 8.5 percent against the US dollar and 2.9 percent against the euro. The Australian dollar also fell against the currencies of Australia’s other major trading partners, which contributed to a 3.1 percent fall in the trade-weighted index. The exchange rate depreciation in 2001 improved Australia’s international price competitiveness, cushioning the adverse effect of the global downturn on economic activity.

FISCAL POLICY

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

In financial year 2002–03, the commonwealth government is expecting to achieve an underlying cash surplus of around 0.3 percent of GDP (or near balance measured on an accrual basis). This is higher than the projected cash surplus of 0.1 percent of GDP (or an accrual deficit of 0.2 percent of GDP) forecast in the 2001–02 budget, largely reflecting an upward revision to the economic growth forecasts for 2002–03.

LONG TERM FISCAL STRATEGIES

In May 2002 the Australian government released its first Intergenerational Report (IGR) in compliance with the Charter of Budget Honesty Act 1998. This landmark report will be compiled every five years to assess the sustainability of current government policies for the subsequent forty years, taking account of the financial implications of demographic change.

The first IGR forecasts that in four decades time the government will face significant fiscal pressure if current policies are maintained, based on projections of Commonwealth spending on health and aged care, social safety net payments to individuals (such as age pensions, disability pensions and unemployment allowances), education and government superannuation. The bulk of this fiscal pressure is associated with an ageing population and the high costs of technological and demand change in health care.

Australia is well placed to meet the challenges identified by the IGR, given the strength of the Australian economy and the Government's sound fiscal management. Australian Governments have also implemented policies to relieve emerging spending pressures, such as targeted age pensions, the maturing superannuation system and low net debt.

MONETARY POLICY

The Reserve Bank of Australia has the primary responsibility for the conduct of monetary policy. The formal objectives of monetary policy require the Reserve Bank Board to conduct monetary policy in a way that will best contribute to currency stability, the maintenance of full employment, and the economic prosperity and welfare of the people of Australia. Price stability is regarded as a critical element in achieving these objectives. In pursuing the goal of medium-term price stability, the Reserve Bank of Australia has adopted, with agreement from the Treasurer, the objective of keeping inflation between 2.0 and 3.0 percent, on average, over the cycle. The medium-term focus of the inflation target provides the bank with the flexibility to 'look through' temporary fluctuations in the CPI.

In pursuit of its objectives, the Reserve Bank of Australia targets a publicly announced overnight cash (interest) rate, determined by the Reserve Bank Board, to act pre-emptively against inflationary or deflationary pressures.

In response to weaker international economic conditions and restrained inflationary pressures in 2001, the Reserve Bank of Australia loosened monetary policy by 200 basis points. The target cash rate was reduced to 4.25 percent by December 2001, its lowest level since the Reserve Bank began announcing cash rate targets in 1990.

MEDIUM-TERM OUTLOOK

In 2002–03[1], economic growth in Australia is forecast to be around 3.75 percent in year-average terms and a strong 4.0 percent through the year to the June quarter 2003. The unemployment rate is forecast to decline slightly from recent levels to be around 6.0 percent in the June quarter 2003. Inflation is expected to be around 2.75 percent in year-average terms in 2002–03 and around 2.5 percent through the year to the June quarter 2003, within the medium-term target band of 2–3 percent. The current account deficit is forecast to widen slightly to around 4.0 percent of GDP, continuing below its average level in the 1990s.

Economic growth in Australia strengthened over 2001. While weaker world growth did lead to a moderation in export growth, domestic activity has been supported by robust household consumption growth and a sharp rebound in investment in residential construction following the temporary slowdown in this sector during the second half of 2000. Economic growth is expected to be around 3.75 percent in 2001–02.

---

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

Domestic demand is expected to strengthen over 2002-03, with gross national expenditure forecast to grow by a very strong 4.75 percent in year-average terms, following expected strong growth of 4.25 percent in 2001-02.

Net exports are expected to subtract 0.75 of a percentage point from GDP growth in 2001–02. This reflects the impact of lower world growth on demand for exports, together with the effects of strong domestic conditions on the demand for imports. In 2002–03, net exports are expected to subtract a further 1.0 percent from GDP growth. While export growth is expected to resume solidly over the course of 2002–03, this is expected to be more than offset by very strong import growth.

The current account deficit (CAD) is forecast to widen modestly from 2.8 percent of GDP in 2000-01, its lowest ratio in twenty years, to around 3.25 percent of GDP in 2001–02. A larger trade deficit in volume terms together with a slight increase in the net income deficit (NID) is expected to underpin a further widening of the CAD to around 4.0 per cent of GDP in 2002–03. At these levels, the CAD would remain moderate, below its average level as a share of GDP during the 1990s, and well below earlier peaks of around 6 per cent of GDP.

New business investment[2] is forecast to grow by a very strong 12 percent in 2002–03, following expected growth of around 4.0 percent in 2001–02. The very positive outlook for business investment reflects strong fundamentals: low interest rates; the competitive level of the exchange rate, which continues to support Australia's export and import-competing sectors; the reduction in the company tax rate; and corporate profitability, which is above longer-run averages as a percentage of GDP and is particularly strong in the rural and mining sectors.

Household consumption expenditure is forecast to increase by around 4 percent in 2002–03, a little faster than in 2001–02. This will see growth approaching the very rapid growth experienced in the latter part of the 1990s (which was buoyed by strong growth in asset prices and household wealth). Household consumption will be supported by lower interest rates, however rising petrol prices and a forecast slowdown in growth of wealth may work to dampen this growth.

Conditions in the labour market are expected to strengthen over 2002–03, with employment growth forecast to be around 1.75 percent in both year-average and through-the-year terms. The outlook for strengthening employment growth in 2002–03 reflects ongoing robust GDP growth and continued moderate wages growth. The moderation in the labour market following the completion of Y2K-related expenditure, the Olympics and the development of new systems associated with the introduction of The New Tax System has now run its course. This has seen a rebound in employment in property and business services in the March quarter 2002, which augurs well for the employment outlook. The unemployment rate is expected to decline slightly over the forecast period, and to average around 6.25 percent in 2002–03 as a whole and to be 6.0 percent in the June quarter of 2003.

The headline CPI is forecast to increase by around 2.75 percent in 2002–03 in year-average terms and around 2.5 percent through the year, within the medium-term target band of 2–3 percent. Although economic growth is forecast to be robust in both 2001–02 and 2002–03, this follows subdued growth of 1.9 percent in 2000–01. The robust growth forecast in 2001–02 and 2002–03 will allow spare capacity to be taken up gradually, rather than necessarily resulting in a build up of inflationary pressures.

---

[2] Private sector net purchases of second-hand public assets can have a significant impact on estimates of business investment and public final demand, despite the fact that these asset purchases have no impact on aggregate economic activity. Accordingly, the forecasts of new business investment abstract from these transactions.

Annex I

AUSTRALIA: OVERALL ECONOMIC PERFORMANCE

	1996	1997	1998	1999	2000	2001
GDP and Major Components (percent change, year over year - earlier period, except as noted)						
Nominal GDP (level in billion US$)	405.1	405.8	362.7	392.5	379.1	358.1
Real GDP	4.3	3.7	5.2	4.8	3.1	2.6
Consumption	3.2	3.6	4.3	5.1	3.2	2.7
Private Consumption	3.2	4	4.7	5.1	2.7	3.2
Government Consumption	3.4	2.6	3.1	4.9	4.9	1.3
Investment	5.2	10.2	6.9	7.2	0.5	-3.4
Private Investment	6.5	13.0	9.8	5.4	-0.4	-4.8
Government Investment	-0.7	-1.0	-7.6	15.7	5.2	3.3
Exports of Goods and Services	10.6	11.1	0.2	4.3	10.9	0.8
Imports of Goods and Services	8.4	10.5	5.9	9.1	7.4	-4.5
Fiscal and External Balances (percent of GDP)						
Budget Balance***	-2.0	-1.0	0.2	0.7	2.0	0.8
Merchandise Trade Balance	-0.1	0.4	-1.4	-2.5	-1.3	-0.6
Current Account Balance	-3.9	-3.1	-4.9	-5.8	-4.0	-2.6
Capital Account Balance	0.2	0.2	0.2	0.2	0.2	0.2
Economic Indicator (percent change, year over year - earlier period, except as noted)						
GDP Deflator	2.3	1.7	0.4	0.7	4.0	3.4
CPI	2.6	0.3	0.9	1.5	4.5	4.4
M3	9.43	9.32	6.76	9.41	7.59	8.82
Short-term Interest Rate (percent)^	7.15	5.4	5	5.01	6.18	4.9
Real Effective Exchange Rate (level, 1997=100)**	100.99	100.00	91.41	91.69	87.30	83.94
Unemployment Rate (percent)	8.2	8.2	7.7	7.0	6.3	6.7
Population (millions)*	18.4	18.6	18.8	19.0	19.2	19.4

Notes: * Population as at December, except 2001, which ends at September.
** OECD Main Economic Indicators
***Figures refer to financial year. Source: Budget Strategy and Outlook 2002-03, Budget Paper No. 1.
^ 90 Day Bank Accepted Bills, annual average

Annex II

AUSTRALIA: FORCAST SUMMARY (percent change from previous year)

	2002					2003				
	Official *	**IMF**	**Link**	**ADB**	**OECD**	**Official**	**IMF**	**Link**	**ADB**	**OECD**
Real GDP	3¾	N.A.	N.A.	N.A.	N.A.	3¾	N.A.	N.A.	N.A.	N.A.
Exports	-2.0	N.A.	N.A.	N.A.	N.A.	6	N.A.	N.A.	N.A.	N.A.
Imports	2.0	N.A.	N.A.	N.A.	N.A.	11	N.A.	N.A.	N.A.	N.A.
CPI	2¾	N.A.	N.A.	N.A.	N.A.	2¾	N.A.	N.A.	N.A.	N.A.

*Official forecasts are based on financial years

Annex III

AUSTRALIA: MEDIUM-TERM TREND FORECAST (percent)

	Period*
Real GDP	3¾
CPI	2¾

* Australia forecasts on a financial year basis.

BRUNEI DARUSSALAM

REAL GROSS DOMESTIC PRODUCT

Brunei Darussalam’s economy grew at 1.5 percent in 2001, down from 2.8 percent in the previous year. The slowdown was mainly attributed to the fall in the world oil prices but at the same time there was also a drop in Brunei’s production due to September shut down (for repair and inspection) of plant in one of the major off-shore complexes in.

The primary sectors comprising agriculture, forestry and fisheries grew by 2.3 percent in 2001, up from 1.8 percent in 2000. The agriculture and fisheries sectors provided the main impetus for growth where the agriculture sector grew by 2.9 percent from 1.7 percent, while the fisheries sector fell by 2.5 percent from 2.6 percent in the previous year.

The mining, manufacturing and quarrying sector grew at 1.0 percent, down from 3.5 percent in 2001. The construction sector grew by 1.1 percent, i.e., from –3.5 percent in 2000 to –2.4 percent in 2001. This slow growth was due to the prudent fiscal policy which badly affected the construction industry.

The electricity, gas and water sector grew by 4.8 percent in 2001, up from 3.5 percent IN 2000. Electricity production grew by 4.3 percent compared to 3.5 percent in 2000. Meanwhile water consumption remains at 3.9 percent.

Wholesale and retail trade rose by 2.1 percent, a significant improvement compared to a contraction of 2.0 percent in 2000. Imports of food, manufactured goods and miscellaneous manufactured articles grew by 22.7 percent, 15.4 percent and – 7.6 percent respectively in 2001, compared to – 2.7 percent, 12.5 percent and 12.0 percent in 2000.

The restaurants and hotels sector grew at 2.5 percent in 2001, up from 1.8 percent in 2000 whilst transport, storage and communication sectors rose by 2.7 percent in 2001, up from 0.9 percent in the previous year. Growth in these sectors are largely attributed to ‘Visit Brunei Year 2001.’

INFLATION

The average Consumer Price Index (CPI) inflation registered at 0.6 percent in 2001 compared to 1.2 percent in 2000. This was in spite of a rise in the cost of transport and communication which increased by 1.8 percent, miscellaneous items by 1.1 percent, housing by 0.4 percent and clothing and footwear grew at 0.1 percent.

The average low estimate for the whole year for 2001 is attributed to a substantial drop in the CPI due to the ‘Brunei Grand Sale’ activities in November and December.

EXTERNAL TRADE

Exports
Total exports decreased by 5.7 percent to BN$6,348.9 million in 2001 from BN$6,732 million in 2000. Petroleum exports (crude and condensate) decreased by 8.6 percent, reflecting lower oil price and volume (oil price decreased by 16.3 percent), while exports of LNG increased by 0.7 percent. Total oil and gas exports decreased by 4.6 percent from BN$5,884.3 last year to only BN$5,612.1 in 2001.

The total value of garments export increased by 27.7 percent i.e. from BN$310 million in 2000 to BN$396 million in 2001. However, overall non-oil and gas export decreased by 13.1 percent, from BN$847.7 million in 2000 to BN$736.8 million in 2001. This was partly because of continuing drop in re-exports, from BN$375.5 million in 2000 to BN$340.8 million in 2001.

Japan remained the dominant export market which account for 43.6 percent of total exports in 2001. This is followed by ASEAN (23.3 percent), Korea (11.3 percent) and USA (8.3 percent). Brunei exports to ASEAN dropped by 15.2 percent in 2001 compared to 2000 due to the current economic slow down currently affecting the region.

Imports
In 2001, total imports increased by 10.3 percent. In value terms, food increased by 21 percent, followed by animal and vegetable oils and fats (14.09 percent), manufactured goods (14.09 percent), chemicals (13.36 percent) and machinery and transportation equipments (6.5 percent). Imports of mineral fuels decreased by 54.22 percent, while crude material inedible decreased by 4.23 percent and beverages and tobacco by 4.03 percent.

Looking at the origin of imports in 2000, 52.64 percent of total imports were from ASEAN countries. Imports from the European Union accounted for a 15.31 percent share. Imports from Japan and the USA accounted for 6.38 percent and 8.77 percent shares respectively.

Current Account Balance
In 2000, an increase in exports improved the current account balance. In 2001, the trade surplus were reduced by 5.0 percent, mainly due to the effects of decreases in production and prices of oil and gas. As a result, the current account surplus had decreased from BN$6,907 million (93 percent of GDP) in 2000 to BN$6,561 million (86 percent of GDP) in 2001 (excluding foreign investment income).

EMPLOYMENT

Total employment grew by 1.9 percent in 2001 to 144,000 as a result of a favorable economic growth performance of 1.5 percent. Two thousand seven hundred new jobs were created. The overall labour force participation rate (LFPR) in 2000 was 65.1 percent. There was an increase in the female LFPR from 55.1 percent in 2000 to 55.5 percent in 2001. During the same period, the male LFPR also showed an increase from 73.8 percent in 2000 to 74.2 percent. From 2000 to 2001, the unemployment rate remained at 4.7 percent. Despite the economic crisis experienced by Brunei since the end of 1997, the percentage of migrant workers in the private sector increased slightly from 73.9 percent (66,700 workers) in 2000 to an estimated 74.9 percent in 2001 (72,000 workers). The role of these workers in Brunei's economic development is still vital, particularly in the pursuit of her economic diversification drive.

FISCAL POLICY

The government continued its prudent fiscal policy following the fall in revenue from hydrocarbon exports following to the fall in the oil price and the lower demand for petroleum products from importing partners since mid-September 2001.

Total government expenditure in 2001 stood at an estimated BN$3,744.4 million, a reduction of about 10.8 percent from BN$4,196.5 million in 2000. The reduction was due to 13.4 percent decrease in current expenditure. Capital expenditure also fell by 3.9 percent compared to 2000.

In 2001, government revenue fell around 23.6 percent* from BN$5,084.4 million in 2000 to BN$3,883.6 million in 2001. The decrease was mainly due to reduction in revenue from the oil sector following the fall in oil and gas prices and production in 2001.

MONETARY POLICY

Fluctuation in the exchange rate over the period continued to affect the growth of GDP. Brunei Darussalam continued its effort to create an environment supportive of economic recovery by strengthening its financial position. This helped to facilitate infrastructure and economic development activities, to improve the balance of payment position to control the domestic inflation rate and to preserve price stability.

Exchange Rate
The movement of Brunei currency against the US currency was quite stable in 2000, at an average exchange rate of BN$1.74, and increase to BN$1.84, a net 5.8 percent by the end of 2001.

Interest Rate
The Brunei prime rate moves with the prime rate in Singapore plus a margin between 0.25 and 0.5 percent and acts as a benchmark lending rate only. However in practice a lower rate is applied to preferred customers and to consumer loans. The Brunei Bankers' Association also sets monthly maximum rates for savings and time deposits up to BND 50,000 and BND 100,000 respectively, though not in a fixed relation to the prime rate. Interest on deposits above BN$100,000 are freely determined. Demand deposits are not remunerated, except those of the government which earn 2.5 percent annually.

MEDIUM-TERM OUTLOOK

The performance of Brunei Darussalam's economy in 2002 still very much dependent on price of oil and gas and the implementation of the government's various projects and programmes under the 8th National Development Plan covering the period 2001–2005. Oil sector's growth for 2001 has been revised from initial estimate of 4.0 percent to 0.8 percent following the fall in oil prices since mid-September 2001. However the price is expected to grow and stablise around 5.0 percent in the first quarter of 2002. This is partly due to the agreement made by the OPEC and the five non-cartel producers to slice almost two million barrels per day from world supplies from 1 January.

The growth of the non-oil sector in 2001 was revised downward from 2.9 percent to 2.2 percent, where the government sector growing at 2.1 percent from initial estimate of 3.0 percent whilst the private sector grew at 2.4 percent from initial estimate of 2.8 percent. In 2002, government is expected to grow at the same rate at last year i.e. around 2–3 percent and the private sector is expected to perform better than in 2001. The retail trade; electricity, gas and water; transport, storage and communications; banking, finance and insurance; and mining, quarrying & manufacturing sectors provide the main impetus for growth in the non-oil sector. The GDP outlook for 2002 is expected to be around 3–4 percent and the inflation is expected to be maintained at around 1 to 2 percent.

Some important factors which would significantly influence the macro-economic performance of Brunei Darussalam in the medium-term, are:
- The BND1 billion allocated for the implementation of the 8th National Development Plan in 2002;
- The impact of commercialisation, corporatisation and privatisation of some government activities;
- The improvement of the business and investment climate to encourage foreign direct investment (FDI);
- The establishment of Brunei Darussalam as an International Financial Centre;
- The reduction in vehicle import tax since November 2001; and
- The production levels and the price of the oil and gas exports.

The economy's population will continue to grow at a moderate rate of between 2.0 percent and 2.5 percent in the years ahead. It is estimated it will grow from 344,500 in 2001 to 351,400 in 2002. Total labour force will also increase, by 2.7 percent to 156,300 in 2002. Similarly, employment, migrant workers and the unemployment rate will also be expected to grow, to 4.6 percent, 4.0 percent, and 4.7 percent respectively in 2002.

In 2002, the current account balance and government revenue is expected to increase with the expected favorable prices of oil and gas.

RECENT ECONOMIC DEVELOPMENT

THE $1 BILLION DEVELOPMENT BUDGET FOR THE YEAR 2002

Brunei Darussalam has faced economic difficulties over the past few years following the East Asian financial crisis. The sharp drop in oil prices and the crisis, had heavily affected many individuals and businesses in the country. In an effort to recover from these economic difficulties, his majesty the Sultan and Yang Dipertuan of Brunei Darussalam, during the 7th Asean Summit on the 6 November 2001, has announced the allocation of $1 billion development budget for the year 2002 under the (current) 8th NDP. The objective of the fund injection into the NDP is to ensure that the development projects and programs can be effectively implemented so as to accomplish the target of reaching the economic growth of between 5.0 and 6.0 percent p.a. The budget allocation is also aimed at reducing the high cost of living to certain extent, increasing job opportunities and boosting business growth in the country so as to regain the confidence of investors.

THE ALLOCATION OF $1 BILLION DEVELOPMENT BUDGET BY SECTORS

SECTORS	***ALLOCATION***	**percent**
1. Industry and Commerce	$131,789,800	13.2
2. Transportation and Communications	$189,861,000	19.0
3. Social Services	$166,837,000	16.7
4. Public Utilities	$256,440,000	25.6
5. Public Building	$76,864,000	7.7
6. Security	$61,850,000	6.2
7. Information and Communication Technology	$51,000,000	5.1
8. Human Resource and Science and Technology	$47,655,000	4.8
9. Pulau Muara Besar Project	$5,000,000	0.5
10.Miscellenous	$12,703,200	1.3
TOTAL ALLOCATION	**$1,000,000,000**	**100.0**

The $1 billion allocation for the year 2002 represents an 82 percent increase in the budget allocation compared to the 2001 budget of around $550 million. The budget allocation will be used to finance new projects and to pay for existing and newly completed projects. The public utilities sector, comprised of electricity, sanitation, water and drainage and considered one of the priority sectors, has been given a substantial allocation of $256,440,000 or 25.6 percent of the total development budget. This is followed by the transportation and communications sector with a total allocation of $189,861,000 (19.0 percent). The social services sector, comprised of education, medical and health, government housing, national housing, religious affairs and public facilities and environment has been given an allocation of $166,837,000 (16.7 percent) and the industry and commerce sector, consisting of agriculture, fishery, forestry, entrepreneurial development and industrial development was allocated $131,789,800 (13.2 percent). The newly introduced sectors under the current 8th NDP namely information and communication technology;

human resources and science and technology; and Pulau Muara Besar project have been allocated $51,000,000 (4.8 percent), $47,655,000 (0.5 percent) and $5,000,000 (0.5 percent) respectively.

SHORT-TERM ECONOMIC RECOVERY PLAN PHASE 2

The second phase of the BN$200 million Short-term Economic Recovery Plan was announced recently at a press conference held at the Department of Economic Planning and Development. Various projects and programmes have been identified for the remaining plan budget allocation of $115 million. They are as follows:

- Continuing the construction of 250 public housing and other related infrastructure works;
- Completing the Computer for Schools and BruNet Expansion projects, through the upgrading of internet and ICT training in all schools and educational institutions (worth $6.9 million);
- Continuing the promotion of the tourism and hospitality industry training by widening its scope through the inclusion of other sectors, e.g., by improving and upgrading ICT skills of both job seekers and those currently in the labour force (worth $3.1 million);
- Constructing of additional tourism facilities to contribute towards the tourism and hospitality industry;
- BN$31 million maintenance projects for government buildings, compounds and assets; and
- BN$30 million additional Working Capital Credit Fund.

ECONOMIC DEVELOPMENT BOARD

The Brunei Economic Development Board was formed on the 26 November 2001 through the Brunei Economic Development Board (Amendment) Order 2001. One of the main roles of the newly established Brunei Economic Development Board is to promote Brunei Darussalam as an investment destination and the new appointees are expected to carry out this task through the Brunei Economic Development Board.

As a government statutory body, the Brunei Economic Development Board has autonomy to carry out its role and responsibilities according to the Brunei Economic Development Board (Amendment) Order 2001.The main role of the Board is to stimulate the growth, expansion and development of the economy by promoting Brunei Darussalam as an investment destination. The Board will also be responsible for implementing government policies and preparing investment promotion plans, incentives and marketing strategies to attract foreign and local investment in advanced technology industries and skill intensive services which enjoy good export market prospects.

Apart from the above roles of promoting the aforementioned industries through joint ventures, the board will assist and facilitate industrial development as a whole, including supporting the development of small and medium-sized enterprises. Presently the focus and priority of the board is to prepare, promote and develop industrial sites, and also strategic and competitive facilities for prioritised industries. This includes the development of Pulau Muara Besar.

This year Brunei Darussalam is all set to carry out BDN$1 billion worth of projects and development programmes to help spur the economic situation of the country to a more progressive mode to make it attractive for businesses and investors.

The Government of His Majesty the Sultan and Yang Di-Pertuan of Negara Brunei Darussalam is entrusting several senior officials and prominent local business figures to sit as executives and members on its newly formed Economic Development Board which will be the steering body guiding the nation towards greater economic growth.

The new appointees of the Board are as follows:

1. Chairman: Dato Paduka Awang Haji Yusof bin Haji Abdul Hamid;
2. Deputy Chairman: Mr Timothy Ong Teck Mong;
3. Ex-officio Members: Permanent Secretary, Ministry of Industry and Primary Resources; The Chairman currently holds Chief Executive Officer of the Board; and a representative from Ministry of Finance;
4. Other Members: Awang Haji Kamis bin Haji Tamin, Acting Director General, Department of Economic Planning and Development; Yang Dimuliakan Pehin Orang Kaya Seri Dewa Major General (R) Dato Seri Pahlawan Haji Awang Mohammad bin Haji Daud; Pengiran Dato Paduka Sharifuddin bin Pengiran Haji Metali; and Awang K.V. Tan.

Annex I

BRUNEI: OVERALL ECONOMIC PERFORMANCE

	1996	1997	1998	1999	2000	2001
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (Billion US$)	5.2	5.3	5.2	3.9	4.2	4.3
Real GDP	1.0	3.6	-4.0	2.6	2.8	1.5
Consumption	N.A	N.A	N.A	N.A	N.A	N.A
Private Consumption	N.A	N.A	N.A	N.A	N.A	N.A
Government Consumption	6.5	0.5	5.9	13.5	-2.6	-9.8
Investment	N.A	42.1	-17.1	65.6	14.3	-29.9
Private Investment	-19.2	40.4	-17.7	-13.1	15.9	-3.6
Government Investment	NA	84.3	-5.4	1,394.5	12.8	-56.3
Exports of Goods and Services	8.3	3.3	-21.6	32.6	51.1	0.6
Imports of Goods and Services	16.7	3.7	-13.2	-3.1	-1.4	6.9
Fiscal and External Balances (percent of GDP)						
Budget Balance	-9.7	-15.1	-30.3	-22.2	11.9	4.9
Merchandise Trade Balance	4.7	12.9	15.0	30.7	66.2	59.8
Current Account Balance	54.2	51.7	53.8	62.6	92.8	89.1
Capital Account Balance	-43.5	-42.2	-52.4	-48.4	-49.2	-50.6
Economic Indicator (percent change, year over year - earlier period, except as noted)						
GDP Deflator	-0.8	-0.6	-10.8	6.6	1.3	0.9
CPI	2.0	1.7	-0.4	-0.1	1.2	0.6
M2	-2.3	-4.6	-1.4	3.1	25.9	-7.1
Short-term Interest Rate (percent) (3 mth)	3.0	6.5	1.5	3.0	2.7	1.4
Exchange Rate (BND$/US$) Avg. for period	1.4	1.5	1.7	1.7	1.7	1.8
Unemployment Rate (percent)	3.9	4.2	4.7	4.5	4.7	4.7
Population (millions)	0.3	0.3	0.3	0.3	0.3	0.3

Annex II

BRUNEI: FORECAST SUMMARY

	2002					2003				
	Official	**IMF**	**Link**	**ADB**	**OECD**	**Official**	**IMF**	**Link**	**ADB**	**OECD**
Real GDP	3.0	N.A.	N.A.	N.A.	N.A.	4.8	N.A.	N.A.	N.A.	N.A.
Exports	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Imports	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
CPI	-2.0	N.A.	N.A.	N.A.	N.A.	1.0	N.A.	N.A.	N.A.	N.A.

Annex III

BRUNEI: MEDIUM-TERM FORECAST (percent)

	Period*
Real GDP	4.1
CPI	1.0

Notes: Forecasting period for GDP is 2002–2006.
Forecasting period for CPI is 2002–2003.

CANADA

REAL GROSS DOMESTIC PRODUCT

For Canada, 2001 marked the tenth consecutive year of economic growth, continuing one of the countries longest and most stable expansions of the post-war era. However, growth in real gross domestic product (GDP) slowed, with output growing at about one third of its pace in 2000. Domestic demand growth weakened while foreign demand declined. Helping to sustain growth was a drop in imports, permitting domestic production to satisfy a greater share of the increased domestic demand.

Growth slowed noticeably to an annual average of about 1.0 percent in the first half of 2001. Real GDP declined in the third quarter but recovered in the fourth. Economic evidence suggests that the economy grew solidly in early 2002, as consumers increased spending and foreign demand rebounded.

The slowdown in final domestic demand growth from 4.0 percent in 2000 to 2.2 percent in 2001 partly reflected declining business investment, especially in machinery and equipment, after a sharp increase in 2000. The retrenchment was severe in telecommunications and industrial equipment. Growth in non-residential structures slowed to less than 1 percent from over 5 percent in 2000. And inventory disinvestment contributed to the slowdown. Residential investment, on the other hand, surged, spurred on by declining interest rates during the year.

Consumer expenditure growth weakened to 2.5 percent in 2001 from a 3.6 percent gain in 2000. This slowing was widespread among goods and services categories. However, growth in the fourth quarter of 2001 rebounded, with widespread strength in goods.

INFLATION

Underlying price and cost pressures remained subdued in 2001, with consumer price inflation (growth in the consumer price index) averaging 2.6 percent. Consumer price index (CPI) inflation moved above 3.0 percent in late 2000, owing in large part to the impact of volatile energy and food prices. The world price of oil had risen sharply. However, by mid-2001, CPI inflation had fallen back below one percent, as oil prices retrenched. In early 2002, it moved back to near 2.0 percent. Core CPI, which excludes the eight most volatile items, meanwhile, began 2001 below 2.0 percent but moved above that level by April and remained there until November. It ended the year below 2.0 percent; but it again pierced the 2.0 percent barrier in early 2002. For 2002 and 2003, private/business sector forecasts show CPI inflation to average near the mid-point of the inflation target bands of 1.0 to 3.0 percent set jointly by the government and the Bank of Canada.

EMPLOYMENT

Over 1997–2000, employment grew at an average rate of 2.6 percent, bringing the unemployment rate to 6.8 percent in 2000—its lowest level in 25 years. Following these four consecutive years of robust gains, Canadian employment growth slowed early in 2001, dropping the pace of increase to 1.1 percent for 2001 and raising the unemployment rate to an average of 7.2 percent. A major factor in this was the loss of jobs in agriculture and manufacturing, as sharp declines in information and communication technology industries (ITC) largely offset continued gains elsewhere. Consequently, the unemployment rate moved up during the year, peaking at 8.0 percent in December. Strong employment growth in early 2002 brought the unemployment rate back down to 7.6 percent by April 2002.

TRADE

International trade has always played an important role in Canadian economic activity. In 2001, exports of goods and services fell 2.1 percent to Cdn$469.4 billion, equivalent to 43.3 percent of GDP (see Table 1). Imports of goods and services decreased by 2.9 percent to Cdn$413.8 billion or around 38 percent of GDP. The merchandise trade balance represented 5.7 percent of GDP in 2001, about the same as in 2000. In real terms, in 2001 exports and imports dropped by 3.7 percent and 5.7 percent, respectively.

Table 1: Trade as a percent of GDP, 1990–2001

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Total exports	25.7	25.1	27.0	30.1	33.9	37.2	38.3	39.4	41.2	42.9	45.4	43.3
Goods	22.3	21.5	23.3	26.1	29.5	32.7	33.4	34.3	35.6	37.4	40.0	38.1
Services	3.4	3.6	3.7	4.0	4.4	4.6	4.9	5.1	5.6	5.5	5.4	5.2
Total imports	25.6	25.6	27.4	30.1	32.7	34.0	34.3	37.4	39.3	39.6	40.4	38.2
Goods	20.7	20.5	22.0	24.3	26.9	28.3	28.3	31.4	33.1	33.5	34.4	32.4
Services	4.9	5.2	5.4	5.8	5.8	5.7	5.9	6.1	6.2	6.1	6.0	5.8

Source: Statistics Canada, *National Income and Expenditure Accounts*, Catalogue no. 13-001-PPB, 4th Quarter 2001.

The current account has improved dramatically from the deficits in the 1990s. It moved from a deficit of Cdn$12.3 billion or 1.3 percent of GDP in 1998 to a surplus of Cdn$1.7 billion or 0.2 percent of GDP in 1999, a surplus of $26.9 billion or 2.5 percent of GDP in 2000, and a surplus of Cdn$29.1 billion or 2.7 percent of GDP in 2001. The main factor underpinning this improvement was an increase in the merchandise trade surplus from Cdn$22.8 billion in 1998 to Cdn$61.5 billion in 2001.

On a regional basis in 2001, merchandise exports to the United States fell modestly as that economy slipped into recession. However, its share of Canada's goods exports, which has trended up, most recently rising from 80 percent in 1997 to 85 percent in 2000, remained stable. Exports to Japan dropped sharply in 2001 to their lowest level since 1993. Economic growth in that economy has yet to respond strongly to policy initiatives. While sales to the United Kingdom dipped, those to other European Union economies remained nearly unchanged, as they registered modest growth for 2001.

Exports to most other major markets were, for the most part, little changed from 2000, as global economic growth was weak. Exports to Latin American destinations rose modestly following an earlier gain in 2000, with mixed results by economy. Exports to Mexico, Canada's free trade partner, increased again; but those to Argentina tumbled. Overall, exports to Latin America have not recovered to their 1997 level, as that region continues to experience economic troubles. Exports to Asia Pacific economies other than Japan retrenched somewhat, with the exceptions of China and Singapore.

On a sectoral basis, the most noticeable aspects of 2001 were the significant drops in exports of machinery and equipment and automotive and forest products. In particular, exporters of high-technology products experienced sharply reduced international sales, especially of telecommunications equipment. Automotive exports lagged as the recession in the United States lowered sales of motor vehicles. Thus, machinery and equipment, despite a drop in its share of total Canadian merchandise exports to less than 24 percent, maintained its position as Canada's leading major export sector. Energy sector exports rose modestly as oil prices moved down during the year, although they maintained an average price in 2001 above that in 2000.

With regard to service trade in 2001, the decline was modest and confined to transportation, reflecting reduced goods movements across international borders. Travel to Canada actually expanded somewhat, driven by the lower value of the Canadian dollar.

The contraction in imports reflected the slowing growth in the Canadian economy and the lower value of the Canadian dollar. Sectorally, the import decline was greatest for purchases of machinery and equipment and automotive products. Again, high-technology products suffered large declines. In regional terms, Canada imported less from most of its trading partners, with significant drops in purchases from the United States, Japan and the United Kingdom.

EXCHANGE RATE

The Canadian dollar is a freely floating currency, which in recent years has experienced downward pressure from weakness in world commodity prices and flights to the quality of the US dollar. The Canadian dollar began 2001 at close to US$0.67. It trended downward in value throughout the year and ended 2001 at less than US$0.63. This trend continued into early 2002; but the Canadian dollar has regained ground recently, rising in value to above US$0.65.

Yield spreads between Canadian and US government securities turned positive for maturities of 2 to 30 years at the end of 2000 and generally have remained that way since then. This reflected in part an increased preference for US assets on the part of global investors who have sought the safety and liquidity of US financial markets at a time of market uncertainty. This change in investor sentiment was one of the factors behind the reduced value of the Canadian dollar during 2001. Compared to other major currencies, however, the Canadian dollar has remained quite firm.

FISCAL POLICY

Canada recorded the largest improvement in its financial balance of all G-7 countries from 1992 to 2000. And according to the Organisation for Economic and Development (OECD), Canada is the only G-7 country projected to record a surplus in 2001, 2002 and 2003.

Canada's federal budgetary surplus in 2000–1 was Cdn$17.1 billion. Although final results for 2001–02 will not be available until mid-September, results to date clearly indicate that another surplus will be posted in 2001–02. This will mark the fifth consecutive year that the federal government has recorded a surplus. Net public debt has declined by over Cdn$36 billion over the last five years.

Debt pay down in recent years, coupled with Canada's strong economic growth, has resulted in a significant decline in the federal debt-to-GDP ratio, from its peak of 70.7 percent in 1995–96 to about 50 percent in 2000–01. Sustained economic growth and our Debt Repayment Plan will ensure that the debt-to-GDP ratio remains on a permanent downward track. It is expected to continue to fall to about 40 percent by 2006–07.

Significant improvements in government finances helped turn chronic current account deficits into record surpluses, and cut Canada's foreign indebtedness.

Canada's net foreign debt as a share of GDP is down to its lowest level since the 1950s, from a peak of 44 percent of GDP in 1993 to less than 19 percent in 2001. Canada's net foreign debt as a share of GDP is now lower than in the U.S. for the first time on record.

Targeted spending in the last federal budget coupled with the tax cuts introduced in 2000 amount to Cdn$31 billion in 2002 – or 2.8 percent of GDP (when provincial tax cuts are added this amount grows to 4.0 percent of GDP). These fiscal measures will continue to help support a strong recovery in the months ahead.

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 1.0 to 3.0 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 US Federal Reserve dropped its Fed 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 April 2002 Monetary Policy Report, the Bank of Canada noted the strength of demand for Canadian production. Believing the Canadian economy would approach capacity in the second half of 2003 and that there was a need to lean against these trends in order to preserve the low and stable inflation environment that has been benefiting the Canadian economy, it raised its target rate by 25 basis points. It moved cautiously in reducing the substantial monetary stimulus in the economy because of uncertainties surrounding the robustness of the economic recovery. However, concerned about the sustainability of a robust recovery from the US recession, the US Federal Reserve so far has refrained from increasing its target rate.

The Bank of Canada has continued with the system of eight “fixed” or pre-specified dates each year for announcing changes to the bank rate and the target for the overnight rate. This system was adopted at the end of 2000 and replaced the previous approach in which the bank rate could be adjusted on any business day. The bank says that, in general, fixed dates will increase the Bank’s transparency, accountability, and dialogue with the public.

MEDIUM-TERM OUTLOOK

The Canadian economy is now enjoying a robust recovery, following last year’s global economic slowdown. Real GDP fell slightly in the third quarter of 2001, but growth rebounded in the fourth quarter and continued at a stronger pace in the first quarter of this year. Private sector economists expect Canadian growth will average close to 3.0 percent in 2002, compared to the prediction of 1.0 percent in the December 2001 budget. The IMF and OECD forecast that Canada will lead the G-7 in growth in both 2002 and 2003. This means that Canada will have led the G-7 in economic growth in four of the five years from 1999 to 2003. This reflects our strong macroeconomic fundamentals.

Inflation is forecast to remain low this year. The Bank of Canada’s latest Monetary Policy Report predicts core inflation will average just under 2.0 percent in the second half of 2002 and the first half of 2003, before moving back to about 2.0 percent by the end of the year.

Annex I

CANADA: OVERALL ECONOMIC PERFORMANCE

	1993	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**
GDP and Major Components (percent change, year-over-year, except as noted)									
Nominal GDP (billion US$)	566	566	592	615	639	617	656	711	700
Real GDP	2.39	4.72	2.81	1.57	4.28	3.93	5.07	4.43	1.49
Private Consumption	1.82	3.02	2.06	2.56	4.63	3.02	3.43	3.62	2.53
Government Consumption	0.04	-1.27	-0.56	-1.41	-0.76	1.78	2.63	2.23	2.22
Private Investment	-2.14	7.5	-1.94	5.91	18.14	2.8	6.69	6.6	0.66
Government Investment	-1.33	7.35	-3.15	-4.3	-3.22	-0.93	12.32	7.57	6.85
Exports of Goods and Services	10.84	12.71	8.49	5.6	8.33	8.87	9.9	7.6	-3.66
Imports of Goods and Services	7.35	8.05	5.74	5.11	14.24	4.87	7.35	8.1	-5.72
Fiscal and External Balances (percent of GDP)									
Budget Balance	-8.7	-6.7	-5.3	-2.8	0.2	0.5	1.6	3.2	2.4
Merchandise Trade Balance	1.8	2.6	4.4	5.1	2.9	2.5	3.9	5.6	5.7
Current Account Balance	-3.9	-2.3	-0.7	0.5	-1.3	-1.3	0.2	2.5	2.7
Capital and Financial Account Balance	4.7	2.3	0.2	-1.5	1.8	0.5	-1.2	-1.4	-1.9
Economic Indicators (percent change, year-over-year earlier period, except as noted)									
GDP Deflators (percent change)	1.5	1.1	2.3	1.7	1.2	-0.4	1.4	3.7	1.2
CPI (percent change) 1994 = 100	1.8	0.2	2.2	1.6	1.6	0.9	1.7	2.7	2.6
M2 (percent change)	3	2.2	4.2	3.2	0	-0.7	2.7	6.8	5.2
90 Corporate Paper Rate	4.97	5.66	7.22	4.35	3.61	5.05	4.94	5.71	3.87
Exchange Rate (Cdn/US$)	1.29	1.366	1.372	1.364	1.385	1.484	1.487	1.485	1.549
Unemployment Rate (percent)	11.4	10.4	9.4	9.6	9.1	8.3	7.6	6.8	7.2
Population (millions)	28.67	29	29.32	29.63	29.94	30.21	30.46	30.73	31.03

Annex II

CANADA: FORECAST SUMMARY (percent change from previous year)

	2002			2003		
	Official*	**IMF**	**OECD**	**Official***	**IMF**	**OECD**
Real GDP	3	2.5	3.2	3.8	3.6	4
Exports	N.A.	0.4	2.8	N.A.	6.3	9.1
Imports	N.A.	-1.4	1.6	N.A.	8.2	9.5
Total CPI	1.9	0.9**	1.9	2.2	1.8**	2.2

Notes: * Expected June private-sector survey (to be updated when official data available)
** Private consumption deflator

Source: IMF: World Economic Outlook, April 2002.
OECD: Preliminary OECD Economic Outlook, April 2002

Annex III

CANADA: MEDIUM-TERM FORECAST (Percent-Annual Average)

	2004-2007
Real GDP	3.2
Total CPI	2

Source: Expected June Private-Sector Survey

CHILE

REAL GROSS DOMESTIC PRODUCT

The slowdown and recession experienced by the international economy in 2001 had an impact in the Chilean economy, reducing the rate of growth of its gross domestic product to 2.8 percent, below its potential rate of growth of 5.2 percent, as estimated by economic authorities.

Despite a strong export performance, the economy decelerated in 2001 owing to a contraction in domestic demand of 0.5 percent and deteriorated terms of exchange. Components more sensitive to fluctuations of the exchange rate, such as expenditure in machinery and equipment, along with inventories, were the main contributing factors to this weak performance. Private consumption expanded 3.2 percent similar to the growth in GDP. Investment in construction was stimulated by favorable credit conditions, partially compensating the weak behavior of investment in machinery. The fall in domestic demand, moderate in the second and third quarter of the year, experienced an aggravation in the last quarter (4.9 percent).

INFLATION

Inflation in 2001, according to the consumer price index, was 2.6 percent, which was 0.4 below the middle of the range that the central bank had fixed as a target and continued the declining trend of previous years. This was explained mainly by the sharp drop of imported commodities such as fuel, and by depressed domestic demand.

EMPLOYMENT

Unemployment fell slightly to 8.7 percent during the year as a consequence of a moderate increase in employment in the third and last quarters of the year.

BALANCE OF PAYMENTS

Chile’s external accounts remained sound in 2001 as a result of a prudent macro-economic policy and the dynamic performance of the export sector. The deficit of the current account of the balance of payments amounted to 1.6 percent of the GDP, reaching a modest US$903 million in 2001, marginally better than the US$991 million recorded the previous year, despite a sharp deterioration in the terms of trade.

Although export volumes grew by nearly 10 percent in 2001, revenue fell by 4.0 percent to US$17.4 billions, owing to lower commodity prices. Particularly hard hit were cellulose prices, which fell by 33.6 percent and salmon prices, which halved. On average, prices of export products fell by 11.4 percent. Prices of imports, on the other hand, dropped 3.9 percent, mainly from the effect of lower prices for petroleum imports. Chile has lost an estimated 4.5 percent because of the drop of the relative price of exports in relation to imports.

Nevertheless, the trade surplus improved slightly, to US$1.6 billion, as import spending contracted by 5.1 percent, to US$15.9 billion. The drop was especially strong for consumer goods spending which fell by 7 percent. The improved trade surplus, together with a narrowed non-financial services deficit, helped the current account deficit, but the financial services deficit widened, offsetting some of these gains.

GROSS EXTERNAL DEBT

Foreign debt reached US$37.7 billion in 2001, representing almost 50 percent of the GDP and an increase of 2.5 percent over the previous year. Most of the amount is comprised by mid- and long-term liabilities, which account for 82.8 percent of total foreign debt.

As for the business/private sector, its debt increased by 2.1 percent representing about 84.6 percent of foreign debt. The debt of the public sector increased by 4.8 percent.

EXCHANGE RATE

The nominal exchange rate was characterized by a depreciation of the local currency, in total by 12.77 percent in 2001, and volatility by the end of the year. Record low domestic interest rates, low copper prices and instability in Argentina placed pressure on the currency. The depreciation reached its peak in October, when the local currency had an average of 708.1 pesos per dollar, but receded in the last quarter and the peso closed the year with a value of 669.14 pesos/dollar.

FISCAL POLICY

Fiscal policy was countercyclical but prudent for 2001. The fiscal accounts registered a 0.3 percent deficit, including income from privatization and concessions as current revenue, along with a transfer of US$420 million in funds from the Copper Stabilization Fund. Total expenditure of the public sector rose at a rate of 5.0 percent during the year offsetting the contraction in private domestic demand.

MONETARY POLICY

Monetary policy was expansionary in 2001. The monetary stance was substantially reduced particularly during the first half of the year due to the slow reactivation process in internal demand but attending to internal prices evolution. After that, monetary stance stayed at 6.5 in nominal terms (in August, the central bank changed the way to represent the monetary stance, from real terms to nominal terms which includes the inflation target defined).

MEDIUM-TERM OUTLOOK

The rate of economic growth in 2002 is expected to be around 3.0 percent, and for the year 2003 an annual rate of 5.3 percent is forecast, based on the assumption of a recovery of the international economy, a steady rate of monetary policy of 6.0 percent and a nominal depreciation of the local currency around 2.0 percent. In this context, the forecast of the annual growth of internal demand is 4.8 percent for 2002 and 2003, and the deficit in current account is expected to reach 1.0 percent of the GDP. Inflation for both years should be around 3.0 percent.

In the next quarters, economic growth is expected to rely more heavily on internal demand, as private consumption is expected to have a higher rate of growth. The fiscal budget for 2002 considers an expansion of real public expenditures with a macro-economic impact of 4.9 percent, mainly stimulated by public investment, which will grow by 11 percent.

Annex I

CHILE: OVERALL ECONOMIC PERFORMANCE

	1996	**1997**	**1998**	**1999 [1]**	**2000 [1]**	**2001 [2]**
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (million US$)	75,769	82,809	79,274	73,046	74,953	66,450
Real GDP	7.4	7.4	3.9	-1.1	5.4	2.8
Consumption (Real *)	8.8	6.5	4.3	-0.5	3.4	1.6
Private Consumption (Real *)	9.4	6.6	4.7	-1	3.5	1.4
Government Consumption (Real *)	4	5.8	2.2	2.5	2.8	2.7
Investment (Real)	8.9	9.4	2.2	-19.6	14	-7.6
Exports of Goods and Services	11.8	11.2	5.9	6.9	7.5	-4
Imports of Goods and Services	11.8	12.9	5.4	-14.6	10.1	-4.7
Fiscal and External Balances (percent of GDP)						
Budget Balance	2.3	2	0.4	-1.5	0.1	-0.3
Merchandise Trade Balance	-2.3	-2.7	-4.2	1.8	1.1	2.4
Current Account Balance	5.1	-5	-5.7	-0.1	-1.4	-1.6
Capital Account Balance	7.8	9.8	4.5	-1.1	1.7	1.6
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	1.7	4	2.5	3.5	4.1	na
CPI	6.6	6	4.7	2.3	3.8	2.6
M2 (end of period) [3]	25.2	22.2	12.1	10.6	8.4	7.7
Short-term Interest Rate [4]	7.3	6.8	9.6	6	5.4	4.5
Real Effective Exchange Rate	-4.8	-7.7	-0.2	5.5	4.5	12.5
Unemployment Rate (percent)	6.5	6.1	6.2	9.7	9.2	8.7
Population (millions)	14.4	14.6	14.8	15	15.2	15.4

Notes : * Constant prices of 1996, except for 1996 figures

[1] Provisional figures

[2] Preliminary figures

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

[4] Short-term interest rate is 90 days "*Pagre Reajustable del Banco Central*" (PRBC)

Annex II

CHILE: FORCAST SUMMARY (percent change from previous year)

	2002			2003		
	Official	**IMF**	**Link**	**Official**	**IMF**	**Link**
Real GDP	3.3	3.5	N.A.	4.5	6.0	N.A.
Exports (goods & services)	4.9	N.A.	N.A.	14.9	N.A.	N.A.
Imports	5.7	N.A.	N.A.	12.9	N.A.	N.A.
CPI	3.0	N.A.	N.A.	3.0	N.A.	N.A.

THE PEOPLE'S REPUBLIC OF CHINA

REAL GROSS DOMESTIC PRODUCT

The economy of China continued to perform well, although the world economy experienced an apparent slowdown in 2001. China's gross domestic product (GDP) in 2001 reached US$1159.08 billion, an increase of 7.3 percent in comparable prices over the previous year due to our continued stimulation of domestic demand and our unswerving implementation of a proactive fiscal policy and a stable monetary policy. The value-added of the primary industry, secondary industry and tertiary industry sectors were US$176.52 billion, US$592.86 billion, US$389.70 billion, respectively, with growth rates of 2.8 percent, 8.7 percent, and 7.4 percent respectively.

Investment in fixed assets enjoyed a relatively rapid growth. The investment in fixed assets for the whole economy in 2001 reached US$445.81 billion, which was an increase of 12.1 percent over the previous year. Investment by state and other economic sectors; by township and village economic entities; and by private individuals, increased by 12.8 percent, 8.1 percent, and 12.7 percent respectively. Efforts were made to continue the upgrading of electric power distribution networks in rural areas, the building of major networks of roads in China, and key water conservation and irrigation projects. The growth of investment in western regions was 19.3 percent, which was much higher than it was in the eastern and central regions of China.

Consumer demand went up steadily, along with the continued improvement of the living standard of the people. The total retail sales of consumer goods were US$454.23 billion, with a growth of 10.1 percent year-on-year. The living standards of people in towns and villages were improved steadily. The annual per capita governable income for the residents in cities and towns was US$828.84, with a real growth of 8.5 percent year-on-year. The per capita net income of residents in rural areas was US$285.87, with a real growth of 8.5 percent year-on-year, of which the per capita net income of cash was US$211.20, with a real growth of 5.7 percent year-on-year. The Engel coefficients of residents in urban and rural areas were 37.9 percent and 47.8 percent respectively, both were 1.3 percentage points lower than they were last year.

INFLATION

Market prices were stable throughout the year of 2001. Prices rose in the first half of the year and declined in the second half of the year, influenced by the international economy. The consumer price index (CPI) in 2001 was up 0.7 percent over the previous year, with an increase of 0.7 percent in urban areas and 0.8 percent in rural areas. Measured using components of the price index of goods and services, the price level of foods remained the same. The prices of some goods and services declined: cigarettes and alcoholic drinks by 0.3 percent; dresses and clothes by 1.9 percent, home appliances and services by 2.3 percent, transportation and telecommunication by 1.0 percent. The prices of some goods and services rose:, goods and services for entertainment, culture and education by 6.6 percent; and housing by 1.2 percent. The manufacturer's price of industrial products declined by 1.3 percent. The cost of raw materials, fuel and power declined by 0.2 percent. Fixed-asset investment rose by 0.4 percent.

EMPLOYMENT

The work done to increase employment was strengthened further. By the end of 2001, there were 730.25 million employees, 9.4 million more than the previous year, of which 239.4 million employees were in urban areas, an increase of 7.89 million year-on-year. By the end of 2001, the total number of employees of the state-owned enterprises (SOEs) who was retrenched was 5.15 million, 1.42 million less than the last year. In 2001, every effort was made to help the 2.27 million retrenched workers to find new jobs. By the end of the year, the urban registered unemployment rate was 3.6 percent. Unemployment will remain an important issue in the long-term in China.

The social security system was further consolidated and improved. By the end of 2001, 103.55 million employees were registered in the Unemployment Insurance Program, and a total of 3.12 million unemployed were receiving benefits. A total of 106.30 million employees and 33.46 million retirees had been included in the Basic Retirement Pension Program, and a total of 76.29 million employees and retirees took part in the Basic Medical Care Program. The number of urban residents covered by the Subsistence Allowance System reached 12.70 million, all residents in the urban areas with the lowest per capita incomes in China.

BALANCE OF PAYMENTS

Foreign trade maintained high growth in 2001. Total volume of exports and imports for the year reached US$509.8 billion, up by 7.5 percent over the previous year. The total volume of exports reached US$262.2 billion, up by 6.8 percent over the previous year. The total volume of imports reached 243.6 million US dollars, up by 8.2 percent over the previous year. Exports of machine components and electronic products increased relatively faster. The value of exports of high-tech and new-tech products was US$46.5 billion, up by 25.4 percent, which was accounting for 17.5 percent of total exports, 2.6 percentage points more than the previous year.

The international tourism industry experienced a steady development. In 2001, China received 89.01 million tourists from overseas, up by 6.7 percent year-on-year. The foreign currency revenue from international tourism was US$17.8 billion, with a growth rate of 9.7 percent year-on-year. The number of Chinese tourists going abroad increased by 15.9 percent, of which 6.95 million people/trips were private travelers, with a growth rate of 23.4 percent year-on-year.

Foreign Direct Investment (FDI) increased rapidly. In 2001, a total of 26139 new foreign-invested project/enterprises were approved, up by 16.0 percent over the previous year. The contractual investing value amounted to US$69.2 billion, up by 10.4 percent over the previous year. The actual value of utilized FDI was US$46.8 billion, up by 14.9 percent over the previous year.

National foreign exchange reserves continued to increase. By the end of 2001, total foreign exchange reserves reached US$212.2 billion, an increase of US$46.6 billion than the previous year.

EXCHANGE RATE

The exchange rate of the renmimbi (RMB) against foreign currency kept stable. By the end of 2001, 1 US dollar was equal to 8.2766 RMB. The RMB appreciated by 15 basic points.

GROSS EXTERNAL DEBT

By the end of 2001, the recorded balance of the foreign debts amounted to US$170.11 billion, not including debt in Hong Kong, China; Macao; and Chinese Taipei. As the Chinese government used the international standard statistical category for foreign debt instead of the one implemented before 2000, data for 2001 is not comparable to the data of 2000. By the end of 2001, foreign government loans and international finance institutes' loans amounted to US$23.70 and US$27.57 billion respectively. National debt issued overseas reached US$12.67 billion.

FISCAL POLICY

The statistics in this section do not include debt revenues. In 2001, the total fiscal revenue reached US$197.80 billion, with an increase of US$35.96 billion over the previous year, up by 22.2 percent year-on-year. Total fiscal expenditure amounted to US$227.68 billion, an increase of

US$17.95 billion more than was budget of the year. This was an increase of US$35.73 billion over the previous year, up by 18.6 percent year-on-year. There was a fiscal deficit of US$29.88 billion in 2001.

In 2001, a total of US$18.12 billion of Long-Term Treasury Bonds for Construction were issued. The total value of Long-Term Treasury Bonds for Construction issued from 1998 to 2001 reached US$61.62 billion, which played an effective role in attracting supplementary investments and loans from local governments, economy sectors, enterprises and banks resulting in a total investment of US$362.47 billion on projects and programs supported by treasury bonds. These projects and programs played an important role in stimulating economic growth, restructuring economic instituitions, increasing employment opportunities, and improving people's living standards.

The total deficit in the central budget for 2001 accounted for 2.7 percent of GDP. The remaining debts totaled US$188.58 billion, accounting for 16.3 percent of GDP. Both the deficit and the remaining debts were within safe limits.

MONETARY POLICY

The growth of monetary supply consistent with economic growth and the objects of monetary policy were basically achieved. By the end of 2001, the balances of the broad money supply (M2), the narrow money supply (M1), and cash in circulation (M0) reached US$1912.65 billion, US$723.39 billion and US$189.56 billion respectively, and up by 14.4 percent, 12.7 percent and 7.1 percent year-on-year, respectively. The net amount of cash put into circulation amounted to US$12.52 billion in 2001, a decrease of US$1.95 billion, which could be explained by the sharp increase of use of all kinds of card issued by banks and a decrease in cash payments for the purchase of agricultural products and by-products.

Savings and loans in financial institutions increased steadily. Savings and deposits in various forms in all banking institutions totaled US$1735.22 billion, up by 16.0 percent. The balance of loans issued by all financial institutions amounted to US$1357.01 billion, with an increase of 11.6 percent using comparable measures of which, the balance of short-term loans was US$813.46 billion and the balance of long-term and medium-term loans was US$414.10 billion, up by 7.7 percent and 15.2 percent respectively. The structure of loans was continually improved.

MEDIUM-TERM OUTLOOK

In 2002, China's government will focus on the following:

(1) The structure of the agricultural industry will be adjusted. More work should be done to accelerate industrialization and economies of scale in agricultural sectors. Living standards in rural areas should be improved and the burden on rural residents should be alleviated. Every effort will be made to strive for a 4 percent increase in rural per capita net income in real terms.

(2) A total value of US$18.12 billion Long-Term Treasury Bonds for Construction are going to be issued to maintain sustained and steady growth of the economy and to curb any potential deflation.

(3) Great efforts will be made to create more job opportunities and to further improve the social security network. Vigorous steps will be taken to develop labor-intensive industries with comparative advantages. It is hoped that in urban areas there will be 8 million more employees in 2002 than there were in 2001.

More effort will be made to develop the Insurance System for Residents with Low Living Standards in Urban Areas and to help disadvantaged groups with difficulties. Diligent efforts will be made to increase the incomes of residents in both urban and rural areas, especially those with low incomes. Positive steps will be taken to further develop the Basic Endowment Insurance System, the Unemployment Insurance System and the Basic Medical Care Insurance System for employees in urban areas.

(4) Actions will be taken to further develop policies and improve the environment for consumers. It is expected a credit system for private individuals will be established and developed. More action will be taken to expand the scale of credit consumption and introduce new consumption behaviors, such as renting consumption. Consumers will be encouraged to spend money on housing, cars, telecommunication, tourism, cultural entertainment, sports and medical care. New consumption fields and behaviors will be cultivated and developed.

(5) Positive efforts will be made to integrate information technology and application into the national economy and the wider society. Moves to upgrade the industrial structure will be accelerated in order to improve the overall quality of industries. Key sectors and enterprises will be reengineered by using the high, new and advanced technologies applicable to them to improve this R&D capacity and meet market demands.

(6) The economic system will further reformed. Reform of the shareholding system in State-Owned Enterprises (SOEs) will be standardized. Corporate governance in companies will be improved. The management of enterprises will be improved and enterprises will be encouraged to make more use of information technologies. Restructuring of monopoly industries will continue and more steps will be taken to introduce reforms. The sound development of non-state sectors of the economy will be supported, encouraged and guided while measures are taken to ensure the development of state sectors of the economy.

(7) The implementation of 'opening' policy to the outside world should be further improved. Every effort must be made to improve foreign trade and foreign investment. The structure of export goods should be adjusted and optimized to realize the strategy of market diversification and increase exports. Qualified enterprises are encouraged to invest and compete for contracts in foreign countries, which will be an effective way to stimulate the export of equipment, materials, and labor and the importing of goods and energy that are in short supply in China. Careful arrangements will be made to import key equipment and technologies and important raw and processed materials that are badly needed in China.

The investment environment will be further improved to encourage foreign investors to invest in fields such as modern agriculture, high-tech industry, infrastructure construction, the development of western regions of China and the reengineering of SOEs. The opening of the services trade should be carried out step by step. The management of foreign debts needs to be improved to reduce debt risks.

(8) Actions will be taken to continue the implementation of the strategy of developing China's western regions and the coordination of regional economic development. The improvement of infrastructure and ecological conditions in the western region will be accelerated. Efforts will be directed at developing science, technology and education, stepping up the development of unique industries and transforming resource advantages into economic advantages.

(9) The structure of budgetary expenditures should be optimized to bring the role of finance into full play to contribute to economic growth. The total budget revenue will reach US$217.66 billion and total expenditure will be US$255.09 billion, with the central budget deficit of US$37.43 billion under control.

More play will be given to the role of the prudent monetary policy so that the financing will make a greater contribution to economic growth. The structure of credit should be adjusted and optimized. Vigorous efforts will be made to improve financial services. The loan hypothecation system for small enterprises should be improved. Small sum credit loans will be introduced positively and steadily into rural areas. More actions will be taken to standardize and develop the securities market and appropriately increase the enterprise bond scale. Monetary policy instruments such as interest rate, behaviors in open markets and rediscount rate will be applied more to allow greater flexibility in regulating the money supply. Conscientious efforts will be made to further reform financial institutions to improve the supervision of financial institutions, and the quality of financial assets, to reduce the proportion of non-performing assets, and to enhance competitiveness and risk-resistance capacity.

(10) More efforts will be made to accelerate the development of science, technology and education and implementation of the sustainable development strategy consistent with the development of all social undertakings. Great effort will be put into promoting scientific and technological progress and innovations. The process of applying scientific and technological advances to production and industrialization will be accelerated and the development of a system of technical standards will be promoted. Self-owned intellectual property rights for key technologies will be developed and the protection and management of intellectual properties will be strengthened. The system of venture capital investment and innovation of scientific inventions will be developed.

We shall adhere to the idea that the development of education must lead the way of the development of China. The elementary education will be further strengthened, compulsory education will be made universally, and overall the quality education of students will be promoted. The compulsory education project for poverty-stricken areas will be carefully implemented. The introduction of information technology to institutions of higher education in western regions will be carefully carried out to promote the integration of information technology in education.

Efforts for the improvement of the ecological environment and environmental protection will be further strengthened. An integrated monitoring system will be established to monitor the effects of development on ecology, environment, resources and disasters. More efforts will be made to develop shelter forests and natural reserves in key areas.

(11) Further steps will be taken to deepen the reform and ‘opening’ policy and meet the challenges and opportunities arising after China’s accession to the World Trade Organization (WTO). Positive actions will be made to revise and make national and local laws, rules and regulations, relating to administrations by following the rules of the WTO and China's commitment to them. More efforts will be made to make administrative rules and regulations to regulate the behaviors and orders in the market.

The measures of macro-economic adjustment will be further optimized. The government will make the economic adjustments by indirect methods, such as policy guidance and information publication, with a reduction in direct intervention on micro-economic activities.

More efforts will be made to regulate economic order in the market. The regulations will be set to manage and administrate key markets such as medicine market and food market. Local discrimination obstacles and the illegal rules that restrict marketing and investment across regions will be removed and further use forbidden. Further, harsh actions will be taken to prevent the illegal production and marketing of counterfeit and poor quality commodities in the market.

The major anticipated targets of the economic and social development for China in 2002 are as follows:

- Economic growth rate around 7 percent;
- A growth rate around 10 percent in investment in fixed assets;
- The increase of the price level of consumer's goods and services by 1 to 2 percent;
- An increase of the total volume of foreign trade, both imports and exports;
- The fiscal deficit of the central government to be under US$37.43 billion;
- The growth of the supply of broad money (M2) and narrow money (M1) to be around 13 percent, with under US$18.12 billion cash in circulation;
- The registered unemployment rate in urban areas to be under 4.5 percent; and
- The natural growth of population to be under 8 thousandth.

Note:

1. 2001 statistics are quoted from the official statistics published by National Bureau of Statistics of China. They are preliminary data.
2. The statistics of the Hong Kong Special Administration Region and the Macao Special Administration Region are not included.
3. Statistics do not include the data from Chinese Taipei.
4. The absolute values of GDP and the value-added of all sectors are calculated based on current values, while the growth rates are calculated based on comparable prices.

Annex I

CHINA: OVERALL ECONOMIC PERFORMANCE

	1993	1994	1995	1996	1997	1998	1999	2000	2001
GDP and Major Components (percent change from previous year, except as noted)									
Nominal GDP (billion US$)	601.1	540.9	697.65	816.9	903.0	960.9	991.1	1080	1159
Real GDP	13.5	12.6	10.5	9.6	8.8	7.8	7.1	8.0	7.3
Total Consumption	9.3	8.0	9.2	9.3	6.1	6.8	7.9	10.4	8.07
Private	9.4	7.7	10.1	9.6	5.8	6.1	6.8	9.5	6.94
Government	9.1	9.1	5.9	8.4	7.2	8.9	12.0	13.8	12.24
Total Investment	24.9	15.6	15.5	10.4	7.1	14.4[1]	5.2	9.3	12.1[1]
Merchandise Exports	8.0	31.9	22.9	1.5	20.9	0.5[2]	6.1	27.8	6.4
Merchandise Imports	29.0	11.2	14.2	5.1	2.5	-1.5[3]	18.2	35.8	8.2
Fiscal and External Balances (percent of GDP)									
Budget Balance	-0.85	-1.23	-1.00	-0.78	-0.78	-1.5	-2.1	-2.8	-2.6
Merchandise Trade Balance (f.o.b.)	-2.03	0.99	2.41	1.51	4.46	5.48	2.9	2.23	1.6
Current Account Balance	-1.98	1.42	0.23	0.89	3.29	3.03	1.07	1.90	1.5
Capital Account Balance	3.91	4.68	4.74	4.89	2.54	0.00	0.01	0.18	3.0
Economic Indicators (percent change from previous year, except as noted)									
GDP Deflator	14.6	19.5	13.1	6.1	1.5	-1.3	-3.0	0.9	-
CPI	14.7	24.1	17.1	8.3	2.8	-0.8	-1.4	0.4	0.7
M2	32.4	34.5	29.5	25.3	19.58	15.3	14.7	12.3	14.4
Short-term Interest rate (percent)	8.8	9.0	9.0	9.72	7.65	6.34[4]	5.58	5.58	5.58
Exchange Rate (RMB/US$)	5.76	8.62	8.35	8.31	8.28	8.28	8.28	8.28	8.2766
Unemployment Rate (percent)	2.6	2.8	2.9	3.0	3.1	3.1	3.1	3.1	3.6
Population (millions)	1185.2	1198.5	1211.2	1223.9	1236.7	1248.1	1259.1	1265.8	1276.3

Notes: [1] Real Investment in Fix Assets Growth
[2] Current price
[3] Current price
[4] 3 months inter-bank rate

Annex II

CHINA: FORECAST SUMMARY (percent change from previous year)

	2002					2001–2005				
	Official	**IMF**	**LINK**	**ADB**	**OECD**	**Official**	**IMF**	**LINK**	**ADB**	**OECD**
Real GDP	7 or so	7.0	N.A.	N.A.	N.A.	7.0	N.A.	N.A.	N.A.	N.A.
Merch. Exports	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Merch. Imports	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
CPI	1-2	N.A.	N.A.	N.A.	N.A.	3.5	N.A.	N.A.	N.A.	N.A.

Annex III

CHINA: MEDIUM-TERM TREND FORECAST (percent)

	2001–2005
Real GDP	7.0
CPI	3.5

HONG KONG, CHINA

REAL GROSS DOMESTIC PRODUCT

Affected by the global economic downturn, the Hong Kong, China economy underwent a distinct slow-down over the course of 2001. The Gross Domestic Product (GDP)[1] still put up growth at 2.3 percent and 1.6 percent respectively in real terms in the first and second quarters of 2001 over a year earlier, before receding to declines of 0.3 percent in the third quarter and 0.9 percent in the fourth quarter. For 2001 as a whole, GDP growth in real terms decelerated sharply to a mere 0.6 percent, from 10.2 percent in 2000.

Hong Kong, China's exports of goods were still slack in the first two months of 2002, yet resumed positive growth in the ensuing months as the global and regional economic conditions turned steadier. In the first half of 2002, total exports of goods had a 1.8 percent growth in real terms, propelled mainly by a distinct rebound in exports to the East Asian region. Exports of goods to the United States also rebounded to a distinct rise towards the middle of the year. Bolstered by leaps in both offshore trade and inbound tourism, exports of services picked up to a notable growth of 8.2 percent in real terms in the first half of 2002 over a year earlier.

But the domestic economy was still in the midst of consolidation. Local consumer spending was restrained by rising unemployment and moderating wages, falling by 1.4 percent in real terms in the first half of 2002 from a year earlier. Concurrently, investment spending came down even more, by 7.1 percent in real terms, though with a relatively better performance in the second quarter than in the first quarter. Machinery and equipment intake was held back by a subdued business climate, while building and construction output was also modest in overall terms.

Granting that the external economic environment will hold steady and not deteriorate, the Hong Kong, China economy should continue to revive in the second half of 2002. For 2002 as a whole, GDP is forecast for a mild growth of 1.5 percent in real terms[2]. Externally, exports of goods, having resumed positive growth by the second quarter of 2002, should remain on an uptrend in the quarters ahead. Exports of services should continue to fare better than exports of goods in 2002, given the on-going structural shift towards offshore trade, and the boost to inbound tourism upon removal of the quota on visitors from the mainland of China. Locally, both consumer and investment spending may remain subdued in the near term, possibly with some improvement later in the year as overall economic conditions turn better.

INFLATION

Overall consumer prices fell for the third consecutive year in 2001. The rate of decline narrowed in the first seven months of 2001, but widened again in the remainder of the year, amidst a slack local demand prompting further moderation in labour wages and property rentals. Import prices continued to ease, due to a general softening in world commodity prices and the relative strength of the US dollar at that time. Furthermore, local retailers continued to offer large price discounts

---

[1] In accordance with the established international practice of undertaking a comprehensive review and update of the GDP series when it has run for some years, the Hong Kong SAR Government introduced a major revision to the GDP series on 1 August 2002. It was done mainly for benchmarking and rebasing so as to bring the compilation framework up-to-date, as well as for gearing in with the latest statistical standards in this area. Stemming from this 2002 round of major revision, the level of nominal GDP is revised upward, ranging from 1.3 percent to 1.8 percent in the past six years. As to the annual growth rate, GDP growth in nominal terms and in real terms is revised, either up or down, by a range of 0.1 to 0.4 of a percentage point in the past six years.

[2] This forecast was released at end-August 2002, with the effect of the 2002 round of major revision to the GDP series incorporated.

on many items in a move to promote sales. For 2001 as a whole, the Composite Consumer Price Index (CPI) went down by 1.6 percent, which was nevertheless smaller than the 3.8 percent fall in 2000.

The decline in overall consumer prices widened further in the first half of 2002, as manifested by a 2.9 percent drop in the Composite CPI over a year earlier. Yet this was partly due to the influences of some special factors, including in particular the rates concessions and the waiver of water and sewage charges by the government. For 2002 as a whole, the Composite CPI is forecast to decrease by 2.8 percent.

EMPLOYMENT

The labour market held broadly stable in the first half of 2001, but slackened visibly since the second half of the year. Reduced labour demand, consequential to the downturn in economic activity, coupled with a further expansion in labour supply, led to a marked loosening in the manpower resource balance. The seasonally adjusted unemployment rate jumped from 4.5 percent in the first quarter of 2001 to 6.2 percent in the fourth quarter. It continued to surge in the first two quarters of 2002, to 7.0 percent and 7.7 percent respectively. The increase in the unemployment rate occurred extensively across almost all the major economic sectors and occupation categories.

Total employment had a marked slow-down over the course of 2001, with the year-on-year growth rate moderating from 3.1 percent in the first quarter of 2001 to -0.4 percent in the fourth quarter. It then contracted more visibly, by 1.0 percent and 1.9 percent respectively in the first and second quarters of 2002. There were increased incidents of corporate downsizing and lay-offs, and employers had generally adopted an even more cautious attitude towards staffing. On the other hand, the year-on-year growth rate of total labour force, having slowed down from 2.0 percent to 1.4 percent over the course of 2001, picked up again to 1.5–1.7 percent in the first two quarters of 2002. These differential growth rates likewise reflected a clear slackening in the labour market.

On short-term outlook, labour supply is likely to continue to grow, especially during the summer months of the year upon increased entry of fresh graduates and school leavers into the labour market. The effect on unemployment further ahead will depend on the extent to which these new comers can be readily absorbed into jobs, which in turn will hinge on the pace of pick-up in the overall economy giving rise to new labour demand. Restructuring of the economy will tend to impinge more on the less educated and lower-skilled workers.

EXTERNAL TRADE ACCOUNTS

Affected by the austere external economic environment, Hong Kong, China's merchandise exports fell by 5.7 percent in value terms to HK$1,489.0 billion (US$190.9 billion) in 2001. Imports of goods likewise shrank, by 5.4 percent in value terms to HK$1,554.0 billion (US$199.3 billion) in 2001. As total exports of goods fell somewhat faster than imports of goods in value, the visible trade deficit reckoned on an balance of payments (BoP) basis widened slightly, to HK$65.0 billion (US$8.3 billion) or 4.2 percent of the value of imports of goods in 2001. This was nevertheless more than offset by an invisible trade surplus reckoned on a BoP basis at HK$133.5 billion (US$17.1 billion) in that year, thereby yielding a combined surplus of HK$68.5 billion (US$8.8 billion), equivalent to 3.9 percent of the total value of imports of goods and services, in 2001.

Notwithstanding a rebound in exports of goods upon firmer regional demand, Hong Kong, China's merchandise exports still fell by 2.1 per cent in value terms over a year earlier to HK$699.8 billion (US$89.7 billion) in the first half of 2002, as export prices fell over the period. With import prices also falling and with subdued domestic demand, imports of goods declined to a greater extent, by 4.5 per cent in value terms over a year earlier, to HK$728.6 billion (US$93.4 billion) in the first half of 2002. Taken together, the visible trade deficit reckoned on a BoP basis narrowed to HK$28.8 billion (US$3.7 billion) or 4.0 per cent of the value of imports of goods in the first half of 2002. Along with an invisible trade surplus reckoned on a BoP basis at HK$69.1 billion (US$8.9 billion) in that period, there was a combined surplus of HK$40.3 billion (US$5.2 billion) or 4.9 per cent of the total value of imports of goods and services in the first half of 2002.

BALANCE OF PAYMENTS

The current account registered a further sizeable surplus of HK$91.5 billion (US$11.7 billion) in 2001, equivalent to 7.2 percent of GDP in that year. But concurrently there was a substantial net outflow of financial non-reserve assets in the capital and financial account, totalling HK$40.1 billion (US$5.1 billion) or 3.1 percent of GDP. This was largely attributable to a substantial net portfolio investment outflow, which more than offset the net inflows of direct investment and other investment. Taken together, a notable balance of payments surplus of HK$36.5 billion (US$4.7 billion), equivalent to 2.9 percent of GDP, was recorded in 2001.

EXCHANGE RATE

The Hong Kong dollar was generally stable against the US dollar in the first half of 2002. The market exchange rate stayed within a narrow range of 7.7980-7.8000, notwithstanding occasional shocks (such as the abandonment of the currency board arrangements in Argentina, concerns about the persistent fiscal deficits and renewed rumours about the Link) during the period. The Nominal Effective Exchange Rate Index was stable at around 106 in the first three months of the period, but gradually weakened to around 102 by end-June 2002 as the US dollar fell against major currencies.

FISCAL POLICY

The financial results for 2001–02 (ending on March 31) showed a deficit of HK$63.3 billion or 4.9 percent of the forecast GDP for 2001 as compared with the original budget deficit of HK$3.0 billion. The fiscal reserves stood at HK$372.5 billion at end-March 2002, representing a decrease of HK$57.8 billion from the balance of HK$430.3 billion at end-March 2001. The fiscal reserves at end-March 2002 represented 19 months of government expenditure in 2001–02.

The 2002–03 budget forecasts a deficit of HK$45.2 billion, equivalent to 3.6 percent of the forecast GDP for 2002. The budgeted government expenditure represents a growth of some 7.7 percent in real terms over 2001–02.

In the remaining years of the Medium Range Forecast from 2003–04 to 2006–07, government expenditure is planned to grow at annual average rate of 1 percent in money terms, below the trend GDP growth rate of 4.4 percent a year in money terms over the period 2003–04 to 2006–07.

MONETARY POLICY

The best lending rate offered by major commercial banks remained unchanged at 5.125 percent in the first half of 2002. Hong Kong dollar interbank interest rates eased amid ample liquidity in the banking sector. The three-month rate dropped from 2 percent at end-2001 to 1.81 percent at end-June 2002, while its spread over the US dollar counterpart narrowed from 13 basis points to –7 basis points.

Seasonally adjusted narrow money grew strongly by 16.4 percent in June 2002 from a year ago, largely reflecting the low opportunity cost of holding narrow money. However, broad money increased by only 0.9 percent, broadly in line with the movements in nominal GDP.

Domestic credit slackened on the back of weak economic fundamentals. Loans for use in Hong Kong fell by 3.5 percent in June 2002 from a year ago. The overall quality of the loan portfolio of banks worsened slightly, with the ratio of overdue and rescheduled loans to total loans for retail banks[3] rising from 4.57 percent at end-December 2001 to 4.69 percent at end-March 2002.[4] Banks remained well-capitalised, with a 16.6 percent consolidated capital adequacy ratio for all locally incorporated authorised institutions in Mar 2002, 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 remains good, underpinned by further economic reform and development and on-going market liberalisation in the Mainland. China's accession to WTO will open up even more opportunities for trade and investment. Hong Kong, China will continue to serve as an important foothold and conduit for business between the Mainland and the rest of the world. Yet with only a mild growth envisaged for 2002, and with the ensuing pick-up likely to be relatively gradual, the trend growth rate of GDP in real terms is forecast at 3 percent per annum for 2002–06 as a whole.

---

[3] Retail banks comprise all the locally incorporated banks plus 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.

[4] Overdue and rescheduled loans are loans and bills more than three months overdue and rescheduled loans.

Annex I

HONG KONG, CHINA: OVERALL ECONOMIC PERFORMANCE

	1996	1997	1998	1999	2000	2001
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (US$ billion)	157	174	165	161	165	164
Real GDP	4.3	5.1	-5.0	3.4	10.2	0.6
Consumption	3.2	6.5	-6.1	1.3	5.4	2.1
Private Consumption	3.1	6.9	-6.7	1.3	5.9	1.4
Government Consumption	3.8	2.4	0.7	3.1	2.0	6.0
Investment	10.9	12.6	-7.3	-16.6	11.0	2.9
Private Investment	9.7	16.5	-7.0	-19.8	15.5	4.0
Government Investment	16.8	-5.2	-9.7	0.6	-10.3	-2.6
Exports of Goods and Services	5.9	5.0	-3.9	4.0	16.5	-1.8
Imports of Goods and Services	4.4	6.8	-6.3	-0.2	16.8	-1.7
Fiscal and External Balance (percent of GDP)						
Budget Balance	2.1	6.5	-1.8	0.8	-0.6	-5.0
Merchandise Trade Balance	-11.4	-11.8	-6.4	-3.5	-6.6	-6.8
Current Account Balance	N.A.	-3.1	2.7	7.5	5.5	7.2
Capital and Financial Non-reserve Assets Balance*	N.A.	10.6	-6.6	-0.4	1.6	-3.8
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	5.8	5.7	0.2	-5.8	-6.2	-1.4
CPI	6.3	5.8	2.8	-4.0	-3.8	-1.6
M2[@]	N.A.	N.A.	11.6	8.8	7.8	-2.7
Short-term Interest Rate (percent)[+]	5.4603	7.1235	8.0605	5.8402	6.1146	3.5566
Real Effective Exchange Rate (level, 1997=100)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Unemployment Rate (percent)[#]	2.8	2.2	4.7	6.2	4.9	5.1
Population (millions)[#]	6.4	6.5	6.5	6.6	6.7	6.7

Notes :
- N.A. Not available.
- ^ Revised series incorporating the results of the major revision to GDP as announced on 1 August 2002.
- * Before the detailed breakdown of the capital and financial account was available for the reference year of 1998, net errors and omissions within the BoP identity were embedded in the net change in capital and financial non-reserve assets in 1997.
- @ As from June 2002, figures are compiled on the basis of the revised definition by including short-term Exchange Fund placements in the monetary aggregate. With the series backdated only to April 1997, percentage changes prior to 1998 are not available.
- \+ Three-month HIBOR.
- \# As from August 2000, the "resident population" approach is adopted in place of the "extended *de facto*" approach for compiling the population figures, and a set of revised figures on total population, total labour force, total employment, numbers employed, numbers underemployed, and labour force participation rate backdated to 1996 is thus compiled. The unemployment rate is nevertheless generally unaffected.

Annex II

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

	2002				2003		
	Official	**IMF**	**Link**	**ADB**	**IMF**	**Link**	**ADB**
Real GDP	1.5	1.5	1.1	2.1	3.6	3.0	4.8
Exports#	5.4	N.A.	-1.4+	1.6+	N.A.	0.5+	6.2+
Imports#	4.9	N.A.	-0.6+	1.9+	N.A.	1.0+	7.8+
CPI	-2.8	-2.5	N.A.	-0.8	0	N.A.	0.6

Sources: International Monetory Fund (IMF) forecasts, The World Economic Outlook Database (April 2002).
Asian Development Bank (ADB) forecasts, Asian Development Outlook 2002(April 2002).

Notes: The Link forecasts on the Hong Kong, China economy, as are currently known, were produced in fall 2001which by now may not accord fully with the latest economic situation and outlook for the year.
\# Referring to merchandise trade.
\+ Forecasts in US$ terms.
N.A. Not available.

Annex III

HONG KONG, CHINA: MEDIUM-TERM TREND FORECAST (percent)

	2002–06
Real GDP	3
GDP Deflator	0.4

INDONESIA

Indonesia is expected to head towards a more structurally sound, market-based and transparent economy, supported by comprehensive reforms encompassing broad-based areas such as political reform, regional autonomy, fiscal transparency and financial monitoring, legal reform as well as financial sector reforms. Along with abundant natural and human resources, Indonesia provides many opportunities for investments.

For the 2002 outlook, the prospect of continuing consumer spending and increasing bank financing for investments, coupled with an early US economic recovery, make the authorities are optimistic that economic growth can be sustained this year and that economic recovery will resume in the following years.

REAL GROSS DOMESTIC PRODUCT

Indonesia's economic growth slowed in 2001, but to a pace that was still better than the growth experienced by other economies in the ASEAN region. This slowdown was attributable to unfavorable domestic and external developments. Domestically, social, political and security conditions have yet to be resolved resulting in high degree of economic and financial risk. Yet, GDP grew at 3.3 percent, following the previous years' growth of 4.9 percent. The GDP growth was mostly derived from domestic consumption.

The prospects for Indonesia's economy in 2002 are affected by developments in other economies, notably the major industrialized economies such as the United States, Japan and the European Union whose economic slowdown appears to be bottoming out. While early signs of global recovery have emerged, the pace and sustainability of recovery are not yet assured. Current accounting scandals in the US stock market illustrate the fragility of the recovery and the danger of "a contagion" effect, especially to a vulnerable economy. Under the circumstances, domestic demand will remain one of the main drivers of Indonesia's economic growth. Given that a number of domestic structural problems are resolved and certain risks and uncertainties successfully addressed, Bank Indonesia estimates that the economic recovery will be sustained in 2002 after achieving 3.3 percent economic growth in 2001. Combined with expansion in exports and investment, and the progress in bank restructuring programs, economic growth is expected to reach 3.5 percent in 2002.

On the demand side, economic growth in 2002 will be dominated by consumption, which is driven by incomes and increased financing for consumption. Investments and exports are forecast to record slightly higher growth than in 2001, whereas imports are forecasted to increase in line with higher consumption and investments. More favorable investment out-turns will be supported by increasing bank financing coupled the decelerating trends of interest rates, and improvements in overall business confidence. Meanwhile, early recovery of the global economy, notably the major industrialized economies, will provide more impetus to Indonesian export performances.

On the supply side, almost all sectors will contribute to moderate growth in 2002. In line with the dominant role of consumption as the main engine of growth, the biggest share of growth will come from manufacturing and trade sectors. Some manufacturing sub-sectors will increase sharply, for example, food and beverages and motor vehicles. Industries producing main export products such as textiles, footwear and wood industries may experience less favorable growth. Meanwhile, the trade sector, particularly retail, will experience a relatively large increase due to strong private consumption, the main engine for the domestic economy. Growth in the mining sector will be modest, mainly due to uncertainty in law enforcement and security issues. Other sectors, such as construction, should revive in line with the resumption of some major toll-road constructions and housing projects. Agriculture is most likely the weakest sector due to the return of *El Nino* and unsettled issues concerning the production and distribution of fertilizers.

INFLATION

Inflation in 2001 accelerated and reached 12.6 percent compared to 9.4 percent recorded in the previous year. The high pressure on Indonesia's inflation stemmed from the impact of some adjustments in government administered prices, for example, increases for fuel prices, transportation costs and the electricity tariff. In addition, the weaker exchange rate and deteriorating inflationary expectations caused rising producer costs.

Unlike in 2001, the exchange rate pass-through effects to inflation will be subdued in 2002. The rupiah exchange rate is expected to strengthen and become more stable, and that would be favorable for the pricing of imported goods and for production costs of entities using imported materials. Therefore, inflation in 2002 will be influenced primarily by government policy on prices and by inflationary expectations, while demand pressures are still relatively weak. As was the case in the preceding years, the needs for reductions in subsidies necessitate that the government increases some administered prices. This policy, together with the income policy on minimum wages, would exert strong pressures on inflation in 2002. These pressures will include: raise in fuel prices, increases in basic electricity tariffs as well as telephone tariffs; higher excise taxes on cigarettes; and a plan to raise regional/provincial minimum wages. Experience in 2001 showed that these policies added about 3.8 percent to the total CPI inflation of 12.5 percent. For 2002, we estimated that the policies on administered prices would add around 3.5 percent to the total CPI inflation of 10 percent. Inflation rate for the year-to-date July 2002 is 5.3 percent.

Meanwhile, unless there is disruption on supply and distribution of goods due to natural disaster or social-political turbulence in some regions, we estimate that the demand pressures on inflation are still relatively low. This is because the expansion of private consumption will be matched by increases in production following utilization of existing under-capacity and/or increasing investments. Inflationary pressures may be higher if disruptions of agricultural production and food supplies due to *El Nino* in 2002 cannot be matched by higher imported food supplies

EMPLOYMENT

The financial crisis in Indonesia had a detrimental effect on employment. Although higher than those of recording in neighboring economies, Indonesia's economic growth since the crisis have not been adequate enough to absorb the increase in the workforce. The unemployment rate was estimated to have increased to 8.1 percent in 2001 from 6.1 percent in 2000. It is estimated that unemployment was more pronounced in urban areas than in rural areas. Fortunately, the more detrimental effects of slowing economy on unemployment have been negated by the fact that some of the work force engage in the informal sector. This is evidenced from the 2000 population census which showed that, even though the number in formal employment fell, the number of people working in the informal sector had indeed increased.

The number in the work force (age 15 and above) in 2001 was estimated to be around 98 million people, an increase of about 2.5 percent from the previous year which amounted to 95.7 million people. By economic sector, most of the labor force (about 45 percent) are engaged in the agriculture sector.

BALANCE OF PAYMENTS

During 2001, Indonesia's balance of payments deteriorated. The current account surplus narrowed due to weaker exports, and the deficit on capital account widened. Total exports fell by 13.3 percent. On the external side, export decline was due to lower prices for main commodities and lower economic growth in export destination countries. Export decline was also caused by the imposition of additional requirements on Indonesia's exports, such as environment-friendly and consumer rights requirements. On the internal side, the decline in exports stemmed from disruption to production and distribution, which were caused by rigorous labor action, and security disturbances. In line with low investment and declining exports, imports also declined at about 14.1 percent, particularly imports of capital goods and raw materials. The decline in imports was also due to depreciation and fluctuations in the rupiah exchange rate. Meanwhile, the wider deficit on the capital account mainly stemmed from a deficit on government capital flows, while the deficit on private capital flows narrowed. With these developments, Indonesia's overall balance of payments in 2001 was in a deficit of US$1.4 billion, causing international reserves at the end of 2001 to slip to US$$28 billion or equal to 6.1 months worth of imports plus government debt repayments.

In 2002, Indonesia's balance of payments is expected to improve slightly. Although lower than that in the previous year, the surplus in the current account could outweigh a deficit in the capital account. The current account surplus is expected to decline to US$4.7 billion in 2002 from US$6.9 billion in 2001 owing to a less favorable global economic environment. Export growth should slowdown in 2002, as a result of declining demand causing by lower economic growth in advanced economies which are Indonesia's main export destinations (e.g., the US, Japan, and the European Union). Likewise, non-oil/gas commodity prices will remain low in the international market place. However, these demand and price pressures are predicted to be short-lived, and they would moderate in the second half of 2002. In this regard, non-oil/gas exports are expected to rise in 2002. Signs of recovery in the world's major economies, led by the United States, have spurred optimism that the global economy will start rebounding soon this year. Spillover of this positive sentiment to Indonesia would be reflected by stronger non-oil/gas exports. Meanwhile, oil export receipts are expected to increase in line with the tendency towards an international oil price increase. Meanwhile, import growth is projected to remain strong prompted by continuing strong consumption and a modest pick-up in investment and exports in 2002.

On the capital account, some improvements are expected with the capital account deficit narrowing to US$5.7 billion in 2002 from a deficit of US$9.0 billion in 2001, owing to a smaller deficit on private capital and a larger surplus on government capital. This would be supported by larger government capital inflows, originating in draw-downs of loans (which were delayed in 2001) from donor countries and from the rescheduling of bilateral debts linked to the successful Paris Club III held successfully. The deficit on private capital should narrow to US$6.8 billion. This mainly stems from estimates of lower private sector foreign debt repayments in line with declining outstanding private foreign debts and limited inflows of new private foreign debts.

Overall, the balance of payments is expected to earn a surplus of around US$0.89 billion, adding to the gross foreign exchange reserves to US$28.9 billion in 2002 (worth about 5.8 months of imports and official debt repayment).

GROSS EXTERNAL DEBT

The amount of external debt serviceing due in 2002 is estimated to reach US$30.1 billion consisting of US$24.4 billion in principal and US$5.7 billion for interest. Out of this total debt serviceing, some US$8.3 billion is attributed to central government while the remaining US$21.8 billion consists of private sector liabilities. With these figures, the debt service ratio is projected at 52 percent of total exports.

The government has undertaken efforts to relieve the public debt burden. So far, the government and Paris Club creditors have signed agreements, known as Paris Club I and II, to reschedule US$10.9 billion of public debt which matured from August 1998 to March 2002. To further reduce the burden for debt repayment in 2002 and 2003, the government and Paris Club creditors have agreed under Paris Club III to reschedule official debt service payments (principal and interests) for period of April 2002 to December 2003 which amounted to around US$5.4 billion.

Apart from Paris Club negotiations, the authorities also seek other alternative ways to reduce the debt burden, such through debt for nature swap as well as debt for development swap.

For private external debts, the restructuring process is done either directly by debtors or through the Jakarta Initiative Task Force (JITF). The government established JITF has a role in facilitating debt-restructuring negotiation between domestic debtors and international creditors. So far, the amount of restructured private external debt is US$14.7 billion or around 32 percent of a total of US$45.3 billion debts registered to be restructured through JITF. The Government of Indonesia expects that by the end of 2002 the cumulative amount of JITF-mediated restructurings will reach US$19–20 billion.

EXCHANGE RATE

During 2001 the rupiah exchange rate depreciated by around 17.7 percent, from an average of Rp8,438 in 2000 to Rp10,255 per US dollar. These downward pressures were related to increasing country risk in line with rising uncertainty concerning domestic socio-political conditions. In addition, exchange rate fluctuations in 2001 were also due to continuing low public confidence in micro- and macro-economic fundamentals. On the macro-fundamental side, despite some significant progress, several economic restructuring programs such as debt and corporate restructuring, and privatization, were moving slowly. These conditions limited foreign currency inflows, causing a shortage of foreign currency in the market. By contrast, demand for foreign currency remained high, both for import needs and debt repayment.

Throughout 2002, the rupiah exchange rate is expected to strengthen with less volatility. With the favorable developments over the first half of 2002, and as political concerns subside especially towards the end of the MPR session, Bank Indonesia recent estimates indicate that the rupiah exchange rate is expected to average at Rp9,300 per US dollar. This projection might turn out to be conservative if, in the near future, several concrete restructuring steps are successfully completed and they further improve market confidence.

The strengthening rupiah in 2002 is supported by both technical and fundamental factors. On the technical side, it is expected that stable overall socio-political conditions can be maintained. This should open the way to accelerated resolution of various economic and financial restructuring programs, and that would create conducive, fundamental economic conditions. Prospect of improving socio-political conditions are also expected to enhance the bank intermediation process. This in turn would reduce rupiah excess liquidity in the financial sector, which has had the potential to put pressure on the exchange rate in the past.

Of the fundamental factors, improved domestic and foreign conditions would narrow the gap between foreign currency demand and supply. Large demands for foreign currency to finance imports and for private debt service payments would be matched by stronger foreign currency inflows, derived mainly from exports receipts and foreign investment (both FDI and Portfolio investment). In addition, with an improving trend in socio-political conditions, pressures on foreign currency demand (speculation and flight to quality) can be minimized. Reinforcing these trends, a more stable exchange rate would reduce uncertainty, helping the economy to run more effectively. Various economic restructuring programs, such as debt and corporate restructurings, would make significant progress, thereby eliminating foreign exchange pressures stemming from foreign debt repayments. Meanwhile, stability in the exchange rate would reduce fiscal uncertainty, which would assist macro-economic stability, while improving public confidence.

FISCAL POLICY

The Government of Indonesia continues its commitment to direct its policy toward achieving fiscal sustainability. For this purpose, the year 2002 state budget contains two strategic objectives, i.e., first, to reduce the size of the budget deficit, both in absolute terms and as a ratio of GDP; and second, to reduce the ratio of government debt—domestic and offshore—to GDP. Therefore, the main thrusts of the fiscal policy are aimed toward:

- Optimizing domestic revenues from both taxes and non-taxes;
- Improving efficiency in state expenditures;,
- Reducing subsidies;
- Allocating balanced funds for regional autonomy; and
- Reducing reliance on external financing.

Overall, the government's budget for the financial operations in 2002 shows a deficit of Rp42.1 trillion (or 2.5 percent of GDP), significantly lower than the Rp54.3 trillion (3.7 percent of GDP) in 2001. To sustain this lower deficit, increases in revenues would be achieved mainly by broadening the tax base, and by greater efficiency in spending through budget prioritization. On the financing side, in addition to secure foreign financing from the donor economies, efforts will be geared to increasing asset sales and privatization both through the Indonesian Bank Restructuring Agency (IBRA) and the Ministry of State-owned Enterprises. Other efforts include the efforts by IBRA to use portions of the restructured assets and sales receipts to reduce domestic debt (asset-for-bond swaps and cash-for-bond swaps).

Total government revenue is expected to rise from Rp286 trillion to Rp301.9 trillion in 2002. The main source of revenue would be tax revenues, from both oil revenues and non-oil revenues. To increase the tax base, the government will continue a number of policies concerning intensification of tax collection and extensions of tax payers and objects. Meanwhile, with the tendency towards an international oil price increase, it is expected that government revenues will be higher than anticipated.

On the spending side, even though the government's expenditure increases in nominal terms to Rp344.0 trillion in 2002, it represents only 20.4 percent of GDP compared to 23.2 percent in 2001. This reduction can be accounted for by the allocation for central government routine expenditures, which falls sharply from 14.7 percent to 11.5 percent of GDP. The high spending is on interest payments on the public debt amounted to Rp88.5 trillion (or equivalent to 5.3 percent of GDP). Nevertheless, these interest payments will be lower in 2002 than in 2001, notably in line with the assumptions of declining SBI rates and strengthening exchange rate.

Three other large spending categories include: (i) subsidies (2.5 percent of GDP), (ii) personnel expenditures (2.4 percent of GDP), and (iii) development expenditures (3.1 percent of GDP). Subsidies will drop significantly from their levels of 2001, mainly due to government policies to raise domestic fuel prices by an average of 25 percent starting by January 2002 and basic electricity tariffs as many as 4–6 percent for each quarter. Personnel expenditure is budgeted to rise in nominal terms owing in part to higher allowances for several functional positions, since those allowances have been unchanged for several years. Meanwhile, funds allocated for development expenditures will remain low compared with routine expenditures.

MONETARY POLICY

Bank Indonesia will continue to direct its policies toward maintaining monetary stability consistent with the attainment of single digit inflation target by the end of 2002. As in the past, Indonesia continues its commitment to a floating exchange rate regime and an open capital account as cornerstone of its economic programs. To attain monetary stability, Bank Indonesia will continue to control liquidity in the market consistent with liquidity needs in the economy. The focus will be on absorbing excess liquidity through open market operations to achieve the indicative target of base money and other indicators agreed under the IMF program. Moreover, foreign exchange sterilization, when necessary, will also be conducted to help mitigate the pressures on the rupiah exchange rate and their pass-through effects on inflation. This effort will be conducted by continuously monitoring the interest rate development in order to give a signal conducive to the acceleration of economic and bank intermediary function recovery.

Overall, the developments since the beginning of 2002 have been encouraging. The recent signs show that inflation has leveled off, notwithstanding the temporary jump at the beginning of the year, and that the base money program has been brought back on track. Moreover, the recent exchange rate appreciation, if sustained, should contribute to a further easing of inflationary pressures. With these, the interest rates for the first half of 2002 show declining trends. These developments could provide some room for a further lowering of interest rates during the course of the year. Nevertheless, Bank Indonesia will remain cautious in signaling the direction of the interest rate, bearing in mind that the stability of inflation and exchange rate is key for the achievement of sustained economic recovery.

BANKING SECTOR REFORM

In the banking sector, the policy priority is to strengthen the resilience of the banking system. To achieve this objective, Bank Indonesia will continue the implementation of the 25 Basle Core Principles for Effective Banking Supervision, whose details have been developed into the Master Plan for the Enhancement of Effectiveness of Banking Supervision. The authorities will continue their efforts to maintain banks' CAR at 8 percent requirements. Special attention will be given to banks whose capital structures are still vulnerable to interest rate increases, exchange rate weakness, and deteriorating asset quality.

To accelerate the bank intermediary function, Bank Indonesia will encourage the banking sector to extend more loans to sectors that are considered to be ready and to be relatively low-risk, such as loans for export and loans for small-to-medium sized businesses, as well as to make some improvements on regulations that expedite the intermediation. Steps have been taken by the government to increase the banks' competency in financing feasible sectors by establishing the SME task force, who will develop collaborative policies together with the World Bank, the ADB, and bilateral strengthened agencies.

Important progress has been made with the divesting of the government's holding in the banking system. The closely watched sale of Bank Central Asia (BCA) was finally completed. An investor consortium led by US-based Farallon Capital was selected to buy 51 percent what was formerly Indonesia's largest private bank from the IBRA. The BCA sale started the privatization drive by the government that is expected to raise more than US$2.6 billion (some 6.5 percent of the government budget) this year by selling government assets such as Bank Niaga, Bank Mandiri, Indosat, Indocement, Indofarma and Kimia Farma. The completion of BCA sales has inevitably shown the strong commitment from the part of government and to some extent succeeded in boosting the positive sentiment about investment prospects in Indonesia.

On the privatization of SOEs issue, a privatization program was approved by the Parliament in March 2002. The government will begin the 2002 privatization program for 25 SOEs. This privatization program is intended to boost the performance and value of SOEs so they become more competitive within the regional, national and global economy as well as accelerating Indonesia's economic recovery.

In the area of asset recoveries, IBRA has formalized its strategy for its cash recovery targets of Rp43.6 trillion in 2002. Roughly two-third of recoveries are set to come from the sale of restructured and un-restructured loans, and IBRA will use a variety of mechanisms, including new joint venture and securitization schemes, to achieve the desired result. In the first half year, the target is to raise at least Rp13.0 trillion in cash. In addition, IBRA will launch a program to sell retail and currently outsourced commercial loans by mid-year.

OTHER REFORMS

Legal Reforms

A strong judicial system is a prerequisite to provide a fair resolution of the emerging legal cases, including those related to debt and corporate restructuring. With this in mind, the authorities expressed their strong commitment to increase the effectiveness of the legal system through improvement of court governance. The authorities have assigned 13 *ad-hoc* judges to deal with specific pending cases. It is expected that confidence in the court system will improve as a result of this measure.

In addition, efforts to improve court governance will be carried out to speed up the resolution mediated by the JITF. As the JITF adopts a "stick and carrot" approach, the authorities need to synergize the approach with the help of the court system. The authorities remain committed to imposing sanctions against parties that refuse to cooperate in JITF-led negotiations, including referring them to the Attorney General for bankruptcy proceedings.

One of the efforts on the matter of legal reform is the passage of the new bankruptcy law. The process of legalizing the law is in progress. The draft of the law has been approved by the President and is currently being handed to the Parliament for approval.

Moreover, with technical assistance from the Asian Development Bank and AusAid, the Government of Indonesia has submitted the draft of an Anti Money Laundering Act. Draft legislation was endorsed by the Parliament on 25 March 2002. Based on the approved draft, the Government of Indonesia will establish the Financial Intelligence Unit (FIU) with the task of accepting and analyzing certain financial transactions submitted by financial service providers.

On the issue of countering terrorism, Indonesia remains an active partner in the international efforts to identify and freeze the funding of terrorist activities. Pursuant to UN Security Council Resolutions 1267 (1999), 1333 (2000) and 1373 (2001), the Attorney General's Office of Indonesia has formally submitted to Bank Indonesia lists of persons and entities suspected of involvement in terrorist activities. Bank Indonesia has circulated these lists to all banks operating in Indonesia. If accounts belonging to these individuals or entities are identified, they are to be frozen. To date, no accounts belonging to listed individuals or entities have been identified. However, the process of identification is on-going. On 21 December 2001, the Ministry of Foreign Affair has submitted a report on efforts to date to the Counter Terrorism Committee (CTC) of the Security Council, pursuant to Paragraph 6 of Security Council Resolution 1373 (2001).

MEDIUM-TERM OUTLOOK

In the medium-term, the prospects of the Indonesian economy are expected to improve further in line with the favorable global outlook, and the strengthening recovery process of the domestic economy. Such an economic improvement will materialize provided that all risks and uncertainties surrounding the Indonesian economy are successfully resolved. Indonesia is expected to be heading towards a more structurally sound, market-based and transparent economy, supported by comprehensive reforms that encompass broad-base area such as political reform, regional autonomy, fiscal transparency and financial monitoring, legal reform as well as financial sector reforms.

Within five years Indonesia is expected to achieve a real GDP growth rate of 4.9 to 5.9 percent, with investment growth improved to 7.4 to 8.4 percent. In the meantime, the authorities have a commitment to gradually reduce inflation to around 6.0–7.0 percent over the medium-term.

Annex I

INDONESIA: OVERALL ECONOMIC PERFORMANCE

	1995	1996	1997	1998	1999	2000	2001*	2002*
GDP and Major Components (percent change from previous year, excepted as noted)								
Nominal GDP (billions US$)	202.2	227.3	218.0	103.1	144.2	151.0	145.1	177.6
Real GDP	8.2	7.8	4.9	-13.7	0.31	4.8	3.3	3.5
Total Consumption	11.2	8.9	5.9	-4.1	3.4	3.9	6.2	6.3
Private Consumption	12.6	9.7	6.6	-2.9	3.7	3.6	5.9	6.4
Government Consumption	1.3	6.6	0.1	-14.4	0.7	6.5	8.2	5.1
Total Investment	14	-3.0	8.6	-40.9	-20	17.9	4.0	6.4
Private Investment							4.1	7.2
Government Investment							3.5	2.2
Export of Goods and Services	7.7	7.6	7.8	10.6	31,6	16.1	1.9	3.1
Import of Goods and Services	20.9	6.9	14.7	-5.4	40.7	18.2	8.1	9.0
Fiscal and External Balances (percent of GDP)								
Budget Balance	1	1	0.4	-1,7	-7.9	-5.1	-3.7	-2.5
Merchandise Trade Balance (f.o.b)	2.8	1.5	4.4	17.8	14.0	16.8	15.7	12.1
Current Account Balance	-3.4	-3.5	-2,3	4.2	3.9	5.3	4.7	2.7
Capital Account Balance	-	-	-	-	-	-	-6.2	-3.2
Economic Indicators (percent Change from previous year, except as noted)								
GDP Deflator	9.9	8.7	12.6	81.2	12.8	10.9	12.6	7.0
CPI	8.6	6.5	10.3	77.6	2	9.4	12.55	10.1
M2	27.6	29.6	23.2	62.4	11.9	15.6	13.0	10.5
Short-term Interest Rate (percent)	13.6	14.1	30.5	64.1	26	12.5	15.5	14.0
Exchange rate (Local Currency/US$)	2,308	2,383	4,650	8,025	7,764	8,544	10,256	9,300
Unemployment Rate (percent)	7.2	4.9	4.8	5.5	6.36	6.1	8.1	
Population (millions)	194.8	198.2	201.119	204.03	204.95	203.025	-	

Annex II

INDONESIA: FORECASTING SUMMARY (percent change from previous year)

	2002					2003				
	Official	**IMF**	**LINK**	**ADB**	**OECD**	**Official**	**IMF**	**LINK**	**ADB**	**OECD**
Real GDP	3.5	3.5	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Real Export G&S	3.1	N.A.	N.A.	3.9	N.A.	4.1-5.1	4.0	N.A.	N.A.	N.A.
Real Import G&S	9.0	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
CPI	10.1	9.7	N.A.	N.A.	N.A.	7.0-9.0	8.2	N.A.	N.A.	N.A.

Annex III

INDONESIA: MEDIUM-TERM TREND FORECAST (percent)

	2003	**2004**	**2005**
Real GDP	4.1-5.1	4.7-5.7	4.9-5.9
CPI	7.0-9.0	8.0-10.0	7.0-9.0

JAPAN

REAL GROSS DOMESTIC PRODUCT

The Japanese economy sustained a gradual recovery from the beginning of 1999, whereupon it weakened again in November 2000. Real GDP growth in 2001 is estimated to be around –0.2 percent, whereas those of 1999 and 2000 were 0.7 percent and 2.4 percent, respectively.

The weakness can be ascribed to three main causes. Firstly, exports, and plant and equipment investment, the engine for economic recovery, were both weak, leaving the recovery to depend too heavily on external demand and IT. Secondly, consumption failed to pick up; and thirdly, the economy was under pressure from the non-performing loans (NPLs) problem and excessive debts.

In August 2002, the economy continues to be in a difficult situation, but it shows signs of an incipient recovery, especially with regard to exports and industrial production.

As for short-term prospects, the impact of a large increase in exports and a rally in industrial production are expected to spread throughout the economy, and bring about an incipient economic recovery. On the other hand, developments in the worldwide decline in stock prices and depreciation of the US dollar are further increasing uncertainty surrounding the future of the world economy, and there are concerns over the downward pressure on final demand that may be expected as a result of this development.

It is expected that a recovery of the corporate profits and an increase in business investment will be seen in the second half of the fiscal year (FY[1]) 2002, the Japanese economy will be broadly flat throughout FY2002, but get out of the stagnation, and begin to move gradually towards a recovery centering on private demand in FY 2003.

INFLATION

Japan has been in a state of deflation since 1999 in terms of consumer prices and, since the mid-1990s, in terms of the GDP deflator. It is the first experience of this for Japan and other advanced economies since the World War II. In FY2002, it is expected that prices will continue to fall, but the rate of decline will be somewhat reduced by a slight improvement in oversupply conditions.

In 2001, domestic wholesale prices declined slightly (by 0.8 percent) compared to the previous year. This decline has continued since 1992, excluding 2000 (when prices were almost unchanged) and 1997 (when they increase by 0.6 percent due to a rise in the consumption tax). The prices of electrical appliances such as personal computers and ICs dropped by 4.9 percent and vehicles prices dropped by 2.0 percent, whereas the cost of petroleum and coal products increased by 4.6 percent. Recently, prices have been broadly flat. The average Domestic Wholesale Price Index in FY2002 is expected to decline by 0.8 percent.

Consumer prices have been declining slightly since the fall of 2000 (in 2001, they declined 0.8 percent, excluding fresh food), mainly due to a fall in the prices of industrial products such as consumer durable goods and food products. The decline in CPI has continued for the first time since 1971 (the oldest comparable data) and the average Consumer Price Index in FY 2002 is expected to decline by 0.6 percent.

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

EMPLOYMENT

The unemployment situation remains severe. Although overtime work hours have increased, the unemployment rate has remained at a high level and wages have continued to weaken.

The number of the employed compared to the same month of the previous year has continued to decline since April 2001, and the decline has been especially sharp since September. The percentage of regular employees (excluding agriculture and forestry) has decreased for seven consecutive years since 1995, whereas that of temporary employees and daily employees has increased over the same period.

Unemployment was at record 5.0 percent in July 2001, the highest since 1953. It has moved to around 5.5 percent since then. According to the "Fiscal 2002 Economic Outlook and Basic Stance for Macroeconomic and Fiscal Management" which the Japanese government published in January 2002, the average unemployment rate in FY 2002 is expected to rise to 5.6 percent while the structural reforms needed for job creation proceed.

The number of the new job offers in 2001 increased by 1.5 percent and has fluctuated since the beginning of 2002. Though job offers continue to show weak movement; the number of effective job offers and the effective job offer ratio have remained low.

BALANCE OF PAYMENTS

Exports have dropped sharply, affected by the slowdown of the global economy in 2001. They bottomed out in spring of 2002. Recently they have increased, as exports of electrical devices, mainly electronic components such as semiconductors, and general machinery are on a sharply increasing trend and exports of transportation equipment are steady, reflecting the worldwide recovery.

Imports in the second quarter (April–June), third quarter (July–September) and fourth quarter (October–December) of 2001 also decreased by 2.9 percent, 3.0 percent and 2.2 percent respectively, and increased sharply (3.8 percent) in the second quarter (April–June) of 2002 after a small decline (0.1 percent) in the first quarter (January–March) in 2002, compared to the previous quarter.

Recently, imports increased slightly, as imports of machinery equipment increased as a result of recovery of production mainly in the electrical appliances industry.

The surplus in the Goods and Services trade balance shrank to 3.2 trillion yen in 2001, the second-lowest level since 1985. Most of the change accounts for the decline of the trade surplus, as imports steadily increased due to structural reasons such as the development-and-import scheme, whereas exports significantly dropped due to the cyclical factors such as the recession of the US economy and the decrease of IT-related demand.

The surplus in the Goods and Services account hit bottom in the second quarter of 2001 and has been increasing recently, as export value increased faster than import value due to the combined effects of the bottoming out in export volume and to the sideways movement of import volume.

The surplus in the merchandise trade balance and the current account balance are expected to increase slightly (the current account balance is 2.1 percent of GDP) in FY2002, partly as a result of the mild recovery of the global economy.

GROSS EXTERNAL DEBT

At the end of 2001, net external assets jumped to 179.3 trillion yen, up from 133.0 trillion yen in 2000. The increase is accounted for by several factors such as the increase of the estimated asset value in foreign currency because of the low exchange rate. External liabilities slightly declined to 200.5 trillion yen, partly reflecting the drop in internal equity investment. Total external assets at the end of 2001 were 379.8 trillion yen.

EXCHANGE RATE

The exchange rate of the yen against the U.S. dollar moved broadly, from 116-125 yen during the first half of 2001, rising to 119 yen (in August) and falling to 131 yen (in December). The yen hovered around 133 yen from January to March 2002 and rose to 119 yen in June.

FISCAL POLICY

The government's basic stance for macro-economic and fiscal management is to steadily implement structural reform and carefully watch the economic situation. In October 2001, the government adopted the "Front-Loaded Reform Program" for accelerating the pace of structural reform and subsequently formulated the first supplementary budget of one trillion yen. It also focused on the creation of new jobs and the formation of a safety net concerning job security and small and medium-sized enterprises.

The serious situation of the economy caused the second supplementary budget of 2.5 trillion yen to be passed in February 2002, based on the "Immediate Action Program for Structural Reform" formulated in December, to accelerate structural reform while avoiding a deflationary spiral.

At the beginning of December 2001, the cabinet decided on the "Guidelines for Formulation of the FY2002 Budget" (hereafter referred to as "the Guidelines"). This shows a strategy to formulate next year's budget as the first step of fiscal reform. Based on the Guidelines, the FY2002 budget of 81 trillion yen was formulated, reducing the amount of general account expenditures by 1.7 percent from the FY2001 initial budget. The budget prioritizes spending by allocating greater funds to the seven priority areas including measures for Japan's aging society, and the promotion of science, technology, and education. On the other hand, public works expenditures were reduced by more than 10 percent, and budget allocation were prioritized towards the designated seven areas.

The Second Supplemental budget for FY2001 and the FY2002 budget are being implemented in an integrated and seamless manner, in order to prevent the Japanese economy from falling into a "deflationary spiral", while at the same time accelerating structural reforms. In June 2002, the Cabinet presented several points for the FY2003 budget compilation as follows; (i) to overhaul the mandatory budget, (ii) to establish a small, efficient government through promotion of public corporations reform, administrative reform of central and local governments, a budget squeeze and organization curtailment, (iii) to change budgetary formulation procedures in order to strengthen the government's decision-making system under the Prime Minister's leadership, and (iv) to ensure the consistency of finance with economy, and revenue with expenditure.

MONETARY POLICY

Looking at short-term interest rates, the overnight call rate moved at a low level in 2001 reflecting the monetary easing policy conducted by Bank of Japan's (BOJ) several times during the year. It fell slightly to 0.001 percent in July, after slight rose to 0.012 percent in March 2002. Interest rates for two- and three- month contracts have continued to move at low levels since April 2001. Long-term interest rates, which had moved downward since August/September 2000, rose from

July to the beginning of August 2001; they have moved sideways since mid-August. After a slight rise in January 2002, they fell from March to July.

The balance of the current account at the BOJ increased significantly, to 14.6 trillion yen in July 2002 from 4.5 trillion yen in March 2001, due to the introduction of quantitative guidelines on money market operations. In addition, the amount of long-term government bonds purchased increased to 12 trillion yen per year in 2001 from 4.8 trillion in 2000.

The BOJ also extended the maximum period for using the Lombard-type lending facility in September to secure smooth fund settlement and the proper functioning of financial markets. In addition, the BOJ decided to purchase commercial paper more actively under repurchase agreements and collateral uses to include asset-backed commercial paper in December 2001, aiming at making of the effect of the monetary easing to corporate banking more pervasive.

MEDIUM-TERM OUTLOOK

On 25January 2002, the Japanese government decided to adopt a document entitled “Structural Reform and Medium-Term Economic and Fiscal Perspectives”, which addressed the government’s medium-term macro-economic and fiscal policies, which are centered on structural reform. It also included a scenario for economic growth over the next five years. The period of intensive adjustment over the next few years will be an important preparation for achieving private-demand-driven economic growth. It is expected that economic growth will stay low for the next two years or so, but subsequently the economy will pick up and achieve 1.5 percent growth or over in real terms and 2.5 percent or over in nominal terms. As for fiscal policy, the ratio of general government expenditures to GDP will be kept at or below its present level during FY2002 and 2006. As a result of positive growth led by private demand and fiscal structural reform, the ratio of the primary balance deficit of central and local governments to GDP is expected to decline from 4.3 percent in FY2000 to approximately half that level by about FY2006, and a primary balance surplus is expected to be achieved in the early 2010s.

OTHER PERTINENT INFORMATION (e.g., structural changes and reforms, foreign direct investments, interest rates, capital markets, etc.)

Since April 2001, the government has fundamentally overhauled and strengthened its programs for structural reform, based on the belief of “no growth without reform.” In June, the government formalized its “Basic Policies for Economic and Fiscal Policy Management and Structural Reform of the Japanese Economy” (hereafter referred to as “Basic Policies”). This was followed by the formulation of the “Reform Schedule” in September, providing a road map for the process of structural reform. Furthermore, the government set out the medium-term prospects for the economy and public finance for the next five years, and introduced the budget in FY2002, which tightly prioritized government spending in ways unseen in previous budgets.

Since FY 2002, the government has a implemented fundamental reform of existing social and economic structures through measures such as the expeditious disposal of NPLs, the resolution of excess indebtedness, regulatory reform and reform of giant public corporations, with a view to developing an environment conducive to rigorous activities of the private sector, and advancing fiscal consolidation through budgetary reform.

Overcoming deflation is the most important task during about two years of the intensive adjustment period necessary for the economic revitalization. On 13 February, the government formulated “Emergency Countermeasures to Deflation”, including the promotion of the disposal of NPLs and stabilization of the financial system, based on the understanding that a resolution of the financial problems is crucial to overcoming deflation. In addition, in June 2002, the government and the ruling parties agreed to implement the structural reform focusing on the magnification of private demand and employment. They also agreed that the measures, such as promotion of a strategy for economic activation including regulatory reform, tax reform and the establishment of a dynamic and secure financial system including the promotion of the disposal of NPLs, should be implemented as soon as possible.

On 25 June 2002, the government formulated the second phase of the Basic Policies, i.e. "Basic Policies for Economic and Fiscal Policy Management and Structural Reform of the Japanese Economy 2002" (hereafter referred to as "Basic Policies 2002"). It sets out a strategy for economic activation by improving industrial competitiveness through "selection and concentration", and by creating demand through creating "specific areas for structure reform". It also presents ideas for tax reform aiming at the recovery of economic viability, removing impediments to individual lifestyles. In parallel, the restraint on budgetary expenditure will be strictly implemented through setting priorities for social infrastructure development, promoting the reform of social security system, and an authority shift from central government to local governments. In July, Prime Minister Koizumi instructed ministers concerned to set up concrete proposals for policy and regulatory reforms according to the "Basic Policies 2002". By implementing those measures, it is expected that a gradual and sustainable economic recovery will begin in FY2003.

Annex I

JAPAN: OVERALL ECONOMIC PERFORMANCE

	1996	1997	1998	1999	2000	2001
GDP and Major Components (percent change, year over year - earlier period, except as noted)						
Nominal GDP (level in billion US$)	4,692	4,310	3,965	4,516	4,764	*4,165*
Real GDP	3.5	1.8	-1.1	0.7	2.4	*-0.2*
Consumption	2.5	0.9	0.5	1.9	1.5	*0.9*
Private Consumption	2.4	0.8	0.1	1.2	0.6	*1.4*
Government Consumption	2.8	1.3	1.9	4.5	4.6	*2.9*
Investment	7.6	0.8	-6.0	-2.1	3.1	*-2.6*
Private Investment	7.8	5.2	-7.3	-4.9	8.5	*-1.7*
Government Investment	7.3	-9.6	-2.6	5.5	-9.6	*-5.3*
Exports of Goods and Services	6.5	11.2	-2.3	1.4	12.4	*-7.0*
Imports of Goods and Services	13.2	1.2	-6.8	3.0	9.6	*-0.8*
Fiscal and External Balances (percent of GDP)						
Budget Balance (excluding social security)**	-6.2	-5.4	-7.2	-8.5	-7.0	N.A.
Merchandise Trade Balance	1.8	2.4	3.1	2.7	2.5	1.7
Current Account Balance	1.4	2.2	3.0	2.6	2.5	2.1
Capital Account Balance	-0.7	-2.9	-3.3	-1.2	-1.8	*-1.2*
Economic Indicator (percent change, year over year - earlier period, except as noted)						
GDP Deflator	-0.8	0.4	-0.1	-1.4	-2.0	*-1.3*
CPI	0.1	1.8	0.6	-0.3	-0.7	-0.7
M2	3.3	3.1	4.0	3.6	2.1	2.8
Short-term Interest Rate (CD New Rate, percent)	0.6	0.6	0.7	0.2	0.2	0.1
Real Effective Exchange Rate (level, 1997=100)***	114.8	100.0	110.7	124.3	129.7	109.4
Unemployment Rate (percent)	3.4	3.4	4.1	4.7	4.7	5.0
Population (millions)	125.9	126.2	126.5	126.7	126.9	127.3

Notes: Figures italicized – A new System of National Accounts (changed in 2002) is applied for the estimation of the figures in 2001. Figures before 2000 are estimated in the conventional method.

** 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: FORCAST SUMMARY (percent change from previous year)

	2002					2003				
	Official	**IMF**	**Link**	**ADB**	**OECD**	**Official**	**IMF**	**Link**	**ADB**	**OECD**
Real GDP	0.0	-1.0	N.A.	N.A.	-0.7	N.A.	0.8	N.A.	N.A.	0.3
Exports	-0.3	1.7	N.A.	N.A.	1.9	N.A.	7.4	N.A.	N.A.	9.0
Imports	-3.0	-1.8	N.A.	N.A.	-5.6	N.A.	4.7	N.A.	N.A.	3.1
CPI	-0.6	-1.1	N.A.	N.A.	-1.2	N.A.	-0.5	N.A.	N.A.	-1.2

as of 1 August 2002

Notes: The official figure for 2001 refers to FY 2002 (from April 2002 to March 2003).
The IMF forecast is based on the IMF World Economic Outlook (IMF, April 2002).
The OECD forecast is based on the OECD Economic Outlook (OECD, April 2002).

Annex III

JAPAN: MEDIUM-TERM TREND FORECAST (percent)

	2004-06
Real GDP	1.5 or over
CPI	N.A.
GDP deflator	1.0

Note: The figure refers to FY 2004-06.

KOREA

REAL GROSS DOMESTIC PRODUCT

In the first half of 2002, Korea's real GDP increased by 6.1 percent. Growth was mainly due to an increase in exports and investment, while consumption grew steadily. The major industries such as electronics, semi-conductors, and automobiles showed a robust rebound.

In July 2002, industrial output continued its upward trend rebounding from 5.4 percent in June to 8.9 percent in July. This was due, in large measure, to an increase in automobile and semi-conductor production. Domestic consumption improved as wholesale and retail trade increased 6.6 percent year-on-year in July. As for investment, capital investment in July was less than in June, while imports of equipment and domestic order for equipment increased. Construction investment in July recorded more than 10 percent growth since June, bolstered by the increase in private sector construction.

INFLATION

The Consumer Price Index (CPI) remained stable until August 2002, increasing 2.9 percent compared to the end of last year, and 2.5 percent compared to the same period last year. In August, mainly due to the increase in food prices as a result of flood damage, the CPI increased by 2.4 percent as opposed to 2.1 percent in June. In view of the fact that economic effects from flood damage usually vanish in a short time, the prices are expected to normalize. Despite uncertainties over domestic and foreign economic recoveries as well as international oil prices, consumer price increases in Korea are expected to remain stable at around 3.0 percent aided by the strengthening won and little change in public utility charges.

EMPLOYMENT

Due to the contraction of the economy and nationwide structural reform after the financial crisis, the unemployment rate reached a peak rate of 6.8 percent in 1998, but has continued to decrease for the last four consecutive years. Strong growth in private consumption, concentrated in cars and other durable goods, helped to improve labor market conditions. Furthermore, an increase in service sector hiring has caused the unemployment rate to fall to 2.7 percent since June 2002, the lowest rate since the onset of the Asian financial crisis.

BALANCE OF PAYMENTS

In 2002, the current account surplus in July narrowed to US$30 million from US$0.8 billion in June. The narrowing is mainly due to the increased service account deficit. The current account included the goods account surplus of US$0.9 billion which is down US$0.9 billion from the previous month and the service account deficit of US$ 0.8 billion which is down US$0.3 billion from June due to an increase in outbound tourist spending.

The current account surplus by July was US$3.5 billion, much smaller than US$7.0 billion during the same period of last year. On the other hand, the capital account surplus expanded to US$2.9 billion in July from a surplus of US$0.8 billion a year ago.

Export growth, continuing the positive trend since the second quarter, has increased by almost 20 percent since July, partly because of the technical rebound from the lows in the second half of last year. For the remaining period of the year, export growth is expected to be more than 10 percent.

GROSS EXTERNAL DEBT

After the early completion of repayments to the International Monetary Fund (IMF) in August 2001, foreign reserves are now at a level that provides substantial insulation against shocks. Moreover, due to Korea's outstanding restructuring efforts and macro-economic performance, its sovereign credit rating was returned to pre-crisis 'A'-levels by the three major credit rating agencies during the first half of 2002. Moody's first changed the rating to 'A3' in March, then Fitch Ratings upgraded Korea's long term foreign currency rating from 'BBB+' to 'A' in June, followed by Standard & Poor's raise from 'BBB+' to 'A-' in July.

Korea's total external liabilities stood at US$125.8 billion at the end of June 2002. The ratio of total external liabilities to GDP was 29.0 percent, while Korea has maintained its position as a less-indebted country according to World Bank standards.

Total external assets, meanwhile, increased US$1.7 billion to US$171.4 billion mainly due to the increase in foreign exchange reserves and external assets in the banking sector. As a result, the value of net external assets climbed to US$45.5 billion, down US$0.6 billion from the previous month, maintaining the net creditor position Korea established in September 1999.

EXCHANGE RATE

The weakness of the yen and falling demand for Korean exports downgraded the won to the 1,362 per US dollar level at the end of 2001. The won-dollar exchange rate has continued to decline since mid-April due to the weakening of the dollar and the continuing Korean export upturn. On 22 July, the dollar rate closed at 1165.6, the lowest since 2001. However, since August, the dollar rate has stabilized around 1200.

FISCAL POLICY

For the first half of 2002, the government initially intended to carry out fiscal policy with a focus on early economic recovery by stimulating domestic demand. The government approved a 112 trillion won budget for 2002, a 5.5 percent increase from the previous year. Over the first six months of 2002, the government allocated 65.4 percent of the budget, focusing on expanding social infrastructure investment. However, the actual expenditure was only 48.4 percent of the budget during the same period. For the second half of 2002, in consideration of the strong economic recovery during the first half year, the fiscal policy was switched back to a neutral regime.

MONETARY POLICY

In the first half of 2002, exports and facilities investment showed recovery while both consumption and construction investment continued buoyant. Consumer inflation eased to 2.4 percent on a year-on-year basis in August from the 2.1 percent of the previous month, as prices of farm products increased because of flood damage.

Looking ahead, the strength of the Korean won against the US dollar and the expected stability of international oil prices will mitigate inflationary pressures. Demand-side inflationary pressures, however, are expected to accumulate and wages seem likely to increase in line with the continued economic recovery.

In the financial markets, stock prices, long-term interest rates and the exchange rate have been falling back simultaneously due largely to the turbulence in the US and other major financial markets. It is necessary therefore, to watch carefully how the impact of the financial market feeds through to the real economy. Laying stress on price stability, the Bank of Korea will operate its monetary policy in a flexible manner with a focus on the stability of financial markets and the prevention of a sharp slowdown in the economy.

MEDIUM-TERM OUTLOOK

The economic growth rate in 2002 is forecast to rise up to 6 percent as domestic demand maintains its steady growth trend while export growth accelerates with the world economy's recovery. Private consumption is expected to increase to the 7 percent range this year. Equipment investment and construction investment growth is forecast to slow down slightly in the second half of 2002, as a rebound from last year's stagnation; the growth rates being expected to rise to a range of 10 percent and between 9 and 10 percent respectively.

Exports in the second half of this year, due to the recovery of the world economy, are expected to increase by around 10 percent. However, imports are also expected to increase by 14 to 15 percent due to the continuing economic growth trends and depreciation of the won/dollar exchange rate. Therefore the current account will remain at 4~5 billion surplus. Consumer prices due to an increase in domestic demand and increase in wages, have been under sustained inflationary pressure. Still, consumer price increases are forecast to remain at a low 3 percent level due to the won appreciation.

It is feared, however, that instability in international financial markets, in the US stock market in particular, may spread to the domestic financial market. Foreign exchange volatility could also weaken the competitiveness of Korean exports. Moreover, regional political agendas and the presidential election might also have a dampening effect on the economic recovery.

With this in mind, the government will maintain its current macro-economic policy framework while monitoring economic demands in order to promote stable economic growth. Efforts will also be made to ensure that market-driven principles take root in the corporate and financial sectors and that improvements in public-sector efficiency and labor-management relations continue. Furthermore, government will develop logistical, business, and financial infrastructures, which will increase industrial competitiveness and transform Korea into a Northeast Asian Hub.

Annex I

KOREA : OVERALL ECONOMIC PERFORMANCE

	1995	1996	1997	1998	1999	2000	2001
GDP and Major Components (percent change from previous year, except as noted)							
Nominal GDP (level in billion US$)	489.4	520.0	476.6	317.7	405.8	461.7	422.2 [1]
Real GDP	8.90	6.80	5.00	-6.70	10.90	9.30	3.00
Consumption							
Private Consumption	9.60	7.10	3.50	-11.70	11.00	7.90	4.20
Government Consumption	0.80	8.20	1.50	-0.40	-1.30	0.10	0.20
Investment							
Private Investment	29.70	9.1	-5.9	-57.6	51.7	23.8	3.10
Government Investment	14.20	44.70	7.60	-21.40	-30.90	-8.80	40.10
Exports of Goods and Services	24.60	11.20	21.40	14.10	15.80	20.50	1.00
Imports of Goods and Services	22.40	14.20	3.20	-22.10	28.80	20.00	-2.80
Fiscal and External Balances (percent of GDP)							
Budget Balance (financial year)	0.4	0.0	-1.5	-4.2	-2.7	1.3	1.3
Merchandise Trade Balance	-0.90	-2.88	-0.67	13.10	6.99	3.65	3.17
Current Account Balance	-1.74	-4.42	-1.71	12.70	6.03	2.41	2.04
Capital Account Balance	3.4	4.5	0.3	-1.0	0.5	2.6	-0.8
Economic Indicators (percent change from previous year, except as noted)							
GDP Deflator	7.20	3.90	3.20	5.00	-2.00	-1.10	1.30
CPI	4.50	4.90	4.40	7.50	0.80	2.30	4.10
M2	15.50	16.20	19.20	19.00	27.90	30.20	15.70
Short-term Interest Rate	11.73	13.53	18.55	7.70	7.16	7.08	5.32
Exchange Rate (Ann. Ave. W/US$)	771	805	951	1,398.9	1,189.5	1,130.6	1,290
Unemployment Rate (percent)	2.00	2.00	2.60	6.80	6.30	4.10	3.70
Population (millions)	45.09	45.52	45.95	46.29	46.62	47.01	47.34

Note: [1] Korean economy recorded 3.0 percent growth in 2001, but nominal GDP in US$ was 422.2 billion dollar, which was smaller than that for 2000, due to changes in exchange rates.

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

Annex II

KOREA: FORECAST SUMMARY (percent change from previous year)

	2002					2003				
	Official	**IMF**	**Link**	**ADB**	**OECD**	**Official**	**IMF**	**Link**	**ADB**	**OECD**
Real GDP	6.0 level [o]	5.0	5.2	4.8	6.0	N.A.	5.5	N.A.	6.0	6.5
Exports	7.0 [1]	N.A.	8.7	7.0 [2]	5.4 [3]	N.A.	N.A.	N.A.	10.0 [2]	13.0 [3]
Imports	9.5 [1]	N.A.	11.8	12.0 [2]	5.8 [3]	N.A.	N.A.	N.A.	14.0 [2]	10.7 [3]
CPI	3.0 level [o]	2.7	2.8	3.5	3.3	N.A.	2.6	N.A.	4.0	3.0

Notes: N.A. Not available.
[o] Korea Ministry of Finance and Economy
[1] The Korea Development Bank
[2] Merchandise trade in US$ terms.
[3] Goods and services in real terms.

Sources: Official forecasts, *MOFE Economic Policy Direction : 2nd Half of 2002 (July 2002)* and *KDB Monthly Bulletin* (May 2002)
IMF forecasts, *The World Economic Outlook Database* (April 2002).
LINK forecasts, *Project LINK World Economic Outlook* (April 2001).
ADB forecasts, *Asian Development Outlook* 2002.
OECD forecasts, *OECD Economic Outlook* (April 2002).

MALAYSIA

REAL GROSS DOMESTIC PRODUCT

The Malaysian economy remained resilient in 2001 in the face of a very challenging and uncertain external environment. While the world economic slowdown was more severe than expected and the unprecedented September 11 events in the United States had widespread implications for all economies, Malaysia was able to steer away from a major economic contraction and GDP growth for the year remained in positive territory.

However, given the openness of its economy with trade accounting for about 200 percent of gross domestic products (GDP), Malaysia was not spared from the negative effects of the United States economic slowdown and global electronics downturn, These were manifested in declining manufacturing production and negative export growth, particularly of electronics. Nevertheless, concerted efforts initiated by the government since the 1997/98 Asian financial crises to stimulate economic growth through accelerating domestic economic activities and reducing the over-dependence on exports helped the nation to sustain a positive real GDP growth, albeit at a modest rate of 0.4 percent in 2001 (2000: 8.3 percent). This growth was achieved within an environment of low inflationary pressures and full employment.

The fiscal stimulus measures and an accommodative monetary policy, coupled with the on-going financial and corporate sector restructuring initiatives, enabled the economy to weather the more challenging external environment. In particular, the increase in public sector expenditure with the introduction of two pre-emptive fiscal packages, amounting to about US$1.9 billion and targeted at encouraging domestic demand spending, helped to cushion the adverse impact of the weak external sector. Public investment expenditure maintained its double-digit growth of 15.5 percent (2000: 19.9 percent), induced by the expansionary budget and augmented further by the need to improve efficiency of project implementation. Likewise, public consumption spending increased strongly by 11.9 percent (2000: 1.7 percent), due mainly to the procurement of office supplies related to e-government flagship applications, payments for professional services and bonus payments for the year. The direct contribution of the public sector was significant, contributing 3.8 percentage points to real GDP growth in 2001 and compensating for the negative 3.4 percentage points from other sectors, particularly the private sector. Private investment expenditure declined sharply by 19.7 percent (2000: +28.7 percent), reflecting the negative impact of lower external demand and excess capacity in certain sectors of the economy, particularly in the export-oriented manufacturing industries. Private consumption has, on the other hand, remained resilient despite lower export earnings following the positive impact of the fiscal stimulus measures. Supported by the government’s measures to increase household disposable income through the reduction in employees’ contribution to the Employees Provident Fund (EPF), provision of higher tax rebates to individual taxpayers and relaxation of Government employees’ eligibility for car loans, together with a low interest rates environment, private consumption continued to increase further, by 2.8 percent during the year (2000: 12.2 percent).

On the supply side, most of the major sectors were adversely affected by the greater-than-expected slowdown in the world economy and contraction of global demand for electronic products and components. The manufacturing sector in particular, which had achieved double-digit growth over the last twenty-one consecutive months since May 1999, experienced a sharp deterioration in output growth, especially in the export-oriented industries. However, the weaker growth in the export-oriented manufacturing industries was partly mitigated by a more resilient performance of the domestic-oriented manufacturing industries that benefited from the expansionary fiscal policy of the public sector. As such, the decline in the manufacturing value added was contained at a single-digit rate of 5.1 percent (2000: +21 percent).

Other major domestic sectors of the economy, especially the services sector continued to expand strongly by 4.9 percent (2000: 4.8 percent) on account of better performance of government services and other services sub-sectors. The fiscal stimulus measures, privatization of infrastructure projects and housing development within a low interest rate environment contributed to a stronger growth of 2.3 percent (2000: 1 percent) in the construction sector. Value-added in the agriculture sector expanded at a higher rate of 2.5 percent (2000: 0.6 percent), largely on account of greater palm oil production. Overall, the effectiveness of the policy measures introduced and Malaysia’s diversified economic structure have moderated somewhat the impact of the decline in output from export-oriented industries.

INFLATION

Inflation remained low in 2001. The consumer price index (CPI) moderated further to 1.4 percent because of the stability of the exchange rate, the low rate of inflation abroad, lower prices for many commodities, and excess capacity in several sectors of the economy. The moderate appreciation of the ringgit against non-US dollar currencies, as well as lower prices paid by the producer (PPI) which fell by 5.0 percent in 2001 also contributed to lower inflation in 2001.

EMPLOYMENT

In 2001, the impact of the slowdown in economic activity was also felt by the labor market, particularly in terms of retrenched workers in the manufacturing sector. However, given the flexibility accorded by the labor market, alternative measures that were adopted by employers (such as pay cuts and temporary layoffs) helped contain the number of workers retrenched. During the year, the slower growth environment resulted in both the total employment and labor force expanding at more moderate rates of 2.6 percent to 9.5 million workers and 3.2 percent to 9.9 million persons, respectively. The unemployment rate edged upwards from 3.1 percent in 2000 to 3.7 percent in 2001. However, in remained below the 4.0 percent deemed to be the full employment level. A total of 38,116 workers were retrenched (2000: 25,236) with 75.6 percent from the manufacturing sector. The electronics and electrical products sub-sector accounted for almost half (45.7 percent) of the total number of workers retrenched. The number of job vacancies increased more moderately, by 6.5 percent to 131,459 in 2001 (2000: 123,484).

EXTERNAL TRADE ACCOUNTS

Malaysia’s external position remained fundamentally strong despite the slowdown in the global economy. In fact, the overall balance of payments position turned around and recorded a surplus in 2001. The improvement was due partly to lower outflows in the financial account. The surplus in the current account remained large, though it narrowed slightly at US$7.2 billion or equivalent to 8.9 percent of nominal gross national product (GNP) (2000: US$8.4 billion or 10.2 percent of GNP). The sizeable surplus reflected a moderate decline in the trade account and improvements in the income and services accounts.

On the trade account, the impact of the world economic slowdown and the global electronics downturn on Malaysia’s external demand has been significant as growth in gross exports, which remained positive since 1987, declined by 10.4 percent in 2001. Almost all categories of exports were adversely affected, particularly electronics and non-household electrical appliances as well the primary commodities as crude oil and palm oil. Nevertheless, given the existing structure of a high import content in exports, coupled with moderation in domestic demand conditions, gross imports also declined by 9.9 percent. This has helped to contain the decline in the trade surplus that remained large at US$14.1 billion (2000: US$16.3 billion). The services account, on the other hand, registered a significantly smaller deficit of US$2.2 billion (2000: -US$3 billion), reflecting the marked improvements in the travel account and the smaller amount of payments related to export and import activities. With lower corporate earnings arising from weaker exports during the year, the deficit in the income account also improved to US$6.8 billion (2000: -US$7.5

billion) on account of lower repatriation of profits and dividends. The financial account of the balance of payments turned more favorable in 2001, with lower net outflows of US$3.9 billion (2000: US$6.3 billion). This was due mainly to lower short-term capital outflows and higher external borrowings by the federal government and non-bank private sector.

With the surplus in the current account more than sufficient to meet the deficit in the financial account, the overall position of the balance of payments recorded a surplus of US$964 million (2000: US$974 million). With this favorable development, Malaysia's net international reserves strengthened further to US$30.8 billion as at end of 2001 (end 2000: US$29.9 billion). The reserves level is adequate to finance 5.2 months of retained imports and cover 5.1 times the short-term external debts. The strengthening of the reserve position is reflected by build-up in foreign exchange holdings from trade and long-term capital inflows.

GROSS EXTERNAL DEBT

Malaysia's total external debt increased by 7.6 percent to RM169.8 billion (US$44.7 billion) in 2001. The increase is also reflected in the ratio of external debt to gross domestic product (GDP), which has increased to 51 percent in 2001 from 46 percent in 2000 (1997: 61 percent). This was largely due to the increase in the private sector's short-term and the federal government debt.

The private sector's short-term external debt increased significantly by 33.7 percent to RM23.3 billion (US$6.1 billion), equivalent to 13.7 percent of total external debt and 19.9 percent of international reserves. This was largely on account of the increase in short-term borrowings by commercial banks mainly to provide for their trade financing activities, revolving credits and inter-company loans.

Although the federal government external debt increased significantly by 29.3 percent to RM 24.3 billion (US$6.4 billion), it accounted for only a small share (14.3 percent) of total external debt. The increase was largely due to additional borrowings to finance the deficit, arising mainly from the implementation of fiscal stimulus measures. The government has also tapped the international capital markets to maintain a market presence as well as to take advantage of the favourable market conditions.

EXCHANGE RATE

The ringgit exchange rate remained pegged to the US dollar at the rate of RM3.80 per US dollar in 2001—an arrangement that has been effective since 2 September 1998. The ringgit appreciated against all major currencies, including regional currencies in tandem with the strong U.S dollar. In terms of its trade-weighted nominal effective exchange rate, the ringgit appreciated 5.5 percent during the year, in line with the appreciation of the US dollar. The pegged exchange rate regime continues to be supported by the strong fundamentals of the economy as reflected by the strong current account surplus, the low rate of inflation and the high level of reserves.

FISCAL POLICY

Prior to the financial crisis in 1997, the federal government recorded five consecutive years (1993–97) of budgetary surplus. From 1998 to 2001, the federal government budgetary position incurred deficits, largely because of expansionary fiscal policy designed to support economic growth and recovery. The focus of the 2002 budget is, therefore, to continue the recovery process to a level consistent with Malaysia's growth potential. The three main thrusts of the 2002 budget as presented to parliament in October 2001 were directed at strengthening Malaysia's economic growth through increasing domestic demand, enhancing the private sector's resilience and competitiveness, diversifying the sources of growth and ensuring a more equitable distribution of wealth.

Although fiscal policy has been expansionary since 1998, Malaysia still enjoys fiscal flexibility, and the continued expansionary budget in 2002 would not create risks in the economy. This is because the federal government debt is expected to be contained at a manageable and sustainable level. Debt servicing of the federal government is also low, with interest payments accounting for about 16 percent of operating expenditure. The level of expenditure would be managed by taking into consideration the need to stimulate economic activities, maintain a surplus position in the current account, avoid excessive reliance on external borrowings, and avoid crowding out the private sector in terms of borrowings from the domestic financial system.

Expenditure allocation would continue to focus on programmes and projects that would have higher multiplier effects on domestic activity and raise the long-term productivity of the economy. In addition, the annual budget contained both tax and non-tax fiscal incentives focused on expanding domestic demand while strengthening the nation's competitiveness and resilience. Apart from promoting new sources of growth, allocation is also aimed at developing skilled manpower and technological competence, and expediting the restructuring of the financial and corporate sectors. Regarding tax policy, the government continued with its tax reform programmes aimed at improving tax buoyancy and tax collection. Emoluments constitute the largest component of operating expenditure. As for development expenditure, education, transport infrastructure and trade and industry are the biggest components.

MONETARY POLICY

Monetary policy in 2001 was directed at promoting domestic activities to mitigate the effect of the global economic slowdown. The absence of inflationary pressures enabled monetary policy to remain accommodative, with interest rates remaining low and stable. Nevertheless, in the wake of the September 11 incidents, the central bank, Bank Negara Malaysia (BNM), reduced its intervention rate by 50 basis points to 5.0 percent on 20 September, marking its first cut in more than two years. The reduction was aimed at countering the impact from the worsening external environment and stimulating domestic consumer and business activities.

Money supply continued to expand in 2001, albeit at a more moderate pace in line with the weaker economic activities, with M1, M2 and M3 increasing by 3.2 percent, 2.2 percent and 2.8 percent, respectively. However, despite the more challenging environment, lending by the banking system continued to expand by higher loans extended to the household sector, particularly for the purchase of residential property and passenger cars.

MEDIUM-TERM OUTLOOK

Given that the outlook for the global economy has improved, supported particularly by positive developments in United States and the expected pick-up in world trade in tandem with a gradual upturn in the electronics sector, the Malaysian economy is well placed to strengthen further in 2002. However, some downside risks need to be addressed as the strength of global recovery is still uncertain and external demand may not be as strong as it was during the 1999-2000 period. The current economic upturn is taking place amidst global excess capacity, particularly in the information and communication technology sector. Malaysia, therefore, needs to ensure that the economic recovery gathers momentum and that the downside risks are minimized.

Toward this end, the government will continue to institute appropriate fiscal and monetary policies to support the recovery momentum. The measures implemented in 2002 budget are expected to contribute to improving the business environment through not only demand side measures, but also supply side initiatives. In this regard, policies and strategies are targeted to realize the full potential of the agricultural and services sectors, including tourism and education, as well as to promote domestic resource-based industries, including support services-related activities. Efforts are also intensified on building strong small- and medium-scale enterprises, developing effective human resources and enhancing productivity and competitiveness. The incentive structures that are provided for in the budget will remain favorable to both foreign and domestic investors.

In 2002, the total external debt is expected to decrease by 1.1 percent to RM167.9 billion (US$44.2 billion), equivalent to 47.9 percent of GDP. Nevertheless, the federal government external debt is expected to increase by 22.9 percent to RM29.9 billion (US$7.9 billion). However, it will continue to account for a small share (18 percent) of the total external debt. The increase is mainly due to higher borrowings by the federal government to finance the envisaged fiscal deficit. The external borrowings of Non-financial Public Enterprises (NFPEs) and the private sector are expected to be relatively small in 2002. The debt service ratio is expected to stabilize at 5.3 percent in 2002.

To further ensure an accommodative environment that would generate greater economic activities, the government's financial policy in 2002 would be placed on meeting the objectives set out in the phase of the Financial Sector Master Plan. This involves enhancing the capacity of the banking groups by benchmarking, upgrading skills, strengthening corporate governance, encouraging new delivery channels and promoting greater operational flexibility so as to become more efficient and effective. In addition, the roles of the development financial institutions would be intensified further to complement the activities of the banking system, with the enforcement of the Development Financial Act Institutions Act 2002. This is also in the light of government's efforts to expedite corporate restructuring and to intensify private sector involvement as well as to broaden the economic base in order to reduce vulnerability and to insulate the economy from external risks.

With strong macro-economic fundamentals already in place and early economic indicators already showing positive signs in consumption, production and investment as well as in anticipation of the gradual improvement of the global economy and trade, the recovery of the Malaysian economy will be modest, with real GDP expanding by 3.5 percent in 2002 (2000: 0.4 percent). All major sectors are expected to record positive growth, with manufacturing as the lead sector, gaining from the improvement in global demand for electronics. The services and construction sectors, on the other hand, are envisaged to continue to support domestic economy activity, benefiting from the impact of the pro-growth policies already in place. As growth gathers momentum, the private sector is expected to play greater role as the engine of the economy, with the public sector providing the necessary support. Domestic expenditure, both consumption and investment, is expected to improve further by 2.8 percent (2001: 2.3 percent), contributing positively by as much as 3.5 percentage points to GDP growth in 2002 (2001: 2.3 percentage point).

The current account of the balance of payments is expected to continue to register a small surplus position. The sharper trade surplus from higher exports is likely to be eroded somewhat by higher imports. Similarly, the services and income account deficit are expected to widen. The current account surplus, however, is forecast to remain large in 2002 at 7.9 percent of GNP (2001:8.9 percent).

The expected pace of economic recovery and sustainable domestic spending are very encouraging in the light of moderate inflationary pressures and improvements in the labor market. For the whole of 2002, inflation is expected to remain subdued although the increase in transportation costs and retail prices of several petroleum products, as well as the higher sales tax on cigarette and tobacco products announced during the 2002 budget, has had some effect pushing up the CPI slightly. This trend continued into the first three months of 2002, although CPI rose only 1.4 percent during the period. The increase in the prices of tobacco, transport and communication, and gross rent and fuels was partly offset by a decline in the prices of clothing and footwear. Continued excess capacity in some sectors and capacity-expansion programmes being undertaken in other sectors, as well as lower inflation abroad, are expected to mitigate any build-up of inflationary pressures.

The labor market situation is expected to improve gradually in 2002 in tandem with the recovery in the export sector. The unemployment rate is forecast to decline to 3.6 percent in 2002 (2001: 3.7 percent). The establishment of nine schemes for skill training and higher education, with an allocation of RM300 million, is envisaged to contribute positively to the development of skills of unemployed graduates and retrenched workers. While IT-related areas are expected to create new employment opportunities, the manufacturing sector will still be a major source of new employment opportunities.

Annex I

MALAYSIA: OVERALL ECONOMIC PERFORMANCE

	1995	1996	1997	1998	1999	2000	2001
GDP and Major Components (percent change, year over year, except for noted)							
Nominal GDP (level in billion US$)	88.7	100.9	100.2	72.5	79	89.7	87.5
Real GDP	9.8	10.0	7.3	-7.4	6.1	8.3	0.4
Consumption	10.5	5.6	4.6	-10	6.3	9.9	4.7
Private Consumption	11.7	6.8	4.3	-10.2	3.3	12.2	2.8
Government Consumption	6.1	0.7	5.7	-8.9	18.5	1.7	11.9
Investment	22.8	8.2	9.2	-43	-5.9	24.1	-2.1
Private Investment	28.1	11.3	9.4	-55.2	-21.8	28.7	-19.7
Government Investment	11.3	0.5	8.4	-8.4	15.9	19.9	15.5
Export of Goods and Services	19.0	9.2	5.5	0.5	13.4	16.1	-7.6
Import of Goods and Services	23.7	4.9	5.8	-18.8	10.8	24.2	-8.6
Fiscal and External Balances (percent of GDP)							
Budget Balance	0.8	0.7	2.4	-1.8	-3.2	-5.8	5.5
Merchandise Trade Balance	0.04	4.0	3.7	24.4	28.7	23.3	21.0
Current Account Balance	-9.7	-4.4	-5.9	13.2	16	9.4	8.3
Financial Account Balance	0.0	0.0	0.0	0.0	-8.4	-7.0	-4.5
Economic Indicators (percent change, year over year, except as noted)							
GDP Deflator	3.6	3.7	3.5	8.5	0.0	4.7	-2.7
CPI	3.4	3.5	2.7	5.3	2.8	1.6	1.4
M2	24.0	19.8	22.7	1.5	13.7	5.2	2.1
Three-Month Interbank Rate (percent p.a., end-period)	6.76	7.39	8.7	6.46	3.18	3.25	3.27
Real Effective Exchange Rate (level, 1997=100)							
Unemployment Rate (percent)	3.1	2.5	2.4	3.2	3.4	3.1	3.7
Population (millions)	20.8	21.3	21.8	22.1	22.7	23.3	23.8

Annex II

MALAYSIA: FORECAST SUMMARY (percent change from previous year)

	2001					2002				
	Official	**IMF**	**LINK**	**ADB**	**OECD**	**Official**	**IMF**	**LINK**	**ADB**	**OECD**
Real GDP	0.4	0.4	5.0	0.4	4.6	3.5	3.0	6.2	4.2	6.0
Exports	-10.4	N.A.	7.2	-8.8#	N.A	4.4	N.A	8.9	7.0#	N.A
Imports	-9.9	N.A.	7.2	-7.6#	N.A	4.8	N.A	9.2	10.0#	N.A
CPI	1.4	1.4	2.1*	1.4	N.A	1.8	1.8	2.0*	2.3	N.A

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

Sources: IMF forecast, The World economic Outlook Database (April 2002)
LINK forecast, Project LINK World Economic Outlook (April 2001)
ADB forecasts, Asian Development Outlook 2002.
OECD forecast, OECD economic Outlook (June 2001)

Annex III

MALAYSIA: MEDIUM-TREND FORECAST (percent)

	Average for 2001-05
Real GDP	7.5
CPI	2.0

MEXICO

REAL GROSS DOMESTIC PRODUCT

During 2001, the slowdown in economic activity that began at the end of 2000 became more pronounced. Gross domestic product (GDP) decreased by 0.3 percent in real terms during 2001 as compared to the previous year. In current prices, GDP amounted to 5,771.9 billion pesos (approximately US$617.8 billion).

The contraction in economic activity during 2001 implied an aggregate demand reduction of 1.0 percent in real terms as compared to 2000. This was a result of, on the one hand, a 1.4 percent real decrease in public consumption, a 5.9 percent real reduction in investment and a 5.1 percent real decrease in exports and, on the other hand, a 3.4 percent real increase in private consumption. With respect to aggregate supply, imports decreased by 2.9 percent in real terms in 2001.

The economic slowdown had an uneven impact across different sectors of the economy. In particular, the industrial sector contracted by 3.5 percent in real terms, while the agriculture and services sectors grew by 2.5 percent and 1.1 percent, respectively, in real terms, in each case as compared with 2000.

INFLATION

The government's fiscal discipline and Banco de México's prudent monetary policy resulted in a significant reduction in inflation during 2001. The INPC registered its lowest rate since the INPC was established in 1968, registering an increase of 4.4 percent for the twelve-month period ending on 31 December 2001; significantly lower than the official target of 6.5 percent established by Banco de México for the year.

The "core" inflation rate, which more accurately measures inflation pressures over the medium-term, registered an annual increase of 5.08 percent at the end of 2001, slightly above the INPC rate, mainly due to the effect of certain temporary and non-recurring price reductions on the INPC. The prices of basic consumer goods, as measured by the Index of Prices of Consumer Goods included in the basic consumption basket, increased 3.83 percent during 2001, 4.91 percentage points below the rate registered in 2000. The positive results observed in the INPC in 2001, however, will not lessen the authorities' commitment to continue with its inflation abatement program.

EMPLOYMENT

The reduction in economic activity also negatively affected the labor market, both in terms of the creation of new jobs and in the number of worker layoffs. The total number of employees registered with the Mexican Institute of Social Security (Instituto Mexicano del Seguro Social, or IMSS), a measure of employment in the formal sector of the economy, fell by 382,631, of whom 313,102 were full-time workers. The contraction in formal employment was reflected by an increase in the open unemployment rate (Tasa de Desempleo Abierto, or TDA). During 2001, the TDA averaged 2.46 percent, 0.25 percentage points higher than the average in 2000.

BALANCE OF PAYMENTS

The worldwide slowdown in economic growth in 2001 inhibited the growth of Mexico's foreign trade. As compared to 2000, total exports and imports decreased by 4.8 percent and 3.5 percent, respectively. The decrease in total exports was primarily attributable to the fall in international oil prices and the recession in the United States. The decrease in total imports was primarily due to a reduction in imports by the *maquiladora*, or in-bond industries, as well as a result of the slowdown in domestic demand.

During 2001, the trade balance registered a deficit of US$9,953.6 million, a 24.4 percent increase as compared to 2000. However, the trade deficit, excluding petroleum exports, decreased 6.7 percent during the year.

During 2001, the capital account registered a surplus of US$23,967.3 million, US$6,386.5 million greater than the amount registered in 2000. The surplus in the capital account is primarily due to an increase in foreign direct investment inflows and in assets held abroad by Mexican residents and to a reduction in the external indebtedness of the public sector.

GROSS EXTERNAL DEBT

As of end 2001, net public sector external debt amounted to 11.8 percent of GDP, a decrease of 1.5 percentage points as compared to the end of 2000. The outstanding amount of net public sector external debt at the end of 2001 was US$76,646.2 million, US$93.0 million higher than at the end of 2000. This increase in net public sector debt was due to the following factors:

- A US$4,261.0 million reduction in the outstanding amount of gross external debt, as a result of (a) a net decrease in indebtedness of US$3,538.9 million derived from US$18,311.6 million of new borrowings and US$21,850.5 million of repurchases and amortizations and (b) net downward accounting adjustments totaling US$722.1 million. These adjustments consisted mainly of downward adjustments due to the appreciation of the US dollar with respect to debt denominated in foreign currencies.
- A US$4,354.0 million decrease in the value of the federal government's international assets related to external debt. This decrease reflects the release of collateral securing cancelled Brady Bonds, variations in the value of international assets and movements in interest rates and exchange rates associated with Brady Bond collateral.

During 2001, the federal government's external debt policy was marked by increased activity in the international capital markets resulting from the implementation of liability management operations. During 2001, the federal government issued a total of US$8,999.7 million of debt securities in the international capital markets, 30.8 percent more than the US$6,881.7 million issued in 2000. These transactions were made possible by Mexico's continued access to international capital markets, and permitted Mexico to diversify its investor base and extend its maturity profile.

EXCHANGE RATE

The government has maintained a free-floating exchange rate regime since December 1994. This regime is one of the main factors contributing to the strengthening of macro-economic fundamentals during recent years. In particular, this exchange rate policy has had the following benefits: (i) it allows gradual and frequent adjustments to external shocks (in place of less frequent, but larger adjustments), (ii) it promotes a change in the composition of capital inflows in favor of long-term capital, such as foreign direct investment, (iii) it reduces speculative attacks on the currency, and (iv) it avoids the accumulation of unsustainable imbalances in the external sector.

FISCAL POLICY

The behavior of public finances in 2001 was influenced by the following factors: a slowdown in economic growth, the strength of the peso, the decline in international oil prices and in the volume of petroleum exports, an increase in revenue sharing to states and municipalities and a decline in both domestic and international interest rates.

In this context, the government's fiscal discipline and prudent management of economic policy contributed to maintaining a stable domestic environment characterized by lower inflation and interest rates. Despite a significant slowdown in economic activity and lower oil-related revenues, the overall public sector deficit amounted to 0.73 percent of GDP, a figure consistent with the target originally established for the year and 34.8 percent lower in real terms than the deficit recorded in 2000.

During 2001, public sector revenues were lower than projected in the program published in the Official Gazette (*Diario Oficial de la Federacion*) on 31 January 2001. The reduction in revenues was mainly due to lower oil-related revenues, caused by the decline in domestic sales of oil-related products that reflected the deceleration of economic activity, the strength of the peso and the reduction in the volume of crude oil exports implemented to help stabilize international oil prices. Non-oil tax revenues, however, increased 4.1 percent in real terms as compared to 2000, as a result of the successful implementation of fiscal measures intended to strengthen tax collection and compliance.

In order to compensate for the shortfall in public sector budgetary revenues, and so as not to exceed the limit on net indebtedness approved by congress, public sector expenditures were revised downwards in accordance with the automatic adjusters included in Article 32 of the 2001 Budget Decree.

MONETARY POLICY

The monetary program for 2001 emphasized the control of inflation through the avoidance of excess supply and the provision of necessary monetary policy flexibility.

In response to the economic slowdown, Banco de México reduced the short twice during the year. The short, or *corto*, is the mechanism that this institution uses to tighten the monetary conditions of the economy in accordance to inflation targets, and to restore orderly conditions in money and exchange markets.

The monetary policy actions carried out by Banco de México during 2001 also affected inflationary expectations and contributed to the decline in the annual inflation rate to 4.4 percent, significantly lower than the official target of 6.5 percent.

The monetary base, which consists of currency in circulation and deposits in Banco de México, reached Ps. 225,580 million at the end of December 2001, Ps. 11,820 million lower than projected in Banco de México's 2001 monetary program. This result was primarily attributable to the slowdown in economic activity.

Net international reserves (defined as the difference between gross international reserves and Banco de México's short-term liabilities) totaled US$40,879.9 million at December 31, 2001. Banco de México's net domestic credit (defined as the difference between the monetary base and net international assets) registered a negative nominal effective balance of Ps185,735 million at the end of 2001, Ps71,517 million lower than the level registered at the end of 2000. The negative flow of net domestic credit was primarily due to the sharp increase in net international assets.

MEDIUM-TERM OUTLOOK

The Mexican government's main economic objective is to strengthen the economy´s fundamentals in order to experience a prompt, orderly and sustainable recovery in a stable context of stability. The achievement of this objective will require sound economic policy management.

In this context, the 2002 economic program approved by congress contemplates a fiscal deficit target equivalent to 0.65 percent of GDP, a figure slightly lower than that of 2001. According to the program, the entire fiscal deficit will be financed in the domestic market. Thus, a zero net external indebteness ceiling was established for the public sector.

The economic program incorporates a GDP annual growth of 1.7 percent, a figure that is consistent with the expected recovery of the US economy. Along these lines, it is also expected that investment will be the most dynamic component of aggregate demand. For 2002, the estimated current account deficit is expected to be around 3.4 percent of GDP, 0.5 percent points higher than in 2001.

In line with the inflation targets set by Banco de México, the economic program remains focused on reducing the growth rate of prices to a level not higher than 4.5 percent. This figure is consistent with the goal of converging to an annual inflation rate of 3.0 percent by 2003. Achievement of the inflation target will require strict monetary policy discipline, since wage increases and the rise in residential energy prices during the first quarter of 2002 have been pushing the general price level upwards.

During 2002, the federal government will insist on promoting the structural reform outlined in the National Development Plan in order to improve productivity and keep Mexico attractive to long-term investment projects, even under unfavorable international economic conditions.

The structural reform package —that includes energy reform, labor reform, budgetary reform, and changes to the legal framework of Mexico´s financial system— will allow a reduction of the negative impact caused by the halt in US demand, the volatility in international oil prices and financial markets, and uncertainty regarding the evolution of the global economy.

OTHER PERTINENT INFORMATION (e.g., structural changes and reforms, foreign direct investments, interest rates, capital markets, etc.)

During 2001, the federal government and congress worked intensively in the establishment of a new legal framework to develop, strengthen and modernize the financial system.

The new legal framework seeks to protect the rights of minority shareholders, establish clear rules on corporate governance practices, reduce the issuance of shares with limited voting rights, provide a regulatory framework that is designed to minimize insider trading, increase competition among financial intermediaries, make investment regimes of investment companies more flexible and strengthen regulatory supervision. These new laws should help the financial system spur economic growth in the coming months.

On 31 December, and 1 January 2002, congress also approved a fiscal package aimed at increasing permanent tax revenues and strengthening fiscal federalism. The new fiscal scheme will help to widen the tax base by bringing the informal economy into the system, while simplifying the tax administration process.

The main elements of the fiscal package include: changes to the income tax law for both firms and individuals, a new tax on luxury goods and services, changes to existing excise taxes and the introduction of new excise taxes. The fiscal package also promotes federalism by giving states and municipalities optional capabilities for tax collection.

With the approval of the fiscal package, congress and the federal government reaffirm their commitment to move forward with the structural reform agenda and the modernization of the Mexican economy.

Annex I

MEXICO: OVERALL ECONOMIC PERFORMANCE

	1996	1997	1998	1999	2000	2001
GDP and Major Components (percent change, year over year - earlier period, except as noted)						
Nominal GDP (level in billion US$)	332.3	400.9	421.0	480.5	580.1	617.8
Real GDP	5.2	6.8	5.0	3.6	6.6	-0.3
Consumption	1.8	6.0	5.0	4.4	7.5	2.8
Private Consumption	2.2	6.5	5.4	4.3	8.3	3.4
Government Consumption	-0.7	2.9	2.3	4.7	2.0	-1.4
Investment	16.4	21.0	10.3	7.7	11.4	-5.9
Private Investment	26.7	23.5	13.8	7.2	9.2	-5.1
Government Investment	-14.8	10.1	-7.5	10.7	24.5	-9.6
Exports of Goods and Services	18.2	10.7	12.1	12.4	16.4	-5.1
Imports of Goods and Services	22.9	22.7	16.6	14.1	21.5	-2.9
Fiscal and External Balances (percent of GDP)						
Budget Balance[1]	0.0	-0.7	-1.2	-1.1	-1.1	-0.7
Merchandise Trade Balance	2.0	0.2	-1.9	-1.2	-1.4	-1.6
Current Account Balance	-0.8	-1.9	-3.8	-2.9	-3.1	**-2.9**
Capital Account Balance	**1.3**	**4.1**	**4.4**	**2.8**	**3.0**	**3.9**
Economic Indicator (percent change, year over year - earlier period, except as noted)						
GDP Deflator	30.7	17.7	15.4	15.3	12.0	5.4
CPI	34.4	20.6	15.9	16.6	9.5	6.4
M2[2]	35.7	33.3	26.0	21.8	**13.1**	**16.3**
Short-term Interest Rate (percent)[3]	**31.4**	**19.8**	**24.8**	**21.4**	**15.2**	**11.3**
Real Effective Exchange Rate (level, 1997=100)[4]	**-9.3**	**-11.6**	**1.1**	**-8.3**	**-6.6**	**-4.5**
Unemployment Rate (percent)	5.5	3.7	3.2	2.5	2.2	2.5
Population (millions)	**90.6**	**92.3**	**94.0**	**95.7**	**97.5**	**98.9**

Sources: Banco de México, Ministry of Finance and Public Credit and National Population Council.

Notes: [1] It corresponds to the economic public sector balance.
[2] It includes public and private sector savings.
[3] 28 day Cetes.
[4] Bilateral real exchange rate between US dollar and Mexican peso (a minus sign means an appreciation)

Annex II

MEXICO: FORCAST SUMMARY (percent change from previous year)

	2002				
	Official	**IMF**	**Link**	**ADB**	**OECD**
Real GDP	1.7	N.A.	N.A.	N.A.	N.A.
Exports	4.2	N.A.	N.A.	N.A.	N.A.
Imports	5.1	N.A.	N.A.	N.A.	N.A.
CPI	4.5	N.A.	N.A.	N.A.	N.A.

NEW ZEALAND

REAL GROSS DOMESTIC PRODUCT

The New Zealand economy has performed strongly since 1999. Even over 2001 as the global economy slowed markedly the New Zealand economy continued to perform well.

The first half of 2001 saw growing momentum in the domestic economy, with growth averaging just over 1 percent per quarter. A second good agricultural season, combined with relatively high commodity prices and a competitive exchange rate, saw continued gains in farm incomes. Rising household incomes on the back of strong employment growth and stimulatory monetary conditions, helped boost consumer spending and provide support to the housing market. The strength in the domestic economy, and high levels of capacity utilisation, also helped underpin growth in business investment.

Robust domestic demand growth continued into the second half of the year. This broad based growth took place despite the backdrop of a slowing global economy. While the tragic events of September 11 added to the uncertainty around the global outlook, and provided a negative shock to business and consumer confidence, the New Zealand economy was in a relatively good position to weather the global slowdown. The downturn in confidence proved short-lived. Firms' balance sheets were in a relatively healthy position following two years of good growth, and there was little investment overhang, with residential investment at a cyclical low and capacity utilisation at high levels.

Quarterly GDP growth averaged around 0.4 percent over the second half of 2001, accelerating into 2002. Growth in the September and December quarters was characterised by strong domestic demand, partially offset by a weaker external sector. Weaker global growth spilled over into the New Zealand economy via lower demand for New Zealand exports, including tourism, which has since bounced back as international travel patterns return to normal; and lower export prices, particularly dairy prices, which comprise 16 percent of total New Zealand exports. Importantly for New Zealand, Australia–our major trading partner–has continued to outperform most other economies.

The economy grew strongly in the March quarter recording quarterly growth of 1.1 percent taking annual average growth to 3.2 percent. Partial indicators suggest that the domestic economy continued to grow strongly in the June 2002 quarter.

INFLATION

After reaching 4.0 percent in the December 2000 quarter, largely due to the depreciation in the exchange rate and oil price rises, headline CPI inflation trended down through much of 2001 as these factors unwound. An increase in state housing rental subsidies in the March 2001 quarter also made an important contribution to the reduction of the annual inflation rate, which fell to 1.8 percent in the December 2001 quarter. Core measures of inflation were however, running somewhat higher than this. In the March 2002 quarter annual inflation increased to 2.6 percent as the previous March's subsidy change dropped out of the calculation, and in the June quarter CPI inflation increased to 2.8 percent largely on the back of increases in the price of oil and international airfares, with housing costs also adding to the increase.

CPI inflation is forecast to remain at or above 2.5 percent over the remainder of 2002, before ameliorating somewhat going into 2003. An appreciating exchange rate is expected to place some downward pressure on inflation, although firms are expected to take the opportunity of robust demand to seek to rebuild margins, particularly over the first part of 2002.

EMPLOYMENT

Three years of relatively strong economic growth have been reflected in the significant improvements seen in the labour market. Initially, employment growth has been in the agricultural and manufacturing sectors, but more recently has spread more widely into the health, education and community services sectors. In the year to June 2002, employment grew 3.1 percent, and at 5.1 percent the unemployment rate has fallen to levels not seen since the late 1980s. Owing to both a rising participation rate and the turnaround in net migration, labour force growth is currently around 2.4 percent.

CURRENT ACCOUNT

The annual current account deficit reduced from 7.0 percent of GDP in the March 2000 quarter to 2.2 percent of GDP in March 2002–the lowest as a proportion of GDP in 13 years. The improvement has largely been driven by an improvement in the goods and services balance.

Over the coming year the current account deficit is expected to increase to about 4.5 percent of GDP. This reflects lower commodity prices reducing export incomes and strong consumption and investment leading to stronger import growth.

EXCHANGE RATE

The exchange rate generally remained low over 2001, but began to appreciate towards the end of the year. On a trade-weighted basis, the exchange rate moved to just above the 50 mark by the end of the year, up from the low of around 48 following September 11. The first half of 2002 has seen an acceleration of the increase in the trade-weighted exchange rate to 55. The biggest gains have been against the US dollar, with the NZ dollar rising from a low of just under US$0.40 to peak close to US$0.50 in June 2002 before retracing some of those gains in July, finishing the month about US$0.47.

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 liability position has remained relatively steady in level terms, more recently around -NZ$93 billion. 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 have been reduced as a percentage of GDP from 41.6 percent in 1992/93 to 29.8 percent in the 2001/02 financial year.

The operating balance is estimated to be 2.0 percent of GDP for 2001/02, rising to 3.0 percent of GDP in 2005/06, as tax revenue growth remains higher than expense growth through the forecast horizon.

Net government debt has fallen from 49 percent of GDP in 1992/93 to 16.8 percent in 2001/02. 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 remain just under 17 percent of GDP, reducing further out to about 16 percent of GDP by 2005/06 (although if the assets of the newly created New Zealand Superannuation Fund this ratio falls to 9.8 percent), and gross debt remains around 30 percent of GDP.

MONETARY POLICY

The Reserve Bank of New Zealand is an independent central bank and by 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 Policy Targets Agreement requires the bank to maintain inflation in the range of 0 percent to 3 percent over any 12-month period. The agreement also stipulates that in pursuing its price stability objective, 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. Over 2001, the reserve bank cut the OCR five times, with reductions totalling 1.75 percent, taking the OCR to 4.75 percent in November. Since then, as a result of the ongoing strength of the domestic economy, together with the improvement in the global economy, the reserve bank has begun removing the interest rate stimulus put in place last year, raising the OCR in four consecutive 0.25 percent increases in the first half of 2002.

MEDIUM-TERM OUTLOOK

Over the medium term, the New Zealand economy is expected to record GDP growth of about 3.0 percent on average, although events in the rest of the world may play an important part in the distribution of this growth through time. Trading partner growth is expected to return to trend in 2003, providing a boost to external demand, and the current and expected investment and employment growth will benefit the economy.

Over the second half of 2002 employment growth is expected to slow as firms focus on productivity to boost output in light of a tight labour market. Household spending is also expected to slow, partly reflecting slowing employment growth, but also reflecting rising interest rates and rising household debt ratios. Providing some support to household spending in the year ahead is the substantial turnaround in net migration, plus the cyclical pickup in the housing sector, with rising house prices increasing household wealth, and new house building boosting durables consumption. Reflecting the relatively strong labour market, and two years of economy wide profits and strong growth in domestic demand, business investment is likely to continue to expand in 2002.

Consumption growth is forecast to pick up in late 2003 as disposable income growth begins to gain some momentum over the year to March 2004. Ongoing household wealth increases, supported by modest growth in house prices, are also expected to reinforce consumption. Market investment remains reasonably strong, reflecting a reasonably tight labour market, with firms using capital to meet more of their output growth, and to provide additional capital to newly employed workers. Steady economic growth over the March 2003 and 2004 years will underpin further growth in employment, and real disposable income.

The pick up in export growth on the back of the global recovery provides support to growth further out. Agricultural exports are expected to continue to grow owing to growth in livestock numbers and ongoing productivity gains. Non-commodity manufactured exports are expected to post ongoing growth, benefiting from solid external demand and an exchange rate that is assumed not to overshoot its equilibrium level.

Going into 2003, inflation is expected to fall back quite quickly towards the mid-point of the Reserve Bank’s 0 percent to 3 percent target band, as inflation pressures moderate on the back of interest rates increases and an appreciating currency keeping inflationary pressures in check over the medium term. Over the medium-term, while the economy is expected to grow at a higher rate than its recent trend, in a cyclical sense potential growth is seen to benefit from both a robust labour force and capital stock growth.

Annex I

NEW ZEALAND: OVERALL ECONOMIC PERFORMANCE

Annual average percent change unless specified	**1993q4**	**1994q4**	**1995q4**	**1996q4**	**1997q4**	**1998q4**	**1999q4**	**2000q4**	**2001q4**
GDP and Major Components									
Nominal GDP 4 quarter total (NZ$M)	79895	85752	91308	96497	99513	100176	103978	110389	117878
Nominal GDP (billion US$)	43.2	51.0	60.1	66.5	65.9	53.9	55.0	50.4	49.5
Real GDP	5.2	5.9	4.3	3.6	2.2	-0.2	4.0	3.8	2.4
Total Consumption	7.8	8.8	1.0	7.0	-0.1	1.1	3.6	2.8	0.5
Private Consumption	2.7	5.9	4.1	4.4	2.4	1.8	4.1	2.0	2.2
Govt Consumption	1.2	1.1	4.4	2.6	7.0	-0.7	5.8	-2.6	2.0
Total Investment	14.6	15.2	12.1	8.6	1.1	-4.8	3.3	7.1	-0.5
Private Investment	21.5	15.7	11.1	8.7	-2.1	-4.6	4.3	7.3	1.1
Govt Investment	-15.7	11.6	19.2	8.1	21.3	-5.9	-2.3	5.6	-9.6
Exports of Goods and Service	4.8	9.8	3.8	3.7	3.7	1.1	7.2	7.4	2.3
Imports of Goods and Service	5.5	13.2	8.8	7.8	2.4	1.4	11.8	1.0	2.0
Fiscal & External Balances (percent of GDP)									
Budget Balance to GDP (June years)	-1.1	0.9	3.1	3.6	2.0	2.6	1.8	1.4	1.3
Merchandise Trade Balance to GDP	2.5	2.0	1.1	0.4	0.3	0.2	-1.4	0.8	2.9
Current Account Balance to GDP	-4.0	-4.1	-5.1	-5.9	-6.6	-4.1	-6.7	-5.6	-3.2
Capital Account Balance to GDP	N.A	N.A	N.A	N.A	N.A	N.A	N.A	N.A	N.A
Economic Indicators									
GDP Deflator (annual percent change)	1.0	2.9	2.8	0.9	0.3	1.7	-0.9	4.7	3.5
CPI (annual percent change)	1.4	2.8	2.9	2.6	0.8	0.4	0.5	4.0	1.8
M3 – December (annual percent change)	5.5	7.4	14.5	12.7	4.2	1.1	6.9	6.5	11.4
Short-term Interest Rate (90 day bank bills) 12 month average	6.3	6.7	9.0	9.3	7.7	7.4	4.8	6.5	5.7
Exchange Rate (12 month average)	1.85	1.68	1.52	1.45	1.51	1.86	1.89	2.19	2.38
Unemployment Rate (4 Qtr average)	9.5	8.2	6.3	6.1	6.6	7.5	6.8	6.0	5.3
Population	3.56	3.6	3.66	3.72	3.76	3.79	3.81	3.83	3.86

PAPUA NEW GUINEA

1. ECONOMIC DEVELOPMENTS IN 2001 AND 2002

Economic Activity

Preliminary estimates of economic activity in Papua New Guinea (PNG) indicate that real gross domestic product (GDP) declined further by around 3.4 percent in 2001, following a real decline of 0.8 percent in 2000. Latest estimates are for economic activity to remain depressed in 2002, with real GDP growth revised downwards from the projected growth of 1.2 percent. The revision was mainly due to expected declines in the mineral sector and subdued activity in the agriculture/forestry/fisheries sector. In the mining and petroleum sector, the decline was attributed to lower crude oil production reflecting the depletion of oil reserves at Kutubu and lower extraction from the Gobe Main and South East Gobe oil fields. The subdued activity in the agriculture/forestry/fisheries sector reflects lower coffee and cocoa production, depressed international prices for the major agricultural exports, poor road infrastructure, and disruptions to harvesting during the national eections.

With the weakening of the kina and increase in import costs, aggregate demand remained depressed. The decline in the overall economic growth was also evident through the decline in general imports, lower lending to the private sector by commercial banks (partly due to lack of demand for credit and depressed business activity), and a decline in employment levels in the private sector.

Exchange Rate

In 2001, the daily average kina exchange rate depreciated against all major currencies. It depreciated against the US dollar by 19.3 percent, euro by 15.4 percent, UK pound sterling by 17.1 percent, Japanese yen by 7.8 percent and the Australian dollar by 12.6 percent.

Over the first half of 2002, the kina depreciated by 4.4 and 13.5 percent against the US and Australian dollars, respectively. The pressure on the exchange rate was mainly attributed to the combined effects of a persistent deficit in the current account of the balance of payments for the non-mineral private sector, increased government expenditures and sentiments related to the national elections. The central bank intervened in the foreign exchange market to smooth out volatility in the exchange rate in order to maintain stability. The real effective exchange rate (REER) declined in the first half of 2002, reflecting the depreciation in the nominal exchange rate and the headline inflation outcome for the first two quarters of 2002. However, the benefits to the export sector from the increase in competitiveness were offset by declines in international prices and structural impediments such as infrastructure, law and order and land tenure.

Inflation

Over the year, the headline inflation rate, as measured by the Consumer Price Index (CPI), increased by 10.3 percent in the December quarter of 2001, compared to an increase of 10.0 percent in the December quarter of 2000. The year-on-year headline inflation for 2001 increased by 9.3 percent, compared to 15.6 percent in 2000. The increase was attributed to the depreciation of the kina, upward price movements in seasonal expenditure items, the impact of excise taxes on some consumer goods, and increases in several price-controlled items.

The over the year underlying rate of inflation increased by 8.2 percent to December 2001, compared to 7.8 percent to December 2000. The year-on-year underlying inflation for 2001 was 6.5 percent, compared to 12.6 percent in 2000. The underlying inflation rate in 2001 was lower than the headline measure mainly because of the exclusion of seasonal items and consumer goods affected by the excise tax.

Headline inflation increased by 2.4 percent in the June quarter of 2002, compared to 1.7 percent in the March quarter. The increase was mainly attributed to price increases in the food expenditure group. The annual headline CPI in the June quarter of 2002 was 9.4 percent higher than the corresponding quarter of 2001. The underlying inflation increased by 3.1 in the June quarter of 2002, compared to the March quarter, reflecting the exclusion of the seasonal low prices for betelnut, which more than offset higher prices for fruits and vegetables, and fuel and power sub-groups. The annual underlying inflation in the June quarter of 2002 was 10.3 percent higher than in the corresponding quarter of 2001.

Export Commodity Prices

Lower international prices for mineral exports and some of Papua New Guinea's agricultural commodities were more than offset by the depreciation of the kina. This resulted in the weighted average kina price of exports increasing by 7.9 percent in 2001, relative to 2000. There was an increase of 10.9 percent in the weighted average kina price of mineral exports, with higher prices of gold, copper and crude oil exports. In the agricultural, forestry and marine products, the weighted average kina price declined by 5.1 percent and this was attributed to lower prices of coffee, copra, copra oil, palm oil, logs and marine product exports, which more than offset increases in the prices of cocoa, tea and rubber exports.

When compared to the corresponding period in 2001, the average international prices for most of PNG's major export commodities improved during the five months to May 2002, with the exception of copper, crude oil and coffee. Most of the non-mineral commodity prices have increased as a result of declining supply in the world market, combined with higher demand for the commodities from major consuming regions.

Gold prices increased due to higher demand from Asia and North America. Cocoa prices increased as a result of lower production from major producers in West Africa. Palm oil prices increased due to declining in production in Malaysia and Indonesia, the world's major palm oil producers. Copra and copra oil prices increased as a result of lower copra production in the Philippines.

Balance of Payments

In 2001, the overall surplus in the balance of payments was K708 million, compared to a surplus of K359 million in 2000. This outcome was due to an improvement in the capital account, which more than offset a lower surplus in the current account. The depreciation of the kina against the currencies of Papua New Guinea's major trading partners resulted in an increase in the kina value of all balance of payment transactions.

The surplus in the trade account was K2,929 million in 2001, compared to a surplus of K3,034 million in 2000. The lower surplus was due to an increase in the value of merchandise imports, which more than offset an increase in the value of merchandise exports. The deficit in the invisibles account was K2,035 million in 2001, compared to K2,049 million in 2000. The lower deficit was due to higher service receipts, which more than offset higher service payments by the resident companies. The surplus in the transfers account was K41 million in 2001, compared to a deficit of K12 million in 2000.

As a result of these developments in the trade, invisibles and transfers accounts, the current account recorded a surplus of K935 million in 2001, compared to a surplus of K973 million in 2000.

There was a deficit in the capital account of K262 million in 2001, compared to a deficit of K650 million in 2000. The improvement was due to higher net official capital inflows, combined with lower net private capital outflows, which more than offset increased holdings of foreign assets by the non-official monetary sector and higher build-up in the offshore account balances of the mineral companies.

For the five months to May 2002, an overall balance of payments surplus of K88 million was recorded compared to a surplus of K180 million in the corresponding period in 2001. This outcome was due to a surplus in the capital account, which more than offset a deficit in the current account. The surplus in the capital account was due to a net sale of short-term money market instruments abroad including the sale of the government's share in Orogen Minerals Ltd to Oil Search Ltd. When combined with the draw down in foreign currency account balances of the mineral companies and a net reduction in the foreign assets of the non-official monetary sector, the inflows more than offset higher net loan repayments by the government. The current account deficit reflected lower values of merchandise exports, mainly crude oil, copper, most agricultural and forestry exports, higher imports and net service payments, which more than offset net transfer receipts.

The level of gross foreign exchange reserves at the end of December 2001 was K1,617 million, sufficient for 6.1 months of total import cover and 8.7 months of non-mineral import cover. By end June 2002, the level was K1,808 million or US$459 million.

Fiscal Outcome

The fiscal operations of the national government for 2001 showed an overall deficit of K363.0 million and represents 3.6 percent of nominal GDP, compared to a deficit of K192.3 million in 2000.

Total revenue during 2001 was K2,864.4 million, 4.8 percent lower than in 2000, and represented 88.9 percent of the budgeted amount. Tax revenue totalled K2,294.3 million, which was K20.7 million lower than the receipts in 2000, and represented 92.6 percent of the budgeted amount. The lower tax revenue was due to a decline in indirect tax revenue, which more than offset an increase in direct tax receipts.

Direct tax revenue totalled K2,508.6 million in 2001, 2.6 percent higher than in 2000, and represented 99.2 percent of the budgeted amount. The increase in direct tax revenue was from personal income tax, which continued to improve partly due to the higher wages and salaries bill of the government and increased enforcement activity by the Internal Revenue Commission (IRC). The decrease in company tax receipts reflected lower corporate income tax receipts, which more than offset higher mining and petroleum tax collections due to favourable crude oil prices. The decrease in other direct tax receipts was attributed to lower interest withholding tax revenue and gaming machine tax receipts, reflecting low turnover from gaming machines.

Indirect tax receipts totalled K785.7 million in 2001, which was 7.1 percent lower than in 2000, and represented 82.2 percent of the budgeted amount. All categories of indirect tax receipts decreased with the exception of excise duties and other indirect tax receipts. Import duty collections fell reflecting a decline in the volume of imports due to lower aggregate demand and the five percent reduction in import duty. The fall in the export tax receipts reflected lower export volume and prices of logs due to lower demand from the Asian economies. The decline in Value Added Tax (VAT) collections was attributed to lower imports, zero rating of mining and petroleum sector, capacity constraint and technical problems at the IRC, including delays in collections. However, excise duties increased slightly due to the introduction of a new excise tax and increased enforcement activities by the IRC.

Total non-tax revenue, excluding foreign grants was K171.5 million for 2001, 8.4 percent lower than in 2000 and represented 87.1 percent of the budgeted amount for 2001. The decrease mainly reflected lower internal revenue collections by government departments, which more than offset dividend payments by the Statutory Authorities and the Mineral Resources Development Company (MRDC). Foreign grants totalled K398.7 million in 2001, compared to K506.6 million in 2000 and represented 72.4 percent of the budgeted amount. The lower receipt of foreign grants was partly attributed to the delay in disbursement of project grants from PNG's traditional donor countries and slower implementation of projects.

Total expenditure in 2001 amounted to K3,227.4 million, 0.8 percent higher than in 2000, and represented 95.9 percent of the 2001 budgeted expenditure. The increase was due to higher recurrent expenditure, which more than offset lower development expenditure. Recurrent expenditure for 2001 was K2,424.9 million, 3.1 percent higher than in 2000, and represents 104.8 percent of the 2001 budget appropriation. Of this total, K1,242.4 million was national department expenditure, which was K0.7 million lower than the 2000 expenditure, and represents 104.9 percent of the 2001 budgeted expenditure. The slightly lower national department expenditure was due to strict expenditure control measures adopted by the government due to declining revenue. However, it exceeded the budget appropriation due to slower implementation of the retrenchment program and the settlement of backdated payments to police and defence force personnel and teachers' awards. Provincial government recurrent expenditure totalled K588.6 million in 2001, K24.7 million higher than in 2000 and represents 100.7 percent of the budgeted amount, largely due to a higher allocation of conditional grants to provinces. Interest payments totalled K433.2 million in 2001, K13.3 million more than in 2000, and represented 105.7 percent of the budgeted amount. The increase was mainly attributed to higher external interest payments, resulting from the lower kina value.

Total development expenditure in 2001 was K802.5 million, K46.3 million lower than in 2000 and represented 76.4 percent of the 2001 budget appropriation. The lower level of spending on developmental projects was attributed to delays in disbursement of external funding for project support and of counterpart funding by the government.

Over the year, there was a net overseas borrowing of K245.5 million reflecting draw downs from extraordinary sources of K477.5 million relating to the government's Structural Adjustment Program (SAP). This was comprised of loans from the World Bank of K201.9 (US$55) million, the Australian government of K63.7 (US$20) million, the Asian Development Bank (ADB) of K132.4 (US$34) million and the Japanese Bank of International Cooperation (JBIC) of K79.5 (US$21) million, which more than offset concessionary and commercial loan repayments of K148.3 million and K83.7 million, respectively. The deficit combined with the net overseas borrowing resulted in a net domestic financing requirement of K117.5 million. This was financed through positive financing from the non-banking system of K226.1 million and from other domestic sectors of K150.6 million, which more than offset a negative financing of K259.2 million from the banking system. The financing from the non-banking system reflected higher holdings of government securities. The positive financing by other domestic sources reflected the higher level of unpresented cheques issued in 2001. The negative financing by the banking system was due to higher government deposits held by the banking system. In its attempt to restructure the debt portfolio from short-term to long-term maturities, the government issued new Inscribed Stocks in 2001and used the proceeds to retire some Treasury Bills and fund the budget deficit.

Over the six months to June 2002, the government recorded an overall budget deficit of K210.2 million, which is equal to 2.0 percent of nominal GDP. The deficit was the result of higher expenditure incurred by the government, which more than offset an increase in revenue. The main fiscal developments in 2002 reflect the following:

- A faster increase in recurrent expenditures relating to school fee subsidies, grants to provinces and statutory bodies, greater than expected expenditure on the 2002 national elections, and the faster release of electoral development funds;
- Increases in ordinary revenue was lower than the pace of expenditure; and
- Reliance on financing of the budget deficit from domestic sources through the net issuance of new domestic debt. The raising of new domestic debt has increased total domestic debt, debt servicing cost and the yield on government securities.

Despite the increase in expenditure, the proceeds from the sale of Papua New Guinea Banking Corporation (PNGBC) and part of the proceeds from the sale of the government shares in Orogen Minerals Ltd were partly used to retire domestic debt. Up to July 2002, the government made a net new issue of K167 million in Treasury Bills and K35 million in Inscribed Stocks, of which K20 million was successfully sold to the public.

Monetary Policy

With the objective of achieving price stability, the central Bank adopted a cautious approach to monetary policy by gradually easing its stance up to September 2001 following declines in inflation to June 2001. This was reflected in a deliberate policy decision by the bank to progressively reduce the newly introduced monetary policy signalling tool, the Kina Facility Rate (KFR) from February 2001 to September 2001. Due to the weakening of the kina and mounting inflationary pressures the KFR remained unchanged in the last quarter of 2001.

The interest rates for the Kina Facility and Repurchase Agreements are tied to the adjustments in the KFR by a predetermined margin for both the buy and sell rates. The dealing margins were initially set at 125 and 150 basis points above/below the KFR for the Kina Facility and Repurchase Agreements, respectively, and were reduced to 75 and 100 basis points in July 2001. The decline in the KFR has accordingly been reflected in lower domestic market interest rates, including the Treasury Bill rates and commercial banks' large term deposit rates.

The neutral monetary policy stance of the central bank continued into 2002, with the KFR maintained at 12.0 percent up to July 2002. Although lending to the private sector by the commercial banks continue to decline and overall. This increased liquidity levels and exerted pressure on the exchange rate and underlying inflation. These factors weighed heavily on the decision to maintain the official interest rate at the current level.

In August 2002, the persistent growth in underlying inflation in 2001 and the six months to June 2002, and the prospect for further increases in the remaining part of 2002 have had an important impact on the bank's decision to increase the KFR to 12.50 percent. Other main factors that have also influenced the monetary policy stance include:

- A substantial increase in the budget deficit equal to 2.0 percent of nominal GDP over the first six months of 2002;
- The significant increase in domestic financing of the budget deficit;
- Significant growth in reserve money following increased government expenditure and transactions demand for money, primarily relating to the national elections;
- The increase in official interest rates of some of PNG's trading partners and prospect of increases in other economies as concerns for inflation re-emerged;
- The pressure on the exchange rate arising from a combination of sentiments related to the national elections, a persistent deficit in the current account of the non-mineral private sector and increased government expenditure; and
- Further delays in the draw down of the second tranche of the Public Sector Reform Program loan from the ADB.

Monetary Aggregates

The average level of the broad money supply (M3*) increased by 10.8 percent in 2001, compared to an increase of 6.9 percent in 2000, while the average level of the broad monetary base increased by 9.4 percent in 2001, compared to an increase of 10.4 percent in 2000. The growth in the average level of broad money supply was mainly attributed to an increase of 63.0 percent in net foreign assets of the banking system, reflecting the disbursement of the external extraordinary financing of the government, which more than offset a decline of 4.1 percent in net domestic credit from the banking system.

Over the year to December 2001, total domestic credit extended by the commercial banks to the private sector, official entities and the non-monetary financial institutions decreased by K85.9 million to K1,670.1 million. Lending to non-monetary financial institutions, the private sector and official entities decreased by K57.6 million, K18.9 million and K9.5 million, respectively.

Between December 2001 and June 2002, the level of broad money supply (M3*) increased by 4.1 percent reflecting an increase in the net foreign assets of the banking system, partly attributed to the effect of a lower exchange rate, combined with a substantial increase in net credit to the government. The growth in reserve money also reflected an increase in currency in circulation as individuals and political parties matured term deposits to fund election related expenses, while the cash holding and deposits of commercial banks with the central bank declined due its tight liquidity strategy.

Total domestic credit extended by the commercial banks to the private sector, official entities and non-monetary financial institutions decreased by K58.6 million to K1,611.5 million, compared with a decline of K4.7 million in the corresponding quarter of 2001. Lending to the private sector and official entities decreased by K62.3 million and K8.7 million, respectively, while lending to non-monetary financial institutions increased by K12.4 million. The substantial decline in credit to the private sector was due to repayment of loans mainly by the agriculture, manufacturing, and other sectors. The annualised rate of decline of domestic credit, excluding the central government and advances under the price support schemes, was 13.7 percent in the first quarter of 2002.

Liquidity and Interest Rates

The average monthly level of liquid assets held by commercial banks increased by 12.0 percent in 2001, compared to an increase of 14.3 percent in 2000. Commercial banks continued to hold the majority of their liquid assets in the form of short-term government securities. The weighted average interest rate on total deposits decreased from 6.7 percent at the end of December 2000 to 4.1 percent at the end of December 2001, and the weighted average rate on total lending from 15.5 percent to 14.6 percent. There were several reductions made by the commercial banks to their Indicator Lending Rates (ILRs) during the year, which reached the range of 15.25 – 15.75 percent by the end of December 2001.

During the first half of 2002, total liquid assets of the banking system increased by 4.6 percent, mainly due to the following factors:

- High government expenditures in 2002 and cheque floats from 2001 financed by the draw down of deposits at the central bank, mainly during the March quarter of 2002. The government deposits were related to the external extraordinary financing from the World Bank and the Japanese Bank for International Corporation (JBIC), which were released in late 2001, following the successful conclusion of the Structural Adjustment Program (SAP);
- Net new issuance of government securities to finance the government's cashflow;

- Utilisation of the Temporary Advance Facility at the central bank to finance mismatches in the cashflow;
- The closure of the Tap Facility for Treasury Bills in January 2002; and
- Lower levels of lending to the private sector.

As a result of the increase in liquidity and reserve money, the weighted average deposit rate declined to 2.6 percent at the end of June 2002, from 4.1 percent at the end of December 2001. At the same time the commercial banks reduced their Indicator Lending Rates (ILRs) from 15.25 percent to a minimum of 13.75 percent over the first half of 2002. The decline in the ILRs can be attributed to the lagged nature of adjustment of the assets and liabilities of the banks to the changes in the KFR, and the lack of demand for credit by the private sector. This resulted in a decline in the weighted average lending rate of the commercial banks from 14.6 percent to 13.8 percent over the first six months of 2002. With the decline in the rates of return on both financial and non-financial assets, the commercial banks have maintained their interest rate spreads between lending and deposit rates to sustain maximum profitability, as reflected by the trend towards increasing interest rate margin.

Consistent with the policy stance and to counteract the adverse impact of excess liquidity on the market interest rates and the exchange rate, the central bank utilised its indirect instruments to sterilise the excessive liquidity in the banking system. This involved increased sales of Treasury bills at the auction and higher volumes purchased under the Kina Facility to diffuse the excess liquidity and sterilise the liquidity impact of the Tap Facility closure in January 2002. The high level of intervention by the central bank in the foreign exchange market to support the volatility in the exchange rate also contributed to this objective. These actions, combined with the net new issuance of government securities to June 2002, contributed to the stabilisation of the declining trend in short-term interest rates of government securities. In the second quarter of 2002, the 28-day Treasury Bill rate increased to align with the KFR, which had diverged by 3.0 percentage points earlier.

Although the ILRs have fallen, lending to the private sector remains depressed, partly reflecting the crowding out by the government through a net new issuance of domestic debt, and a lower investment level due to uncertainties relating to the national elections and lower demand for credit. If the government repay it's domestic debt and returns to a sustainable fiscal deficit, then crowding out will diminish and credit to the private sector should grow. However, this depends also on the recovery of economic activity, demand for credit, and confidence in the government.

Structural Reforms

The government's commitment to the implementation of its reform program reached further milestone in 2002. Of particular note, the sale of Papua New Guinea Banking Corporation (PNGBC), the largest commercial bank, has been completed. There has been significant steps undertaken in the privatization program, with preparations for the sale of state enterprises, including the Harbours Board, Telikom (the telecommunications company), and Elcom (the power utility). The government also successfully disposed of its shares in the minerals companies held by Orogen Minerals Limited, selling them to Oil Search Limited in April 2002. The government established a Peoples Unit Trust (PUT) to provide a vehicle for the public to participate in the ownership of privatized entities. It also established an Independent Public Business Commission (IPBC), which will shield the management of entities considered not yet suitable for sale from any treat of political interference. An Independent Consumer and Competition Commission (ICCC) was established in March 2002 with the responsibility for regulation of public utilities. In order to help build community consensus in support of reforms, a Public Sector Advisory Group has been established by government.

To improve fiscal management, a new financial accounting and management system, and a payroll and human resource management system are being introduced. A series of departmental functional reviews was continued, and led to the closure of some overseas missions and restructuring of some departments. Reforms to the superannuation and life insurance industries were also implemented alongside the recapitalization of the National Provident Fund.

2. POLICY RESPONSE AND ECONOMIC PROSPECTS

A key medium-term challenge for Papua New Guinea is the development of new sources of growth, against the background of a declining mineral resources base. Papua New Guinea has historically been heavily dependent on mineral exports. However, these exports have been declining as a result of a depletion of reserves and limited new exploration activity. The government's continued commitment to the PNG-Queensland gas pipeline project is important for boosting medium-term export and economic growth prospects.

Fiscal Policy

The government recognizes that pursuing fiscal consolidation and management, good governance, keeping inflation under control, undertaking structural reform and maintaining adequate international reserves are essential to boosting growth and, ultimately, alleviating poverty in Papua New Guinea. This has underpinned the government's reform agenda to date. To achieve these objectives, a budget deficit of 2.0 percent of nominal GDP for 2002 to be supported by the structural reform program, including privatization of State assets, and by focusing spending on areas important for on-going development of the economy, was considered necessary. The government is also focusing on a medium-term strategy aimed at fostering growth. The importance of ensuring the sustainability of the fiscal position is recognized, and the newly-elected government has given priority to ensuring an early implementation of this strategy, through the implementation of a Supplementary Budget for 2002 and a framework for the 2003 Budget which was presented to Parliament on 26 August 2002. The 2002 Supplementary Budget aims to achieve a budget deficit of 3.4 percent of GDP.

However, the deterioration in the management of the original 2002 Budget leading up to the national elections, the depreciation of the kina and worsening public confidence has exacerbated the depressed state of economic activity. It is therefore imperative that the Supplementary Budget for 2002 and the 2003 Budget are credible and implemented successfully, with increased focused on areas that can generate revenue and foster economic growth, in order to restore fiscal responsibility and macroeconomic stability. The government has announced that it will pursue an export-led growth strategy, with increased focus on the agriculture sector over the medium-term to achieve its objective of sustainable economic growth.

The prospect of a turnaround in confidence and economic activity in Papua New Guinea depend on the achievement of price and macro-economic stability. The following factors are very important for the achievement of price and macroeconomic stability over the medium-term:

- Fiscal consolidation through the substantial expenditure cuts announced in the 2002 Supplementary Budget and a continuation of this strategy in the 2003 Budget;
- The reduction in uncertainties following the formation of the government and announcement of the medium-term macro-economic policies;
- The continuation of structural reform programs;
- The recovery in international commodity prices and producers' response to higher kina prices of Papua New Guinea's major exports;
- The timely draw down of the second tranche of the Public Sector Reform Program loan from the ADB; and
- The continued recovery of the world economy.

Monetary Policy

The government recognizes the importance of maintaining credibility and independence in monetary policy operations, which are necessary for the achievement of price and macroeconomic stability. Over the medium-term, monetary policy will aim to operate consistent with a prudent fiscal policy to stabilize the macro-economic environment in order to encourage increased investment and growth prospects.

During 2002, the central bank initiated several actions under the Central Banking Act (CBA) 2000. The first is Section 13 (b) of the CBA 2000, which requires the Governor of the Bank of PNG to report to the Minister any developments that may threaten monetary stability, the formulation and implementation of monetary policy, and the achievement of the financial and economic policies of the Government. Due to the increasing pressures on the kina exchange rate and underlying inflationary pressures, the central bank advised the Government on 6 May 2002 to adjust and constrain expenditure to the level of revenue collections, and not to resort to further excessive domestic financing of the budget. The bank further advised that any fiscal slippages would negate the macroeconomic and price stability achieved, and may lead to deterioration in public confidence in the government's management of the economy.

On the 11 July 2002, the Central Bank reiterated its earlier advice to the government and strongly recommended that it severely limit new warrant issues for the remaining part of the year, in order to ensure prudent management of the Budget. The Bank also emphasised that excessive pressure on the exchange rate and upward movement in Treasury Bills rates are a clear reflection of unsustainable expenditure levels. Further deterioration of the Budget could exacerbate the adverse monetary conditions and may lead to a financial crisis, as experienced in 1994 and 1999.

The Bank of PNG also advised that its monetary policy stance in the second half of 2002 will be largely influenced by the following factors:

- The reduction in uncertainties following the formation of the government;
- The government's commitment to fiscal consolidation, to reduce the Budget deficit. Such commitment would reduce the interest rate costs facing the government;
- The underlying inflation outcomes for the second half of 2002;
- The recovery in international commodity prices and producers' response to higher kina prices of Papua New Guinea's major exports;
- The timely draw down of the second tranche of the Public Sector Reform Program loan from the ADB; and
- The continued recovery of the world economy, and the bank's response to such developments to contain further domestic inflation.

The KFR will remain as an instrument for signalling the central bank's monetary policy stance, and daily liquidity will continue to be managed within the reserve money framework. Reserve money is defined as currency in circulation plus the deposit of commercial banks with the central bank, and the level of liquid assets in relation to statutory requirements is an indicator of the banking system's capacity to finance new lending. The revised reserve money growth for 2002 is projected to be 7.7 percent, compared to 4.2 percent from the January 2002 projections. The growth in reserve money is unlikely to impact on inflation, as the central bank will continue to use its open market instruments to sterilize any excess reserve money in the banking system. However, this must be supported by fiscal restraint by the government.

Inflation

In July 2002, the Bank of PNG revised the January inflation projection for 2002 upwards, mainly due to the depreciation of the kina against the currencies of PNG's major trading partners. The revised annual percentage changes in underlying and headline inflation are expected in 2002 to be 11.8 and 11.2 percent, respectively (refer to Annex II). The latest projections take into account a depreciation of 7.2 percent in the Import Weighted Index (IWI) to July 2002. The revised headline inflation projection also takes into account a 2.5 percent increase in excise duty on selected consumer items that will be effective from 1 December 2002, as well as the seasonal price pattern of some commodities.

The performance of the agricultural export sector and the level of government expenditure and their impact on aggregate demand during the second half of 2002 will be the key factors in determining the inflation path for 2002. The expected subdued level of private sector activity due to a lack of major development projects and the adverse income effect from low agricultural export earnings may negate imported price pressures. If the government takes appropriate measures to contain expenditure in the 2002 Supplementary Budget, broad and reserve money are expected to increase significantly in 2002, as a result of the higher net credit to the government.

Balance of Payments

The balance of payments for 2002, is projected to show an overall surplus of K71 million, compared to a surplus of K708 million in 2001. This outcome is attributed to a surplus in the current account, which more than offset the deficit in the capital account. The current account is projected to record a surplus of K800 million in 2002, compared to a surplus of K943 million in 2001. The capital account, which includes the ADB Public Sector Reform Program loan of US$35 (K130) million, is projected to record a deficit of K730 million in 2002, compared to a deficit of K264 million in 2001. The higher deficit reflects increased net loan repayments by the government and resident companies.

The level of gross foreign exchange reserves at the end of 2002 is projected at US$444 million, sufficient for 5.9 months of total and 8.4 months of non-mineral import cover.

Structural Reforms

While the government's reform achievements are many, much more remains to be done. Further progress on the privatization and public sector reform programs are vital for the sustainable recovery of the economy, through stabilization of the macro-economic environment and strengthening of the financial sector. The new government's commitment to a continuation of this process is crucial.

3. SOME RISKS TO THE ECONOMIC RECOVERY

The original objective of the 2002 national budget was to achieve a budget deficit of 2.0 percent of nominal GDP with a net reduction in net domestic debt. However, the significant increase in expenditure, combined with the delays in both the privatization of state assets and the inflow of external funding from the ADB for the Public Sector Reform Program, pose a major threat to the achievement of the 2002 Budget objectives.

It is crucial for the government to take a stern approach in implementing the reduction in the size of the budget deficits in 2002 and 2003, a strong commitment to continue the structural reform programs and to strive for a balanced Budget in the medium-term. Without prudent measures taken by the government commencing in 2002, and given the probability of yet another *El-Nino* episode in 2002/2003, the potential for a financial crisis as experienced in 1994 and 1999 is high. This would damage the hard earned macroeconomic and price stability achieved.

There are risks in the achievement in some of the key factors underlying the projected economic growth in the medium-term. The commencement of the gas pipeline project to Queensland (Australia), an increase in mineral exploration and encouragement of the agriculture sector are key factors for the achievement of sustained economic growth in PNG over the medium-term.

Annex I

PAPUA NEW GUINEA: OVERALL ECONOMIC PERFORMANCE INDICATORS (1995 – 2002)

(Kina Millions)	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	
Nominal GDP	5,888.3	6,881.3	7,063.7	7,788.5	8,780.8	9,514.8	9,815.5	10,745.3	(p)
Real GDP	3,549.4	3,823.9	3,674.6	3,536.1	3,803.5	3,755.4	3,626.4	3,612.9	(p)
Budget Balance	-33.5	37.0	15.4	-137.4	-192.3	-192.0	359.4	-210.2	(End June)
Merchandise Trade Balance	1,800.0	1,338.0	950.0	1,476.0	2,246.0	3,034.0	2,940.0	1,023.0	(End June)
Current Account Balance	859.0	411.0	-167.0	124.0	367.0	973.0	943.0	-89.0	(End June)
Capital Account Balance	-596.0	58.0	30.0	-364.0	-170.0	-650.0	-264.0	282.0	(End June)
CPI	333.2	354.2	369.5	450.1	509.5	560.3	618.3	644.1	(End June)
Broad Money (M3*)	2,066.0	2,736.4	3,101.1	3,212.3	3,500.3	3,747.3	3,904.6	4,202.5	(End June)
Short-Term Interest Rate		8.40	13.75	19.00	22.68	15.67	10.15	11.26	(End June)
Exchange Rate (PGK/US$)[3]	0.7832	0.7553	0.6971	0.4856	0.3922	0.3623	0.2976	0.2672	(End June)
Population (millions) [a]						5.1			
Total Public Debt	3324.2	3780.8	4418	5177.6	5834.2	5621.6	7097.3	7334.2	(End June)

INDICATORS	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**
Percent change from previous year								
Nominal GDP	9.4	16.9	2.7	10.3	12.7	8.4	3.2	9.5
Real GDP	-3.3	7.7	-3.9	-3.8	7.6	-1.3	-3.4	-0.4
Percent of Nominal GDP								
Budget Balance	-0.6	0.5	0.2	-1.8	-2.2	-2.0	3.7	-2.0
Merchandise Trade Balance	30.6	19.4	13.4	19.0	25.6	31.9	30.0	9.5
Current Account Balance	14.6	6.0	-2.4	1.6	4.2	10.2	9.6	-0.8
Capital Account Balance	-10.1	0.8	0.4	-4.7	-1.9	-6.8	-2.7	2.6
Total Public Debt	56.5	54.9	62.5	66.5	66.4	59.1	72.3	68.3
Percent change from previous year								
CPI[1]	18.7	6.3	5.3	21.8	13.2	10.0	10.3	9.3
M3 *	11.1	32.4	13.3	3.6	9.0	7.1	4.2	7.6

Sources: Various Quarterly Economic Bulletins, BPNG
July 2002 Monetary Policy Statement
2002 Budget Documents

Notes: [a] 2000 Population Census
[1] December on December Headline Inflation.
[2] Weighted average 28 day Treasury bill rate.
[3] Average rate for the year

ANNEX II

PAPUA NEW GUINEA: FORECAST SUMMARY, 2002–2003 (Percent change from previous year)

	2001		2002		2003	
	Official	**IMF**	**Official**	**IMF**	**Official**	**IMF**
Real GDP	-3.4	-3.4	-0.4	1.2	1.1	2.8
Exports	-13.7	-15.5	-0.7	0.2	0.0	2.8
Imports	-6.4	-11.2	-7.9	12.3	-13.2	-2.4
CPI (Av)	9.3	9.3	11.2	7.5	9.3	4.7

Sources: Government Budget and 2002 IMF Article IV documents.

Notes: 1. Official forecast of Export and Imports are based on kina values converted to USD at the average projected exchange rate.
The IMF estimates are calculated from US$ values.
2. Official CPI for 2002 is based on Central Bank projection made in July 2002.

ANNEX III

PAPUA NEW GUINEA: MEDIUM TERM TREND FORECAST (Percent)

	2003-2007	
	Official	**IMF**
Real GDP	1.6	2.2
CPI (Av)	5.0	3.7

Source: Government Budget and 2002 IMF Article IV documents.

PERU

REAL GROSS DOMESTIC PRODUCT

In 2001 real GDP grew by 0.2 percent due to the 1.9 percent increase in the primary sectors, reflecting mainly the initial operations of a mining megaproject, Antamina. The slowdown in economic activity that started in the second half of 2000 (0.8 percent after growing 5.5 percent during the first half of 2000) continued into the first half of 2001, with output falling 1.6 percent due to political uncertainty. During the second half of 2001 GDP grew by 2.1 percent as uncertainty diminished following the definition of the new government.

During the year, the positive impulse of 1.9 percent of the primary sectors with mining growing 11.2 percent and fishing falling by 13.3 percent was partially offset by a decrease of 0.2 in the non-primary sectors, where services grew by 0.4 percent, while construction and manufacturing declined 6.0 and 1.1 percent, respectively.

Over the year, overall demand rose 0.4 percent based on export growth of 7.2 percent (traditional and non-traditional) while domestic demand decreased 0.7 percent, mainly explained by the contraction of 8.5 percent in gross domestic investment. The latter was the result of a reduction of 9.8 percent during the first half of 2001 and a lower reduction of 7.0 percent in the second half as a consequence of an improved investment climate, in large part reflecting a more stable political environment.

INFLATION

The –0.13 percent rate of inflation registered in 2001 was the lowest since 1939. This rate fell below the inflation target range (2.5–3.5 percent) established in the Monetary Program for 2001 due to supply shocks in foodstuff and oil prices, as well as the reduction in public service rates, mainly in electricity. Currency appreciation and the decrease in domestic demand also contributed to that outcome.

EMPLOYMENT

The rate of unemployment in the urban areas (7.9 percent) was higher than in the previous year (7.4 percent). This higher unemployment rate is explained by the greater number of the population being of working age (PET). The increase was partly compensated by an increase in the employed labor force.

CURRENT ACCOUNT

The current account deficit amounted to US$1,102 million (2.0 percent of GDP), down from US$1,568 million in 2000 (2.9 percent of GDP). The smaller current account deficit reflected a US$226 million drop in the trade balance deficit due to the reduction of imports (2.0 percent) and a slight increase of exports (1.0 percent).

The expansion of exports was mainly due to the increase in non-traditional exports (6.7 percent) that offset the reduction of traditional exports (1.6 percent) which were affected by the significant reduction of commodities prices including copper, gold, zinc, silver and coffee, and the reduction of volume exports of fishmeal. Among the non-traditional products, the higher growth was due to fabricated metal products and machinery, agriculture and livestock, fishing, and chemicals. The decrease in the value of imports was mainly related to lower acquisitions of capital goods and oil, the latter mainly due to the effect of lower prices of oil imports.

CAPITAL INFLOWS

Net capital inflows in 2001 amounted to US$1,051 million (1.9 percent of GDP), up 0.2 percent of GDP from 2000. Net inflows to the private sector were US$1,149 million (US$267 million corresponding to privatization external receipts), net inflows to the public sector were US$394 million and net short-run capital outflows amounted to US$492 million. There was US$32 million of exceptional financing. Direct investment without privatization and net long-term loans to the private sector were US$1,156 million, that represented about 100 percent of the current account deficit.

EXCHANGE RATE

Peru maintains a floating exchange rate regime. In 2001, the average depreciation of the Peruvian currency (Nuevo Sol) was 0.5 percent in nominal terms which was a 4.2 percent average appreciation in real terms.

FISCAL POLICY

In 2001 the non-financial public sector deficit was 2.5 percent of GDP, down 0.7 percent from 2000. This change resulted from the rationalization of central government non-financial expenditure—accomplished mainly in the first six months—but also from the improvement in the accounts of state-owned enterprises.

Non-financial expenditures of the central government dropped 0.6 percent of GDP in 2001, mainly in capital expenditures. Current revenues fell 0.6 percent of GDP due to economic recession and lower transfers from the state-owned enterprises. Nevertheless, the trade balance of the state-owned enterprises improved by 0.7 percent of GDP, as a result of the better performance of Petroperu (oil company), and Sedapal (water supply) as well as lower transfers to the central government (0.3 percent of GDP).

Privatization and concessions processes implied total revenues of US$327 million. Transmission Lines La Oroya-Paragsha-Antamina and Aguaytia-Pucallpa concessions were granted for the government; these contracts involved US$65 million in investment commitments for building and maintenance during a 30-year period. The electric generation enterprise Electroandes was sold for US$226 millions and it is involved in US$18 million in investment commitments. Also, there were other important investments in agriculture (US$9 million) and mining (US$3 million) in the privatization process.

MONETARY POLICY

The Annual Monetary Program for 2001 was published in January, aiming at reinforcing the transparency of monetary policy. It included the inflation target for the year, the intermediate target and the operational target. Other macro-economic projections were also included to share the bank’s view of the economy with the public.

For 2001, the central bank announced an end-of-year inflation target range of 2.5–3.5 percent, while the final outcome was a consumer price index decline of 0.1 percent. It is worth mentioning that monetary policy was loosened last year, with the bank increasing the operational target (commercial banks’ deposits at the central bank). This loosening was temporarily halted during the second quarter because of the high uncertainty in financial markets, due to political elections at that time. As a result, interest rates have sharply declined since July.

In order to enhance transparency, since February 2001 an Informative Note has been published on the first Thursday of each month. This document provides information concerning monthly monetary targets and benchmark interest rates for the central bank's monetary operations. The targets are set by the board of directors of the bank.

In 2001, total banking system credit to the private sector declined 4.5 percent in nominal terms because commercial banks have maintained the cautious behavior seen in 2000, associated with the delay in the recovery of economic activity. However, the trend changed during the second half of the year and credit has been growing during the last months of 2001, especially soles-denominated credit to the private sector.

Net international reserves increased by US$433 million, from US$8,180 to US$8,613 million. This stock of international reserves is equivalent to 5 times the monetary base, 2 times the domestic currency liquidity, 60 percent of total liquidity and 1.5 times the amortization of the public and the private sector coming due in the next 12 months.

MEDIUM TERM OUTLOOK

In January 2002, the central bank adopted an Explicit Inflation Targeting Framework for monetary policy. The inflation target for the year was set at 2.5 percent, with a maximum deviation allowed of one percentage point above or below the target. At the same time, and continuing with the increased transparency of monetary policy, an inflation report with the latest developments and outlook on monetary policy will be released every four months (in January, May, and September).

Real GDP is expected to grow 3.7 percent due to the recovery of the primary sectors (6.9 percent) and the non primary sectors (2.9 percent).

The current account deficit is expected to remain steady around 2.0 percent of GDP and will continue to be financed mainly by long-term capital inflows. Central bank international reserves are expected to grow around US$300 million in 2002.

Annex I

PERU: OVERALL ECONOMIC PERFORMANCE

	1996	1997	1998	1999	2000	2001
GDP and Major Components (percent change, year over year - earlier period, except as noted)						
Nominal GDP (level in billion US$)	55.8	58.9	56.9	51.6	53.5	54.0
Real GDP	2.5	6.7	-0.5	0.9	3.1	0.2
Consumption	3.2	4.7	-0.5	0.1	4.0	1.1
Private Consumption	3.1	4.3	-0.8	-0.4	3.9	1.3
Government Consumption	4.4	7.6	2.5	3.5	5.1	-0.3
Investment	-4.9	14.9	-2.0	-13.4	-3.7	-8.5
Private Investment	-2.2	16.3	-2.4	-15.3	-2.0	-5.6
Government Investment	-5.7	10.9	3.0	7.2	-15.4	-18.7
Exports of Goods and Services	8.9	13.1	5.6	7.6	7.9	7.2
Imports of Goods and Services	0.1	12.2	2.3	-15.2	3.6	1.5
Fiscal and External Balances (percent of GDP)						
Budget Balance	-1.0	0.2	-0.8	-3.1	-3.2	-2.5
Merchandise Trade Balance	-3.6	-2.9	-4.3	-1.2	-0.6	-0.2
Current Account Balance	-6.6	-5.8	-5.9	-2.9	-2.9	-2.0
Capital Account Balance	6.7	10.4	3.0	1.1	1.7	1.9
Economic Indicator (percent change, year over year - earlier period, except as noted)						
GDP Deflator	10.54	7.60	6.44	3.94	3.67	1.25
CPI (end of period)	11.84	6.46	6.01	3.73	3.73	-0.13
M2 [1]	24.7	19.1	15.3	1.7	5.9	6.8
Short-term Interest Rate (percent) [2]	13.1	12.8	18.7	14.9	12.7	8.6
Real Effective Exchange Rate (level, 1994=100)	-1.9	-1.0	0.5	10.7	-1.1	-4.2
Unemployment Rate in the Urban Area (percent)	n.a.	7.7	7.8	8.0	7.4	7.9
Population (millions)	23.9	24.4	24.8	25.2	25.7	26.1

Notes [1] Average percentage change of banking sector's liquidity in domestic currency.
[2] Average interbank interest rate in domestic currency.

Annex II

PERU: FORCAST SUMMARY (percent change from previous year)

	2002					2003				
	Official	**IMF**	**Link**	**ADB**	**OECD**	**Official**	**IMF**	**Link**	**ADB**	**OECD**
Real GDP	3.5	3.7	N.A.	N.A.	N.A.	4.0	5.0	N.A.	N.A.	N.A.
Exports	8.8	11	N.A.	N.A.	N.A.	8.4	7.7	N.A.	N.A.	N.A.
Imports	3.3	6.3	N.A.	N.A.	N.A.	7.5	8.0	N.A.	N.A.	N.A.
CPI	2.5	2.5	N.A.	N.A.	N.A.	2.5	2.0	N.A.	N.A.	N.A.

Annex III

PERU: MEDIUM-TERM TREND FORECAST (percent)

	2003-2005
Real GDP	4.8
CPI	2.5

PHILIPPINES

GROSS DOMESTIC PRODUCT

The Philippines' gross domestic product (GDP) grew by 3.2 percent in 2001, well beyond the forecasts of private analysts and multilateral agencies, which predicted less than 3.0 percent growth, amidst unfavorable global developments. The growth performance, however, is slightly below government's target of 3.3 percent for the same year.

The better than expected performance of the economy was anchored on the continued growth of the agriculture and services sectors. Favorable weather conditions and the revitalized support of the government contributed to the 3.7 percent growth of the agriculture sector. Major commodities namely, palay, corn, sugarcane, and bananas as well as livestock and poultry all registered output gains.

The services sector expanded by 4.4 percent in 2001 and continued to be the main source of growth for the economy. The attack on the World Trade Center in September 2001 affected the transport, communication and storage subsector, whose growth slowed from 10.4 percent in 2000 to 8.8 percent in 2001. The air transport sector, in particular, took the toll as overall growth for the year dissipated to 5.1 percent from 24.3 percent in 2000. Communication services grew by 20.0 percent in 2001 bolstered by: a surge in total international call volumes in terms of billed minutes for fixed and wireless lines, the continued increase in the net additions in the number of fixed and wireless line subscribers, the huge increase in the number of short messages sent and the expansion in the use of Internet. This was, however, not enough to compensate for the slowdown in the transport and storage sub-sectors' performance.

The global economic slowdown arrested the growth momentum of the industry sector, which grew by 1.3 percent in 2001, lower than the 4.9 percent increase recorded in 2000. The contraction in mining and quarrying, and weakened growths of the manufacturing; electricity, gas and water sub-sectors contributed to the slowdown.

On the demand side, personal consumption expenditure (PCE) and investments supported the economy despite setbacks suffered by exports. Consumer spending almost duplicated its previous year's growth increasing by 3.6 percent in 2001 on account of increased expenditures on transportation and communications and on ownership and maintenance of dwellings. Food expenditures, which account for half of the PCE, increased by 2.8 percent in 2001. Government expenditures grew by 0.3 percent.

Investment growth decelerated to 1.3 percent in 2001 from 5.5 percent in 2000 as public construction contracted by 6.1 percent in the same year. Private construction, however, recovered from a decline of 1.5 percent in 2000 to a growth of 0.3 percent in 2001. Breeding stock and orchard development also made significant gains growing by 5.8 percent compared to 3.7 percent in 2000.

The export sector was particularly vulnerable to the weak global economy. Exports of goods and services contracted 5.2 percent in 2001 after growing by 17.7 percent in 2000. Sector-wise, the poor performance of exports could be ascribed largely to the 24.2 percent drop in non-merchandise exports, a much steeper decline than the 2000s –3.3 percent growth. Merchandise exports slid by 1.6 percent in 2001, following a 22.7 percent gain in 2000. Principal exports namely, semiconductors and electronic microcircuits (-28.0 percent), garments (-1.4 percent), finished electrical machinery (-20.0 percent), ignition wiring sets (-22.4 percent) and shrimps and prawns (-2.8 percent) all posted declines. The decelerated growth in merchandise imports and continued drop in non-merchandise imports in 2000 and 2001 contributed to the weak import performance.

The Philippine economy continued to gain strength in the first half of 2002 as GDP increased by 4.1 percent compared to 3.0 percent in the previous year. The GNP also expanded by 4.7 percent, one percentage point higher than the 3.7 percent growth registered in the same period in 2001.

Industry performance improved, growing by 2.9 percent during the first half of 2002, a marked increase from the 1.3 percent growth registered during the same period in 2001. Significant gains on food manufactures and electrical machinery fueled the growth of the manufacturing sector, which grew by 3.7 percent during the period. Mining and quarrying recovered from a negative growth performance last year to a positive 14.5 percent growth in the first half of 2002. On the other hand, the construction and utilities sub-sector posted negative growths of 1.2 percent and 0.7 percent, respectively.

All of the services subsectors except for finance, posted accelerated growths during the first half year effecting a further increase of 5.3 percent in the gross value-added (GVA) of the services sector from a 4.1 percent expansion a year ago. Trade and transportation, communication and storage continued to be major contributors to this growth.

The agriculture, forestry and fishery subsectors managed to grow by 3.5 percent during the first half year, with most subsectors, except corn and coconut, registering favorable growths.

On the demand side, personal consumption expenditure, spurred by increased expenditures on food, transportation and communication and miscellaneous services, expanded by 3.6 percent. On the other hand, investment expenditures contracted slightly by 0.4 percent as a result of the 2.8 percent drop in durable equipment. Construction and breeding stocks, however, grew by 1.3 percent and 3.6 percent, respectively, during the first half of the year. Growth in government consumption expenditures was flat.

Exports and imports of goods started to show indications of recovery, posting growths of 3.9 percent and 0.2 percent, respectively, during the first half year. Exports of semiconductors grew 5.5 percent during the first six months, recovering significantly during the second quarter with a 20.1 percent growth after five consecutive quarterly declines. Electrical machinery also recovered from its negative growth streak with a 7.3 percent increase during the first half year. Inputs of electrical machinery led the growth momentum with a 19.6 percent increase. Exports and imports of non-factor services however, were still on a decline.

INFLATION

The inflation rate averaged 6.1 percent in 2001, which is at the low end of the 6.0 to 7.0 percent target range for the year. Increased agricultural production coupled with the downtrend in world prices of petroleum and prudent monetary and fiscal policies moderated price increases. Average inflation rates for food, beverage and tobacco reached 4.1 percent while inflation rates for non-food items averaged 8.5 percent.

The average inflation rate from January to July 2002 dropped to 3.4 percent from 6.7 percent in the same period in 2001. Lower inflation rates for major food items rice and corn, as well as for fruits and vegetables led to a more than 50 percent decline in the inflation rate for food, beverages and tobacco, and it fell to 2.0 percent. Furthermore, the significant reduction in the inflation rates of fuel, light and water, miscellaneous items including household furnishing, equipment and operations and services lowered the inflation rate for non-food items to an average of 4.8 percent compared to an average of 9.3 percent in 2001.

The low level of inflation affirms the monetary authorities' expectations of a generally quiescent inflation rate for 2002 given favorable supply conditions, broad currency stability and still subdued, but improving, market demand.

EMPLOYMENT

Efforts to alleviate and reduce poverty by increased employment gained headway. The number of employed workers increased by 6.2 percent in 2001 compared to a 1.0 percent decline in 2000. Employment across all sectors increased on a year-on-year basis, with agriculture registering the highest increase at 6.6 percent, followed by services and industry sectors at 6.1 percent and 5.8 percent, respectively. The manufacturing sector posted an average increase of 5.8 percent. Wage and salary workers comprise nearly half of the total number of employed persons.

A total of 1.7 million jobs were generated during the year compared to a loss of 289,000 in 2000. All sectors registered increases in job generation with the services sector generating 776,000 jobs followed closely by agriculture with 669,000 and industry with 257,000.

Unemployment remained at double digit rates although slightly lower compared to the previous year. Underemployment rates also declined from 21.7 percent in 2000 to 17.2 percent in 2001.

Employment increased by 4.6 percent in the first four months of 2002. The agriculture and services sectors continued to employ the greater number of workers, registering increases of 4.1 percent and 6.9 percent, respectively. The number of employed industrial workers, however, declined by 0.5 percent. Total jobs generated during the same four-month period reached 1.3 million, 13.9 percent higher than the comparable period in 2001. Mirroring this slight increase in the employment rate, the unemployment rate declined from 12.3 percent to 12.1 percent, as job openings were sufficient to meet the higher number of job seekers.

BALANCE OF PAYMENTS

The balance of payments deficit narrowed down from US$513 million in 2000 to US$192 million in 2001. Despite the slowdown in external demand, the current account remained in surplus at US$4.6 billion. Exports contracted by 16.7 percent following a fall in demand from the country's major trading partners, namely, the United States and Japan. Of the three major exports, namely electronics, garments and machinery and equipment, only the latter managed to post positive growth. Exports of machinery and transport equipment grew by 3.8 percent based on strong sales of automotive accessories and parts. On the other hand, import payments fell by 7.9 percent as imports of all major commodity groups dropped.

Meanwhile, the income account (compensation and investment income) continued to be in surplus in 2001 at US$3.3 billion, 4.2 percent higher than the previous year's surplus, following the increase in remittances of overseas Filipino workers (OFW). Remittances by OFW rose from US$6.1 billion in 2000 to US$6.3 billion. The increase in OFW remittances was attributed mainly to the expanded coverage of the remittance monitoring system, which aside from commercial banks now includes foreign exchange corporations and thrift banks.

On the other hand, net outflows for trade in services declined by 7.5 percent on account of lower net outflows for freight, royalties and fees, financial services and other business activities.

Foreign direct investments into the country continued as shown by a 44.9 percent increase in net inflows of US$1.95 billion in 2001. The bulk of direct foreign investments came from the US, Japan, France and Singapore and was directed to the manufacturing and telecommunications sectors and financial institutions.

Net portfolio investments registered a strong turn around from a US$113 million net outflow in 2000 to a US$1.4 billion net inflow in 2001. The other investments account remained in deficit although it was significantly lower than the previous year's level.

As of end 2001, gross international reserves (GIR) stood at US$15.7 billion, sufficient to cover five months of imports of goods and payments of services and income.

For the first five months of 2002, the balance of payments yielded a surplus of US$1.889 billion from a deficit of US$797 million in the previous year. The rise in the current account surplus and the substantial improvement in the capital and financial accounts accounted for this favorable development. At US$3.182 billion, the current account surplus is more than twice what was recorded last year. Higher net inflows in the income account, reduced net outflows in the services account and a sustained surplus in the merchandise account contributed to this trend.

Merchandise exports posted positive growths for April and May 2002, bringing the average export growth in the first five months of the year to 3.1 percent. Sustained higher export shipments of machinery and transport equipment, processed food and beverages and sugar products, and marked increase in exports of electronics in May (23.1 percent) contributed to this upturn. Increased demand from Asian markets, i.e., Chinese Taipei; China; Korea; Malaysia; and Hong Kong, China compensated for the lower demand for electronics in the US and Japan.

Value of imports of goods also grew during the first five months of 2002, up by 3.2 percent from a year ago level. This was due in part to replenishment and inventory build-up by manufacturers following expectations of robust domestic demand.

Lower payments for transportation, and miscellaneous business, professional and technical services, coupled with higher net receipts from travel services narrowed the net service outflow during the period to US$405 million. Higher OFW remittances (US$3.6 billion) and lower interest payments contributed to the income account surplus of US$2.5 billion.

The capital and financial account deficit dropped to only US$821 million during the same five-month period, from a high of US$2.606 billion for the period January to May 2001. The improvement in the portfolio investments mitigated the net outflow of other investments and the lower net inflows of direct investments.

The Bangko Sentral ng Pilipinas' (BSP) gross international reserves as of end-May 2002 reached US$17.1 billion, 9.2 percent higher than the end-December 2001 level. The level of reserves is adequate to cover 5.5 months of imports of goods and payments of services and income.

GROSS EXTERNAL DEBT

The Philippines' total external debt reached US$52.4 million, an increase of 0.6 percent from the US$52.1 billion recorded in the same period in 2000. This was brought about by the upward revaluation adjustments of liabilities denominated in non-US dollar credits, the increase in net availments by non-bank private borrowers and by the BSP for reserve management purposes. Medium- and long-term loans accounted for 88.0 percent of total external loans. The government continued to be the biggest borrower with US$25.1 billion, followed by the private sector with US$15.7 billion and banks with US$11.5 billion. Total external debt accounts for 73.4 percent of GDP.

As of end-March 2002, the economy's stock of external liabilities increased by 2.1 percent from US$52.4 billion in 2001 to US$53.4 billion. Major foreign borrowings amounted to US$2.2 billion during the first quarter of 2002. Fresh borrowings were used to finance projects involving power and energy development, communication, transportation and other infrastructure development as well as to provide budgetary support. Medium- and long-term loans continued to comprise the bulk of external loans, accounting for 89.6 percent of the total. The national government remains the biggest borrower, with US$26.7 billion as of March 2002, followed by the private sector with US$15.6 billion.

EXCHANGE RATE

The peso continued to be put under pressure by a number of events in 2001. The peso reached an average of P55.013/US$ on 18 January 2001 at the height of the political crisis. The peso recovered and gained some stability following the peaceful resolution of the political crisis. However, the peso faced renewed pressures in subsequent months due to bearish market sentiment brought about by domestic and external factors. The weakening of regional currencies particularly the Japanese yen, the Thai baht, and the Indonesian rupiah; concerns over the economic slowdown in the US and in Japan; rising political tensions; worries over the budget deficit, rising corporate dollar demand for mid-year import requirements and dividend repatriation; and renewed weakening of investor sentiment contributed to the weakness of the peso. From an average of P49.24/US$ during the first quarter, the peso depreciated to P51.78/US$ by December 2001. The exchange rate averaged P50.99/US$ in 2001

To address potential inflationary pressures and minimize speculation in the foreign exchange, the *Bangko Sentral ng Pilipinas* implemented a number of measures: raising the liquidity reserve requirements for banks to reduce liquidity in the system (July and August); expanding the Currency Risk Protection Program to provide a hedging mechanism to a greater number of users (August and September), tighter monitoring of foreign exchange transactions of banks (July); and reducing the ceilings on undocumented over-the-counter foreign exchange sales from US$10,000 to US$5,000.

The peso/dollar exchange rate averaged P50.83/US$ during the first half of 2002, a 1.7 percent depreciation over the January–June 2001 average of P49.99/US$. The year-on-year depreciation of the peso mirrored the swings in sentiment on regional currencies and reflected steady corporate demand for dollars.

FISCAL POLICY

Fiscal discipline in 2001 succeeded in curbing the budget deficit to P147.1 billion, slightly exceeding the official target by P2 billion. Revenue collections exceeded program by P5.5 billion on account of a higher income for the Bureau of Treasury from its investments. The privatization program, however, yielded only P1.2 billion in revenues as against the target of P10 billion as the disposition of big ticket items such as MERALCO did not push through given a bearish market. The Bureau of Customs' (BOC) collections were also below target, by some P9 billion, due to the fall in imports. The Bureau of Internal Revenue (BIR), on the other hand, slightly exceeded its revised target of P388 billion (by P620 million).

Meanwhile, expenditures exceeded the program by P7.6 billion due to payment of accounts payables including arrears to local government units' internal revenue allotment. Overall expenditure management remained prudent. The national government limited its spending on items such as subsidies and equity to government-owned or controlled corporations. Furthermore, the government adopted austerity measures and tightened expenditure releases while preserving core expenditures like education, health, agriculture, housing and social welfare. The implementation of austerity measures generated an estimated P259 million in actual savings.

The government continued to obtain the bulk of its financing needs from domestic sources which accounted for 87 percent of total net borrowings. A substantial amount of domestic financing was also obtained through the issuance of Retail Treasury Bonds and Dollar-Linked Philippine Peso Notes. The government also issued global bond issuances to take advantage of the reduction in global interest rates and favorable market sentiment on Philippine sovereign debts. The government likewise continued to avail itself of the long-term concessional loans from multilateral sources. In June and in December 2001, the government issued foreign debt instruments including foreign denominated securities, Shibosi bonds and US dollar Treasury bills. These brought in about P37 billion in foreign financing.

The government posted a deficit of P119.7 billion during the first six months of 2002. Although revenue collection grew by 0.08 percent, it was unable to keep up with government expenditures, which expanded by 12.22 percent during same six-month period. Increased expenditures were channeled to capital outlays for infrastructure and agricultural products, which were undertaken early in the year to take advantage of the dry season and cushion the impact of the *El Nino* phenomenon

Revenue collections by the Bureau of Internal Revenue declined by 1.04 percent as the full impact of the revenue enhancement measures implemented in May will only realized in the second half of the year. Collections by the BOC also dropped by 3.26 percent. The BOC has launched a massive crackdown on large smuggling syndicates, with full support from the Philippine National Police and the Philippine Coast Guard. The Bureau of Treasury continued to offset the revenue shortfall as it posted income amounting to P16.46 billion, P6.6 billion higher than the program.

MONETARY POLICY

The Philippines' monetary policy in 2001 was focused on maintaining stable prices while broadly supporting the economy's output growth objective. The BSP cut its policy interest rates in the first quarter to provide room for market interest rates to go down and thereby encourage and strengthen economic activity. But movements in international prices and the peso-dollar exchange rates warranted a reassessment of the monetary policy towards the middle of the year. Beginning May 21, policy rates were held steady. To address inflationary pressures coming from a volatile peso-dollar exchange rate, the BSP raised the liquidity reserve requirement on deposits by a total of four percentage points in July and in August. The aim was to moderate liquidity growth and at the same time help temper speculations in the foreign exchange market. The adjustment in the liquidity reserve tempered liquidity growth and paved the way for the broad stability of the exchange rate,

The moderate inflation in the third quarter of 2001 and falling interest rates in advanced economies provided the leeway to reduce interest rates to invigorate domestic demand in the face of a weak external environment. The BSP has reduced policy rates 16 times by a cumulative 725 basis points since December 2000. The latest cut of 25 basis points on 14 December 2001 brought the BSP's overnight borrowing and lending rates to 7.75 percent and 10.0 percent, respectively, the lowest levels recorded since 1 September 1995. The BSP likewise reduced liquidity reserve requirements on deposits by two percentage points on 7 December 2001 from 11.0 percent to 9.0 percent as concerns over excess liquidity receded.

The relaxation of the monetary policy stance contributed to the general decline in domestic interest rates. The 91-day T-bill rates registered a significant drop from the average of 12.2 percent posted in January 2001, to 8.9 percent in December 2001, bringing the full-year average to 9.9 percent. This was lower than the government's assumption of 11.0–12.0 percent. Likewise, bank-lending rates declined appreciably to an average range of 12.7–14.2 percent in December 2001 from a high of between 18.0 and 19.9 percent in December 2000. Downward adjustments were also made on deposits and deposit substitute liabilities, common trust funds (CTF) and trust and other fiduciary liabilities (TOFA) of commercial banks and non-banks with quasi- banking functions. In addition, the two a percent reduction in statutory reserve requirements, effective 7 December 2001, released P26 billion into the money stream.

From an accommodative monetary stance in the first quarter, monetary policy shifted to a cautious stance in the second quarter of 2002. The presence of inflationary risks highlighted the need for continued caution in monetary policy and for allowing past monetary easing measures to flow through the economy. For this reason, the Monetary Board decided to maintain the BSP's policy rates at 7.0 percent for the overnight borrowing rate and at 9.25 percent for the overnight lending rate during the period, noting that given the lags in monetary policy, it would be important to have a firmer indication of the extent to which policy moves had been transmitted to the real sector. Reserve requirements were also maintained at their current levels given the adequate level of liquidity in the financial system.

MEDIUM-TERM OUTLOOK

Over the medium term, the government expects to accelerate growth through improvements in productivity, increased employment, and capital. Real GDP is predicted to grow between 4-4.5 percent in 2002, 5.0 and 5.5 percent in 2003 and 5.4 and 6.0 percent in 2004. This growth path hinges on the recovery and robust expansion of investments and exports as the economy benefits from renewed business confidence and sustained macro-economic stability as well as measures to improve governance and competitiveness of all sectors.

The average inflation rate for 2002 is expected to remain either within or below the current target range of 4.5 to 5.5 percent. Based on the BSP forecasts, the relatively weak but improving state of aggregate demand and the favorable supply conditions are expected to maintain the low inflation rates that have been achieved in the first five months of 2002 and to support a generally flat inflation rate through the third quarter of 2002. However, the BSP expects an uptick in November due mainly to expected increases in wage rates implemented during the month. Average inflation is expected to fall further to between 4.0 and 5.0 percent in 2003 and decline to 3.5 to 4.5 percent in 2004. The gradual deceleration is meant to anchor inflationary expectations, while at the same time providing flexibility to monetary policy to respond to unforeseen shocks over the target horizon.

ANNEX 1

PHILIPPINES: OVERALL ECONOMIC PERFORMANCE

	1996	1997	1998	1999	2000	2001	2002 [6]
GDP and Major Components (percent change, year over year, except as noted)							
Nominal GDP (million US$)	82848	82344	65171	76157	74859	71382	36604
Real GDP	5.85	5.19	-0.59	3.40	4.38	3.22	4.11
Total Consumption							
Private Consumption	4.62	4.99	3.45	2.64	3.51	3.58	3.62
Government Consumption	4.13	4.63	-1.95	6.73	6.15	0.27	0.0
Total Investment	12.46	11.70	-16.28	-1.98	5.54	1.33	-4.57
Exports of Goods and Services	15.40	17.15	-21.03	3.62	17.68	-5.16	1.42
Imports of Goods and Services	16.74	13.49	-14.70	-2.80	4.00	-0.83	-1.76
Fiscal and External Balances (percent of GDP)							
Budget Balance	0.29	0.06	-1.88	-3.75	-4.06	-4.04	-6.43
Merchandise Trade Balance[1]	-13.69	-13.51	-0.04	6.51	9.24	3.87	6.35
Current Account Balance[1]	-4.77	-5.28	2.37	9.67	11.30	6.45	13.25
Capital Account Balance[1]	13.37	8.01	0.73	-2.37	-8.64	-5.38	2.04
Economic Indicators (percent change year over year earlier period, except as noted)							
GDP Deflator (percent change)	7.7	6.0	10.7	8.0	6.7	6.6	4.8
CPI (percent change) 1994=100[3]	9.1	5.9	9.7	6.7	4.4	6.1	3.4
M2 (percent change)[3]	15.8	20.5	8.0	19.3	4.8	6.9	7.3
Short-term Interest Rate (%)[4]	12.4	13.1	15.3	10.2	9.9	9.9	5.5
Exchange Rate (P/US$)[2]	26.2	29.5	40.9	39.1	44.2	51.0	50.8
Unemployment Rate (%)[5]	8.6	8.7	10.1	9.8	11.2	11.1	12.1
Population (millions)	71.9	73.5	75.2	76.8	78.4	80.1	81.4

Notes: as of 4 September 2002
[1] - Jan-March 2002
[2] - Jan-June 2002
[3] - Jan-July 2002
[4] - Jan- August 2002
[5] - Jan- April 2002
[6] as at 1st half of 2002

Annex II

PHILIPPINES: FORECAST SUMMARY

	2002					2003				
	Official	**IMF**	**Link**	**ADB**	**OECD**	**Official**	**IMF**	**Link**	**ADB**	**OECD**
Real GDP	4.0-4.5	4.0	N.A.	4.0	N.A.	5.0-5.5	4.2	N.A.	4.5	N.A.
Exports	3.9-4.4	N.A.	N.A.	3.0	N.A.	8.5-9.0	N.A.	N.A.	6.0	N.A.
Imports	5.2-5.7	N.A.	N.A.	2.5	N.A.	8.3-8.8	N.A.	N.A.	4.0	N.A.
CPI	4.5-5.5	5.0	N.A.	5.0	N.A.	4.0-5.0	5.1	N.A.	6.0	N.A.

Annex III

PHILIPPINES: MEDIUM TERM FORECAST

	2002	**2003**	**2004**	**2005**	**2006**
Real GDP	4.0-4.5	5.0-5.5	5.4-6.0	5.7-6.3	6.0-6.6
CPI	4.5-5.5	4.0-5.0	3.5-4.5	3.5-4.5	3.0-4.0

RUSSIA

2001 is characterized as one of the most successful years for the Russian economy in the last decade. The basic indicators marked significant economic growth, especially noted were: gross domestic product (GDP) growth, industrial production, fixed capital investments, indicators of foreign trade activity and real disposable money income of the population.

The rate of inflation decreased, primarily under influence of constrained budget and monetary policy of the Russian Government and the Bank of Russia.

Financial stability was kept, provided by improvements in the collection of taxes and the steady profitability of the federal budget. Foreign debt was serviced according to the accepted schedule and without new borrowings. The situation on the currency exchange market remained steady and predictable.

Normalization of the structure of payments and an increase of the share of money resources in the accounts of the industrial enterprises proceeded.

The economy reached the 1994 level but showed significantly improved characteristics.

GROSS DOMESTIC PRODUCT

GDP grew by 5.0 percent in 2001, with industry, agriculture and construction as the main contributors to the growth. The volume of industrial production grew by 4.9 percent, agricultural production by 6.8 percent, construction by 9.9 percent and transport by 3.1 percent.

Total consumption and private consumption experienced increases of 6.2 percent and 8.7 percent, respectively, over the previous year. Final consumption of the governmental organizations fell by 1.0 percent.

INFLATION

During 2001 rates of inflation in consumer prices declined, but consumer prices grew by 18.6 percent (December to December).

The rate of inflation in industry was lower than the rate of inflation in consumer prices in 2001. The prices of industrial producers grew by 10.7 percent. The lower dynamics of prices in industry were influenced by the decline of world prices for some Russian export goods and by expanding import competition as a result of the strengthening of the rouble.

EMPLOYMENT

The total employed population in Russia increased from 63.5 million in January 2001 to 64.5 million by the end of December.

The number of unemployed [calculated under the International Labor Organisation (ILO) methodology] was reduced from 10 percent of the economically active population at the beginning of 2001 to 8.9 percent by the end of the year.

The share of the officially registered unemployed in the economically active population increased from 1.4 percent in the beginning of 2001 to 1.6 percent by the end of the year.

TRADE ACCOUNTS

The trade balance was at US$47.8 billion in 2001. Russia's foreign trade turnover was basically characterized by a rising trend.

Russian exports in 2001 were 3.8 percent lower than in the previous year. Exports to non-CIS economies fell to 5.3 percent, but exports to CIS economies increased by 6.2 percent over the previous year.

Russian imports in 2001 increased by 19.8 percent. Import deliveries from non-CIS economies increased by 29.6 percent, the deliveries from CIS economies declined by 2.9 percent.

Foreign investment worth US$14.3 billion was infused into the Russian economy, 30.1 percent above the 2000 level. The volume of foreign direct investments was US$4.0 billion, 10.1 percent less than in 2000. The volume of foreign portfolio investments in 2001 was US$451 million, 3.1 times more than the 2000 level.

The volume of other foreign investments was US$9.8 billion (53.9 percent growth over the 2000 level).

GROSS EXTERNAL DEBT

Russia's foreign debt in 2001 was serviced without new borrowings. By the end of 2001 Russia's external debt totaled US$130.1 billion (according to the Ministry of Finance of Russian Federation), lower than the US$143.4 billion registered by the end of 2000. The debt to international financial organizations was US$15.2 billion.

The main part of the debt amounting to US$61.3 billion, is the former Soviet Union's debt (according to Bank of Russia statistics).

EXCHANGE RATE

Throughout 2001, Russia pursued a floating rouble exchange rate policy. During the year the rouble exchange rate was relatively stable.

Over 2001 the official exchange rate of the rouble to the US dollar fixed by the Bank of Russia, increased by 7.0 percent from 28.16 to 30.14 roubles for the dollar. The strengthening of the rouble to the US dollar in real terms amounted to 8.6 percent in 2001 against 11.4 percent in 2000. The real effective exchange rate of the rouble increased by 8.7 percent in 2001 against 18 percent in the previous year.

FISCAL POLICY

Federal budget revenues in 2001 amounted to 17.6 percent of GDP. The major factors that determined the dynamics of the federal budget revenues, were: an increase in industrial production and investments in a fixed capital; improvement of financial conditions of the enterprises; a favorable external economic conjuncture; absence of the current debt on federal expenditures; and an increase of the overall performance and efficiency of the tax authorities.

Federal budget expenditures totaled 14.6 percent of GDP in 2001. The budget surplus amounted to 3.0 percent of GDP (primary proficit - 5.6 percent of GDP).

MONETARY POLICY

The dynamics of macro-economic parameters in 2001 testify to the adequacy of the monetary policy applied to the problems of economic growth. The gross international reserves were increased, the outflow of capital was reduced, and the stability of the exchange rate was ensured.

The high positive level of the foreign trade balance strongly influenced the money supply.

The essential growth of monetization was an important formative factor in the demand for money. It was determined by increasing volumes of production, improvements in the financial conditions of enterprises, and stabilization of the situation in the budgetary sector. As a whole the gross international reserves increased by 30.9 percent.

The refinancing rate (interest rate) was relatively stable in 2001 at 25.0 percent.

The money supply (M2) increased by 40.1 percent (1602.6 billion roubles). This testifies to the increasing money demand in the Russian economy as the monthly average inflation is decreased, the level of money saturation of the economy is increased and non-monetary forms of payments are reduced.

MEDIUM-TERM OUTLOOK

The main economic policy goals for 2001 and 2002 are a gradual recovery of the real money income of the population, and the realization of measures to decrease inflation and increase the investment.

GDP growth is estimated to reach 3.9 percent in 2002, industrial production growth of 4.4 percent, agricultural production growth of 3 percent, investment of fixed capital growth of 4.5 percent, real disposable money income of the population growth of 6.8 percent. The 2002 inflation rate will not exceed 14 percent.

Annex I

RUSSIAN FEDERATION: OVERALL ECONOMIC PERFORMANCE

	1995	1996	1997	1998	1999	2000	2001
GDP and Major Components (percent change from previous year, expect as noted							
Nominal GDP (billion US$)	338.3	418.8	428.5	282.4	193.2	251.1	310.0
Real GDP	-4.0	-3.4	0.9	-4.9	5.4	9.0	5.0
Total Consumption	-2.7	-3.1	3.0	-1.5	-2.4	7.4	6.2
Private Consumption	-2.8	-4.7	5.4	- 2.4	-4.4	9.3	8.7
Government Consumption	1.1	0.8	-2.4	0.6	3.0	1.4	-1.0
Total Investment	-10	-18	-5	-12	5.3	17.4	8.7
Exports of Goods and Services	7.2	0.6	1.1	1.9	9.5	8.7	3.3
Import of Goods and Services	8.1	-2.3	3.1	-13.6	-9.6	12.7	13.9
Fiscal and External Balances (percent of GDP)							
Budget Balance (federal)	- 5.4	- 8.1	- 7.7	-5.9	-1.1	2.5	3.0
Merchandise Trade Balance (f.o.b)	6.0	5.4	4.0	6.0	18.7	24.2	14.4
Current Account Balance	2.2	2.8	0.5	0.2	13.1	18.5	11.2
Economic Indicators (percent from previous year)							
GDP deflator	178.2	44.1	14.5	16.2	64.6	37.1	17.9
CPI	131	22	11.0	84.4	36.5	20.2	18.6
M2	225.5	130.7	129.8	119.8	157.2	162.4	140.1
Short-term Interest Rate (percent)	168.0	85.8	32.0	41.8	39.7	24.4	17.9
Exchange Rate (Roubles/US$)	4.56	5.22	5.79	9.78	24.6	28.12	29.16
Unemployment Rate (percent)	9.5	9.7	9.8	13.2	13.0	10.5	8.7
Population (millions)	147.6	147.1	146.7	146.3	145.6	144.6	144.1

SINGAPORE

REAL GROSS DOMESTIC PRODUCT

The Singapore economy contracted by 2.0 percent in 2001, after achieving a 10 percent growth in 2000. This sharp reversal in growth was primarily due to the slump in external demand although weak household consumption and business investments also contributed to the contraction.

All key economic sectors saw lower growth compared to a year ago. In particular, the manufacturing sector fell by 12 percent, a sharp reversal from the 15 percent expansion of the year before. The construction sector contracted for the third consecutive year in 2001, by 2.1 percent. And as a result of the uncertain economic climate and weak consumer sentiments both domestically and regionally, the wholesale and retail trade sector declined by 2.8 per cent, a sharp reversal from the 15 percent growth in 2000. Although the transport and communications sector expanded in 2001, growth was much lower at 2.7 percent, compared to the 8.5 percent a year ago. The financial services sector moderated from a growth of 4.6 percent in 2000 to 2.2 percent in 2001. The business services sector rose by a moderate 2.8 percent, down from a robust 7.3 percent growth in 2000.

INFLATION

The consumer price index (CPI) rose by 1.0 percent in 2001. Price increases were attributed solely to domestic factors. Domestic sources were responsible for 1.2 percent increase in CPI, while external factors reduced CPI by 0.2 percent. All group indices increased, except for transport and communications. The main items driving the increase in overall prices were tour packages, cigarettes, cooked food, and electricity tariffs, which were partially offset by lower car prices and cheaper petrol and mobile phones. Producer prices were mostly weaker in 2001, led by the decline in crude oil prices. With the exception of the import price index, prices have posted declines ranging between 1.6 and 3.8 percent.

EMPLOYMENT

Singapore's labour market in 2001 was affected by the deterioration in the external environment. A rapid contraction in economic activity saw retrenchments hitting 25,838 in 2001, more than double the 11,624 seen in 2000. Employment in goods-producing industries experienced a sharp decline, but this was mitigated by employment growth in the services sectors. At the end of 2001, the overall unemployment rate rose to 4.4 percent. For the whole of 2001, the unemployment rate averaged 3.3 percent, compared to 3.1 percent in 2000.

BALANCE OF PAYMENTS

Singapore's overall balance of payments recorded a deficit of $1.6 billion in 2001, compared with a surplus of $11.8 billion in 2000. Despite an expansion in the current account surplus, the overall balance declined due to significantly larger outflows from the capital and financial account. Specifically, direct investments recorded net outflows, while outflows from the volatile "other investments" account jumped by $20.2 billion over the year before. Nonetheless, Singapore's official foreign reserves rose to $140 billion as at end-2001 (equivalent to 8.1 months of current imports), as valuation gains offset the contractionary impact of the balance of payments deficit.

GROSS EXTERNAL DEBT

As at end-December 2001, the Singapore government did not have any external debt.

EXCHANGE RATE

The Singapore dollar weakened against the US dollar and the Euro but strengthened against most Northeast Asian currencies in 2001.

The Singapore dollar's fall against the US dollar in the first half of 2001 was due to expectations of fresh merger and acquisition activities by Singapore companies and persistent weakness in regional currencies. Market sentiments also shifted against the domestic currency when weak economic data pointed to a sharp downturn in the economy. In the months prior to 11 September, the domestic currency recovered against the US dollar to the levels prevailing at end-January 2001, reflecting a fall in the US dollar against the Japanese yen and euro. The attacks on 11 September further dragged down the US dollar and at end-September, the domestic currency had strengthened by 3.1 percent from end-June 2001 to $1.7651 to the US dollar. From October, however, the gains were reversed, and the Singapore dollar weakened against the US dollar, in line with the depreciating Yen.

Overall, the domestic currency depreciated by 3.8 percent against the US dollar and 0.8 percent against the Euro in 2001. Nevertheless, the Singapore dollar performed slightly better against the Pound Sterling by 1.3 percent and strengthened against the beleaguered yen by 8.5 percent.

INTEREST RATES

In line with the spate of interest rate cuts by the US Federal Reserve, domestic interest rates were on a declining trend throughout most of 2001. In the first half of 2001, the 3-month US$ Singapore Interbank Offered Rate (SIBOR) eased steadily from 6.39 per cent at end-2000 to 4.88 percent at end-March 2001 and 3.83 percent at end-June. This, in turn, has translated into lower domestic interest rates since the end of 2000, with the 3-month interbank rate easing from 2.81 percent in December 2000 to 2.25 percent at end-June 2001. As a result, the differential between the two rates narrowed from 358 basis points at end-2000 to 158 basis points at end-June 2001, lower than its historical average of 167 basis points over the pre-crisis period of 1991–1996. Reflecting further monetary easing by the US Federal Reserve, the 3-month US$ SIBOR continued to edge downwards during the third quarter of 2001, down by about 123 basis points from end-June. The rate fell sharply in September, as both the Federal Reserve and the European central bank cut their interest rates by 50 basis points each to boost liquidity in the financial system after the terrorist attacks on the US. As at end-September, the US$ SIBOR stood at 2.60 percent. The domestic 3-month interbank rate also ended lower, at 1.81 percent in September, compared with 2.25 percent at end-June. As interest rates in the major economies continued to ease in response to uncertainty in the global economy, the 3-month US$ SIBOR and 3-month interbank rate hit their lowest levels in almost twenty years to end the year at 1.88 percent and 1.25 percent respectively.

FISCAL POLICY

Fiscal policy seeks to create an environment that promotes a dynamic private sector, generates robust growth and employment, and advances the development of Singapore.

The focus of government expenditure is on the delivery of essential public goods and services, particularly in the key areas of education, housing, economic infrastructure, basic healthcare and national security. As in previous years, the bulk of government expenditure in 2001 was allocated to social development (42 percent) and security and external relations (37 percent). Economic development accounted for another 16 percent of total expenditure.

On the revenue side, taxation policy in 2001 continued to focus on ensuring an internationally competitive tax structure that would encourage entrepreneurship and attract investments and talent. Despite the sharp deterioration in the external environment and the slowdown in the Singapore economy, sufficient revenue was raised to finance the Government's operating and development expenditures.

MONETARY POLICY

Monetary policy remained focused on maintaining low and stable inflation over the medium-term, while ensuring support for economic activity during a period of weak external demand conditions and subdued inflationary pressure.

In January 2001, the Monetary Authority of Singapore (MAS) decided to maintain the stance of a modest appreciation of the trade-weighted Singapore dollar within an unchanged policy band. It aimed to cap medium-term inflationary pressures, while continuing to be supportive of economic activity as growth came off its cyclical high and moderated to a slower pace. In July, against the backdrop of a weaker external environment and subsiding inflationary pressure, the MAS shifted to a neutral exchange rate policy stance, with the policy band reflecting a zero per cent appreciation of the trade-weighted nominal effective exchange rate (S$NEER). With heightened uncertainty in the external environment following the terrorist attacks in the US, the MAS decided to widen the policy band in October, so as to allow greater flexibility in managing the exchange rate. The widened policy band continued to be centred on a zero appreciation of the S$NEER.

MEDIUM-TERM OUTLOOK

After a dismal performance of 2.4 percent in 2001, the global economy is expected to pick up this year. The US and the EU economies are recovering, led by improvements in sentiments. The US economy saw positive growth of 2.7 percent in the fourth quarter, supported by higher consumer and government spending. For the EU, the spate of interest rate and tax cuts has held up consumer sentiments. The manufacturing Purchasing Managers' Index in March 2002 also indicated that manufacturing activity in the euro zone has stopped contracting for the first time since March 2001. While the Japanese economy also showed some signs of bottoming out, it remains weak, plagued by flagging economic confidence and sluggish household and business spending.

The global electronics industry, which saw a record decline of 32 percent last year, is also expected to turn around this year. The drop in worldwide semiconductor sales has moderated but the pace of recovery is still uncertain. Industry monitoring group Gartner Dataquest expects the industry to grow by –5 to +8 percent while the Semiconductor Industry Association's forecast is 6.3 percent. On the domestic front, forward-looking indicators have also improved. The composite leading index (CLI) has recorded three positive quarterly readings since the fourth quarter. The business expectations surveys show that while business sentiments remain subdued, more businesses in the manufacturing and services sectors expect an improvement in the economy.

The Ministry of Trade and Industry's (MTI) preliminary 2002 growth forecast, made in October 2001, was –2 to +2 per cent. This was in view of the great uncertainties following the terrorist attacks in September 2001. As the outlook of the global economy has improved since then, the MTI has revised Singapore's 2002 growth forecast upwards to 3–4 percent (August 2002).

CHANGES UNDERTAKEN TO STRENGTHEN MARKETS

Free Trade Agreements

Singapore is one of the strongest supporters of the multilateral trading system under the World Trade Organization (WTO). We are highly committed to the Doha Development Agenda agreed to by world trade ministers at the fourth WTO Ministerial Conference in November 2001. Meanwhile, Singapore will push the envelope of free trade through bilateral Free Trade

Agreements (FTAs), in line with APEC's Bogor Goals to achieve free trade and investment by 2010 for developed economies and 2020 for developing economies. Singapore is a member of AFTA and had concluded FTAs with New Zealand and Japan as at end-2001. Negotiations with the United States, Mexico, Canada, Australia and a collective bloc of Scandinavian countries were in progress as at end-2001.

Enterprise Ecosystem

We have implemented various initiatives to bring about a conducive environment for enterprises to start, grow and thrive. Singapore is being developed as a business financing centre with a broad range of funds to support the formation and growth of enterprises. Incentives to encourage our enterprises to exploit intellectual property have been introduced, such as giving a writing down allowance for IP transferred. One-north, a science hub close to the universities and research institutes, is being developed to be a technopreneurial hotbed where talent and companies can congregate.

Science and Technology

The Science & Technology (S&T) 2005 Plan for the next five years was launched in 2000. A key thrust is to support industry research and development (R&D), with S$2 billion of the S&T 2005 Plan allocated for this purpose. During the previous 5-years (FY1996-2000) about four dollars were attracted from the industry partners for every dollar spent by the government on R&D. This is an important market discipline to ensure that public R&D funds go into economically relevant pursuits. The target is for private sector research to account for two-thirds of Singapore’s overall expenditure on R&D by 2005.

Liberalisation of Electricity and Gas Industries

The new wholesale electricity market which would enhance competition in the electricity generation and retail sectors in Singapore is scheduled to open by the second half of 2002. In addition to the energy spot market, there will be a market for reserve. Consumers will have the choice of an interuptible supply of energy at a lower price. The electricity retail market will be further liberalised in phases. More consumers will be able to choose their electricity retailers. The monopolistic businesses of electricity transmission and gas transportation will continue to be regulated. The Energy Market Authority of Singapore (EMA) is the authority responsible for regulating the electricity and gas industries. The EMA will also regulate the monopoly providers of district cooling services.

Annex I

SINGAPORE: OVERALL ECONOMIC PERFORMANCE

	1996	1997	1998	1999	2000	2001
GDP and Major Components (percent change, year over year - earlier period, except as noted)						
Nominal GDP (level in billion US$)	90.9	94.5	82.2	82.6	92.7	85.6
Real GDP	7.7	8.5	-0.1	6.9	10.3	-2.0
Consumption	10.1	5.8	-1.5	6.3	10.8	1.8
Private Consumption	8.1	5.5	-3.8	6.4	9.9	0.5
Government Consumption	19.3	7.1	8.0	6.1	14.0	6.6
Investment	23.1	9.7	-6.1	-4.0	6.3	-4.6
Private Investment	27.4	7.1	-9.4	-6.2	8.2	-7.5
Government Investment	5.7	22.3	8.4	4.1	0.3	5.5
External Demand	7.6	7.5	-5.4	7.8	15.3	-7.3
Fiscal and External Balances (percent of GDP)						
Merchandise Trade Balance	2.4	1.1	18.1	13.6	12.5	15.0
Current Account Balance	13.8	19.2	24.0	20.0	17.2	20.9
Capital and Financial Account Balance	-9.8	-14.6	-25.8	-14.0	-11.9	-22.1
Capital Account (Net)	-0.2	-0.2	-0.3	-0.2	-0.2	-0.2
Financial Account (Net)	-9.7	-14.4	-25.5	-13.7	-11.7	-21.9
Economic Indicator (percent change, year over year - earlier period, except as noted)						
GDP Deflator	1.1	0.8	-1.8	-4.8	3.5	-1.9
CPI	1.4	2	-0.3	0.0	1.3	1.0
M2	9.8	10.3	9.7	8.5	-2.0	5.9
Short-term Interest Rate (3-Month Fixed Deposits)	3.40	4.10	1.70	1.68	1.70	1.10
Unemployment Rate (percent)	2.0	1.8	3.2	3.5	3.1	3.3
Population (millions)	3.7	3.8	3.9	4.0	4.0	4.1

Annex II

SINGAPORE: FORCAST SUMMARY (percent change from previous year)

	2002			2003		
	Official	**IMF**	**Asia Pacific Consensus Forecast**	**Official**	**IMF**	**Asia Pacific Consensus Forecast**
Real GDP	3.0-4.0	3.2	4.3	N.A.	5.1	5.8
Exports	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Imports	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
CPI	0.0	1.1	0.0	N.A.	1.6	1.6

Annex III

SINGAPORE: MEDIUM-TERM TREND FORECAST (percent)

	Up to 2010
Real GDP	4.0-6.0
CPI	N.A.

CHINESE TAIPEI

REAL GDP GROWTH

The Chinese Taipei economy was in recession in 2001. With notable declines in investment and consumption, real GDP shrank 2.18 percent. Both domestic and international research institutions repeatedly lowered their forecasts for the economy during the year. The recession was triggered by global as well as short-term and long-term domestic forces.

On the global front, the worldwide high-tech downturn had a significant impact on Chinese Taipei's export-led production. Commodity exports contracted 17.2 percent from the previous year, with information and communications technology (ICT) exports down 23.6 percent. The industrial production index fell 7.3 percent.

On the short-term domestic front, consumer and business confidence was eroded by the ravages of destructive typhoons as well as by rapidly rising unemployment and steep falls on the stock market. As a result, private consumption and investment both declined. The stock price index slumped from 9,891 in February 2000 to 3,782 in October 2001. Concerned with the worsening situation of non-performing loans, banks turned more conservative in lending, which further dampened private investment. At the same time, a proposed stimulus package was prevented from having its desired effect due to delays in the legislative process.

On the long-term domestic front, industrial restructuring has resulted in more business exits than entries. While knowledge-intensive industries have been vigorously promoted, most traditional industries and some information technology industries have relocated overseas in pursuit of the optimum mix of competitive advantages. But as domestic innovation and the creation of new industries have not been able to keep pace with the exodus, both industrial production and employment have lost growth momentum.

Domestic demand shrank by 5.18 percent, contributing -4.93 percentage points to the overall economic growth of -2.18 percent in 2001. Owing to significant capacity excess and production outflows, private investment declined 29.17 percent, contributing –4.78 percentage points to growth. Private consumption registered a positive growth of 1.04 percent, contributing 0.62 percentage point. As the government cut spending, government consumption was 1.02 percent smaller than the previous year, contributing -0.12 percentage point. Because of delays in bureaucratic and legislative processing, government investment decreased 2.2 percent, contributing -0.1 percentage point. Exports of goods and services shrank 7.8 percent due to a substantial downturn in the ICT market. Imports declined 13.9 percent with the slump in export-induced demand and domestic demand. Exports and imports translated into a 2.8 percentage-point contribution by net foreign demand.

Both industry and agriculture declined in 2001. Agricultural production, accounting for merely 2.0 percent of GDP, slipped 2.1 percent due to bad weather and cutbacks in rice growing. Industry, accounting for 31.1 percent of GDP, recorded a record fall in output of 6.0 percent, with manufacturing and construction shrinking 5.7 percent and 12.6 percent, respectively. Manufacturing's share of GDP shrank from 26.4 percent to 25.6 percent whereas that of the service sector decreased by 0.1 percent to 67.0 percent. Transportation and communications posted a 3.1 percent expansion, with the steady development of mobile telecommunications. Financial services and real estate grew by a meager 0.5 percent, due to lower levels of stock trading and loans.

INFLATION

Though the depreciation of the New Taiwan dollar generated upward pressure on import costs, the softening international prices of oil, raw materials and finished products produced an opposite effect and helped reduce wholesale prices by 1.3 percent. Consumer prices slipped fractionally by 0.01 percent, thanks to increasing competition in the domestic market.

EMPLOYMENT

The labor market has seen rising unemployment in recent years as job creation by the high-tech and services industries has failed to keep pace with redundancies in construction and traditional industries. In 2001, the labor market generally reflected the recession and investment outflows. Moreover, the domestic labor market has lacked the flexibility to adjust to cyclical change, while imported foreign workers have filled a large percentage of jobs in construction, the wholesale and retail trade, restaurants, and housekeeping. As a result, employment dipped 1.1 percent from the previous year and the unemployment rate jumped to a historic high of 4.6 percent.

The monthly earnings of labor in industry and services increased only 0.2 percent, the lowest increase ever recorded. Among the unemployed, 45.8 percent were out of work due to business closures or downscaling. Most affected were those in the age group 35–54, who are generally family providers, not easily able to switch to different occupations.

As the knowledge-based economy has been developing in Chinese Taipei, knowledge-based employment has been on the rise. Between 1987 and 1993, such employment increased 7.5 percent yearly. Although the rate slowed down to 2.5 percent between 1994 and 2000, it was above the economy-wide average. As a result, the proportion of knowledge-based employment grew from 17.5 percent in 1987 to roughly 28 percent in 2001.

EXTERNAL TRADE ACCOUNT

Heavily affected by the global downswing and tumbling demand for information technology products on the international market, Chinese Taipei's goods exports contracted 17.2 percent to US$122.9 billion in 2001. Most affected were ICT exports, down 23.4 percent from the previous year. Imports in value terms decreased 23.4 percent to US$107.2 billion, depressed by a slump in the purchase of capital equipment. The goods trade balance showed a surplus of US$15.6 billion for the year.

Having grown steadily in the 1990s and through 2000, Chinese Taipei's trade in services shrank 3.6 percent in 2001 under the impact of the global economic downturn. Because it contracted less sharply than trade in goods, its share of trade in goods and services rose to 17 percent from 14.4 percent in 2000. Services exports increased 2.5 percent year-on-year to US$20.5 billion, with exports of trade-related services growing 30 percent. Trade-related services have become the key component of services exports since 1997 as global logistics activities by domestic industries have gained increasing importance. Services imports decreased 8.2 percent to US$24.7 billion, with travel services accounting for the lion's share of the total. While trade in services has always shown a deficit, the deficit has narrowed since 1996, and in 2001 it diminished considerably to US$4.2 billion from US$6.9 billion in the previous year.

The current account balance recorded a surplus of US$18.9 billion and the capital account a deficit of US$0.2 billion. The current account surplus rose to 6.7 percent of GDP, as imports contracted more than exports. The financial account recorded a modest outflow of US$0.7 billion, down substantially from the preceding year's US$8 billion. The narrowing was owing to an increase in foreign purchase of domestic securities and global depository receipts (GDRs) issued by domestic enterprises. Though inward foreign direct investment (FDI) decreased by US$0.8 billion to US$4.1 billion, it was the second highest level on record. Outward FDI amounted to

US$5.5 billion and portfolio investment by domestic residents increased significantly to US$12.4 billion. The capital account displayed a net outflow of US$0.2 billion as outward remittances related to emigration moderated. The overall balance of payments posted a much larger surplus of US$17.4 billion thanks to a sizable current account surplus and a modest financial account deficit.

EXCHANGE RATE

The exchange rate of the New Taiwan (NT) dollar against the US dollar strengthened in the first quarter of 2001, thanks to an upsurge in the stock market and indications of a downward trend in US interest rates. It then weakened in the second quarter under the impact of the devaluating Japanese yen, reports of financial troubles in the corporate sector, the downward spiral of stock values, and lower-than-expected economic growth. After a modest rebound in the fourth quarter, the continuing yen devaluation set it falling once again. Over the year, the currency slid 7.6 percent from the previous year to 33.81 against the US dollar, with its real effective exchange rate down by 5.2 percent.

FISCAL POLICY

Government revenues totaled NT$2,100.3 billion in 2001, up 13.1 percent from the previous fiscal year. With government expenditure increasing 22.1 percent to NT$2,577.3 billion, the fiscal deficit grew to NT$457.0 billion.

Tax revenues fell for the third consecutive year due to the economic recession and a series of tax cutting measures, including the waiver of tax on capital gains and a lowering of the land tax base. Tax revenues as a percentage of gross national product (GNP) maintained their downward trend by falling to 12.9 percent, the lowest on record, with a corresponding lessening of the tax burden.

Although government expenditure narrowed substantially as government at all levels cut spending, the ratio of tax revenue to government expenditure continued to fall, reaching a historic low of 52.0 percent. As a result, the budget deficit as a percentage of GNP rose to 4.7 percent. With the government depending increasingly on raising public debt to cover expenditure, outstanding debt climbed to 31.4 percent of GNP in 2001.

MONETARY POLICY

To boost the economy in 2001, an expansionary monetary policy was adopted amid price stability. The central bank lowered rediscount rates twelve times from 4.625 percent in 2000 to 2.125 percent. With the required reserve ratio also adjusted downward in October, both interest rates and the reserve ratio stood at all-time lows. The inter-bank call-loan rate fell from 4.73 percent to 3.69 percent, and the short-term bills rate from 4.91 percent to 3.69 percent.

With the private sector cutting back investments and showing weaker debt repaying ability, financial institutions curbed lending and investment. As a result, lending and investment contracted 1.02 percent, with lending to private enterprises falling 3.8 percent. The annual growth of broad money supply M2 dipped further to 5.8 percent in 2001, from the preceding year’s 7.0 percent. The annual growth of the narrow measure M1B fell 1.0 percent, due to a reduction in stock market trading.

The non-performing loan (NPL) ratio continued to hit record levels in 2001. The key factor behind the rise of domestic banks’ NPL ratio from 5.34 percent in 2000 to 7.48 percent in 2001 was the worsening performance of community financial institutions. Because of their small scale and limited sphere of activity, these grassroots institutions have been greatly affected by the recent progress of financial liberalization and internationalization. While numerically they make up one quarter of all financial institutions, their shares of deposits and loans slipped to 12.1 percent and 7.6 percent, respectively. Affected by worsening profitability, deteriorating asset quality and a flurry of scandals, these institutions' NPL ratio went up to 16.39 percent. After the implementation of a series of NPL resolution measures, their growth in net worth turned from negative during the previous two years to a positive 3.9 percent.

MEDIUM-TERM OUTLOOK

With the global economy heading more clearly toward recovery, the Chinese Taipei economy is expected to return to positive growth in 2002. As the upswing in domestic and foreign demand gains strength, the Chinese Taipei economy is forecast to grow 3.14 percent in 2002 while maintaining price stability.

Clearer signs of a recovery in the US will boost the expansion of global trade, which is expected to pick up steadily. This trend should help to nudge Chinese Taipei's bilateral trade back to a stable growth path. Exports of goods are forecast to grow 5.4 percent and imports 6.1 percent, generating a trade surplus of roughly US$15.8 billion. Real growth of goods and services exports is projected at 8.1 percent and imports at 6.5 percent.

Consumer confidence is on the rise as the effects of equity wealth reduction are diminished by buoyancy in the stock market and as pessimism recedes in the job market. Furthermore, private consumption is expected to be boosted by low interest rates and the influx of consumer imports following market-opening measures. The real growth of private consumption is projected to be 2.2 percent in 2002.

The semiconductor and opto-electronics industries in particular have expansion plans and so do other industries which are expected to rally as they take advantage of new tax concessions and other incentives. Given that the sign of economic recovery is not yet clear and the market competency remains fierce, investment willingness is considered to be conservative. As such, private investment is expected to increase only slightly by 0.7 percent in real terms.

As the government cuts back outlays for personnel and general purchase, government consumption will shrink by 1.8 percent in 2002. With the completion of several large transportation projects, government investment will contract by 9.5 percent as new investment projects remain in the early stage of implementation. Investment by public enterprises will increase by 1.9 percent.

Despite a rising trend in international crude-oil and raw-material prices, domestic market-opening and tariff reductions as part of Chinese Taipei's WTO commitments will help keep domestic prices stable. Consumer and wholesale prices are expected to increase 0.3 percent and 0.01 percent, respectively.

Annex I

CHINESE TAIPEI: OVERALL ECONOMIC PERFORMANCE

	1996	1997	1998	1999	2000	2001
GDP and Major Components (percent change, year over year - earlier period, except as noted)						
Nominal GDP (level in billion US$)	279.6	290.2	267.2	287.9	309.4	281.2
Real GDP	6.1	6.68	4.57	5.42	5.86	-2.18
Consumption	6.56	6.99	6.06	3.13	4.18	0.70
Private Consumption	6.53	7.26	6.52	5.37	4.93	1.04
Government Consumption	6.66	5.87	4.12	-6.49	0.55	-1.02
Investment	1.66	10.65	8.01	1.78	8.61	-20.61
Private Investment	3.4	18.6	11.8	-0.7	15.7	-29.17
Government Investment	-0.31	0.48	0.09	3.64	-4.66	-4.77
Exports of Goods and Services	6.74	9.08	2.41	11.9	17.55	-7.77
Imports of Goods and Services	6.03	13.74	6.34	4.41	14.53	-13.87
Fiscal and External Balances (percent of GDP)						
Budget Balance (fiscal year, as % of GNP)	-1.7	-2.4	1.2	0.5	-1.3	-4.7
Merchandise Trade Balance	4.85	2.64	2.21	3.79	2.69	5.56
Current Account Balance	3.91	2.43	1.29	2.91	2.88	6.71
Capital Account Balance	-0.23	-0.11	-0.07	-0.06	-0.09	-0.06
Economic Indicator (percent change, year over year - earlier period, except as noted)						
GDP Deflator	3.11	1.68	2.64	-1.42	-1.73	0.57
CPI	3.07	0.9	1.68	0.18	1.26	-0.01
M2	9.2	8.3	8.8	8.3	7	5.79
Short-term Interest Rate (one-month deposit rate)	5.03	5.21	4.66	4.42	4.34	2.13
Real Effective Exchange Rate (level, 1997=100)	99.91	100.00	95.41	91.12	94.15	89.25
Unemployment Rate (percent)	2.6	2.72	2.69	2.92	2.99	4.57
Population (millions)	21.39	21.58	21.78	21.95	22.13	22.28

Annex II

CHINESE TAIPEI: FORCAST SUMMARY (percent change from previous year)

	2002				
	Official	**IMF**	**Link**	**ADB**	**OECD**
Real GDP	2.55	0.7	N.A.	2	N.A.
Exports	6.2	N.A.	N.A.	N.A.	N.A.
Imports	7.2	N.A.	N.A.	N.A.	N.A.
CPI	0.6	N.A.	N.A.	N.A.	N.A.

THAILAND

The Thai economy is expected to grow at a rate of 3.5–4.0 percent in 2002. The recovery of internal and external demand will play an important role in restoring the economy. Private consumption and investment are anticipated to continue expanding, due primarily to the recovery of both business and consumer confidence and a low interest rate environment, as well as effective government policies. Furthermore, the world economy has recovered faster than expected; as a result, this has considerably stimulated Thai exports. In 2002, monetary policy is also expected to play a more important role in stimulating the economy. Since inflation is expected to remain low, the policy interest rate, i.e. the 14-day repurchase rate, is likely to remain at a low level to continually stimulate domestic demand continually.

REAL GROSS DOMESTIC PRODUCT

In 2001, the Thai economy grew at a rate of 1.8 percent, compared to a 4.6 percent growth rate in 2000. The slowdown in the Thai economy was mainly attributed to the adverse impact of the sluggish world economy since exports, which accounted for more than 60 percent of GDP, contracted by 6.9 percent. While the growth rates of private consumption and private investment were 3.4 and 5.1 percent, respectively, the growth rates of public consumption and public investment were 1.6 and –6.6 percent.

According to the National Economic and Social Development Board (NESDB), the Thai economy is expected to expand by 3.5–4.0 percent as both internal and external demand is likely to recover. The domestic demand is now retrieved as a result of government stimulus policies and the remained low interest rate. Also, the cyclical pick-up of the world economy would substantially benefit Thailand's export volume.

Private consumption is forecast to increase at a rate of 3.5 percent, compared to 3.4 percent in 2001. Higher consumer confidence and a low interest rate environment will be the main supporting factors for increased private consumption in 2002. Private investment is expected to grow at a rate of 5.8 percent, slightly higher than that of 2001. Construction will be a key driving force for private investment, as a result of the government policies to stimulate the real estate sector and a low interest rate environment. It is also anticipated that investment in machinery and equipment will pick up in 2002 although to a lesser extent since excess production capacity still prevails in many sectors of the economy.

In 2002, fiscal spending is expected to remain an important force for economic growth as government consumption and investment are expected to grow at the rates of 8.0 and 2.0 percent, respectively. In addition, economic recovery of trading partners will lend support to economic growth in 2002. Export value is anticipated to expand at a rate of 1.7 percent, compared to –6.9 percent in 2001. Imports are also expected to recover, in tandem with consumption, investment, and exports. Import value is forecast to be at a rate of 4.5 percent, compared to –2.8 percent in 2001.

INFLATION

Although the baht depreciated by more than 10 percent in 2001, headline inflation was recorded at 1.6 percent, only slightly higher than it was in 2000 (1.5 percent). The subdued inflation was a result of the slowdown in the Thai economy coupled with a decline in oil prices.

Headline inflation in 2002 is projected to be 1.3 percent, due mainly to the low pressure on volatile oil prices. Core inflation in 2002 is likely to be in the target range of 0.0–3.5 percent and is expected to be around 0.5–1.0 percent.

EMPLOYMENT

In 2001, the labor force expanded by 1.8 percent, whereas the number of persons employed increased by 2.6 percent, reflecting the ability of the labor market to absorb new labor entries. Thus, the unemployment rate dropped slightly to 3.3 percent, compared with 3.6 percent in 2000, with the economy still producing below its potential level.

EXTERNAL TRADE ACCOUNTS

In 2001, Thailand's exports experienced a sharp decline of 6.9 percent in US dollar, due mainly to a slowdown in the world economy. Even with the plunge in exports, the trade balance in 2001 remained in surplus (US$2.5 billion) since imports declined by 2.8 percent. The service balance decreased slightly from a surplus of US$3.9 million in 2000 to a surplus of US$3.7 million in 2001. Therefore, the current account recorded a surplus of US$6.1 billion (5.3 percent of GDP), declining from a surplus of US$9.3 billion (7.6 percent of GDP) in 2000.

Thailand's trade surplus in 2002 is expected to decrease to US$0.9 billion. As the economy begins to rebound, imports are expected to grow by 4.5 percent, while exports are likely to increase at a rate of 1.7 percent. Travel and income receipts are also expected to increase more than travel and income payments. Therefore, the current account in 2002 is expected to remain in surplus at US$4.4 billion, or 3.6 percent of GDP.

GROSS EXTERNAL DEBT

External debt declined from US$79.7 billion in 2000 to US$67.5 billion at the end of the year 2001, and was comprised of US$28.3 billion for public external debt and US$39.2 billion for private external debt. The drastic decline was mainly a result of increase in both public and private long-term external repayments.

EXCHANGE RATE

The average exchange rate of the baht depreciated to 44.5 baht per US dollar in 2001, compared with 40.3 baht in 2000. The exchange rate is expected to be stable in 2002 for the following reasons:

- The upturn in the US economy will positively affect the volume of trade surplus. Therefore, exports are expected to increase in 2002.
- Capital inflows to the securities market are likely to persist throughout the year 2002, while the private sector's debt repayment continues, but in a lesser amount as a large portion of private external debt has already been repaid.
- External stability is likely to remain strong. International reserves at the end of May were 35.3 billion US dollars, which was equivalent to 2.5 times the short-term external debt and covered more than 4.5 months of imports.

- The Thai economy in 2002 has shown signs of improvement. The GDP growth rate is currently predicted to be 3.5–4.0 percent.

FISCAL POLICY

In 2001, the government continued to implement an expansionary fiscal policy, in order to stimulate the sluggish economy affected by the global slowdown. The government net revenue in FY2001 was 765.4 billion baht while the budgetary expenditure was 876.0 billion baht, leading to a 110.6 billion baht budgetary deficit (GFS basis) or 2.2 percent of GDP.

In FY2002, the government keeps maintaining the expansionary fiscal policy. To cope with the global economic slowdown and the uncertainty of its recovery, especially in the first and second quarters of FY2002, the government intends to have a wider budgetary deficit gap to boost the economy. Following to the GFS basis, it is anticipated that government net revenue will be 800.1 billion baht, while the budgetary expenditure is expected to be 993.1 billion baht. Hence, budgetary deficit is projected to be 202.2 billion baht or 3.9 percent of GDP, which is approximately 1.7 times higher than that in FY2001.

In FY2003, as economic outlook is expected to improve and the private sector is likely to become the major force of economic growth, the government plans to consolidate fiscal policy in concern of fiscal sustainability. To impose fiscal discipline, the government aims to reduce the budgetary deficit, projected to be 156.2 billion baht or 2.8 percent of GDP in FY2003.

With regards to public debt, at the end of March 2001, outstanding public debt was 2,869.4 billion baht or 53.5 percent of GDP. It is expected to peak in FY2002 at 59.18 percent of GDP and then gradually come down to 49.33 percent of GDP in FY 2007.

The government has realized the importance of fiscal sustainability in the medium term. Therefore, it will not allow the debt/GDP ratio to be higher than 65 percent, while the debt service is strictly limited to 16 percent of the government's budget. Furthermore, to maintain long-term economic development, the ratio of government's capital expenditure to the budget has to be higher than 20 percent. In the medium term, the government will aim to balance the budget by FY2008.

MONETARY POLICY

Thailand has adjusted its monetary policy in order to suit the changing economic situation. In June 2001, the Bank of Thailand (BoT) adopted a tight monetary policy aimed at strengthening external stability, by raising the 14-day repurchase rate, a policy instrument, from 1.50 percent to 2.50 percent. This slowed down capital outflow and brought international reserves to a satisfactory level. As external stability became strong and inflation remained at a subdued level, at year-end, the BoT started to ease monetary policy not only to stimulate growth, but also to facilitate its fiscal policy, which has reached its limitation. Consequently, the BoT lowered the 14-day repurchase rate twice, from 2.50 percent to 2.25 percent in December 2001 and from 2.25 percent to 2.00 percent in January 2002.

The eased monetary policy should help in stimulating the sluggish economy. The decline in a policy rate will eventually lower the deposit rate. A decrease in the deposit rate would then help commercial banks reduce their operating costs, thus enabling them to lower the lending rate, and hopefully narrow the spread. An expansionary monetary policy therefore should eventually enhance domestic demand, the expected major driving force of economic recovery. As a result, the credits adding back debt write off and transferred loans grew by 1.4 percent in April 2002 after contracting by 13.2 percent in 1999.

MEDIUM-TERM OUTLOOK

In the medium term, the government has set the macro-economic framework, including an economic growth rate of 5.0 to 6.0 percent per annum, an inflation rate of no greater than 3.0 percent per annum, a current account surplus of 1.0 to 2.0 percent of GDP, and an appropriate level of international reserves.

The government will continue to implement an expansionary fiscal policy in the next five years. However, to maintain fiscal sustainability, the size of the budget deficit will continue to be smaller over time. According to the ninth National Economic and Social Development Plan, the government's current expenditure growth is expected to decrease from 8.0 percent in 2002 to 5.0 percent in 2003 and stay at 4.0 percent in 2004 to 2006, while the government's capital expenditure is likely to maintain a growth rate of 3.0 percent per annum. Over the medium term, the consumer price index inflation rate is expected to be around 2.4 to 2.6 percent.

As the world economy's recovery is anticipated and the government stimulus plans for the domestic economy are expected to be effective, GDP growth is projected to increase continuously over the medium term, reaching 5.0 and 5.5 percent in 2005 and 2006, respectively. Private consumption and private investment also are expected to improve with average growth rates of 4.5 and 5.9 percent over the 2003–06 period.

	2003	**2004**	**2005**	**2006**	**Average**
Real GDP Growth (%)	3.0	4.0	5.0	5.5	4.4
GDP (Current price, Baht Billions)	5,564.8	5,926.5	6,377.0	6,893.5	6,190.5
(US$ Billions)	123.7	131.7	141.7	153.2	137.6
Consumption Growth (%, 1988=100)	3.5	4.0	5.1	5.3	4.5
Private	3.2	4.0	5.3	5.5	4.5
Public	5.0	4.0	4.0	4.0	4.3
Investment Growth (%, 1988=100)	3.6	3.7	5.5	6.5	4.8
Private	4.0	4.2	7.0	8.5	5.9
Public	3.0	3.0	3.0	3.0	3.0
CPI Inflation (%)	2.4	2.5	2.6	2.6	2.5
Export Value Growth (%, 1988=100)	5.0	5.7	7.5	8.7	6.7
Import Value Growth (%, 1988=100)	5.7	6.5	7.9	9.0	7.3
Trade Balance (% of GDP)	0.4	0.0	-0.2	-0.3	0.0
Current Account (% of GDP)	2.3	1.5	1.1	0.8	1.4

Source: National Economic and Social Development Board, as of March 18, 2002.

The growth rates of exports and imports are expected to increase over time since trading partners' economies and the domestic economy are likely to improve. However, import growth will be higher than export growth leading to a decrease in the trade surplus, and the trade balance is projected to become negative in 2005. Nevertheless, the current account is likely to remain positive with an average of 1.4 percent of GDP over the 2003–06 period, mainly due to gains from the service sector, especially tourism.

In the medium term, international reserves are anticipated to remain around US$30 billion. Although the Bank of Thailand will still have to pay back the external debt to the IMF in the amount of US$9.6 billion and the debt burden will be ended in 2005, it will not have an impact on the stability of international reserves.

THAI ASSEST MANAGEMENT CORPORATION AND FINANCIAL REFORMS

The health of Thai financial institutions has been improved as the government has implemented several measures to restructure and strengthen the troublesome financial sector. The capital adequacy of the banking sector stays at a satisfactory level, 14.0 percent of risk weighted assets and more than 8.0 percent of Tier 1 capital. In addition, non-performing loans declined from 47 percent of total outstanding loans in 1998 to 10.35 percent at the end of April 2002 as a large portion of NPLs has been transferred to the Thai Asset Management Corporation (TAMC) since July 2001. It is also expected that the recovery of the world economy will enhance the economic activities, thus inducing an expansion in domestic credit.

The establishment of the Thai Asset Management Corporation aims at alleviating the problem of excessive non-performing loans efficiently. The TAMC will purchase default loans from state-owned and private financial institutions and AMCs, then take the lead in dealing with non-performing assets and related corporate restructuring activities. This process should increase the capital adequacy of commercial banks even further. The banks then could provide new lending, thus supporting economic expansion in the near future as well. As of May 2002, the total number of debtor cases transferred to the TAMC amounted to 4,726 cases with a book value of 708.9 billion baht or 54 percent of total assets to be transferred. In addition, 357 cases with book values totalling 157.6 billion baht have now been concluded.

The government has gradually privatized state-owned commercial banks. The plan to privatize two of four state-owned banks are expected to be concluded in the near future, while a strategic plan for the other two banks is also under development.

Several legal infrastructures such as the Central Bank Act Amendment draft and Financial Institution Act draft have been prepared to establish a solid foundation for financial institutions in the future.

CAPITAL MARKET DEVELOPMENT

In 2001, the Stock Exchange of Thailand (SET) revived significantly with improved price stability and active trading activities. The SET index recorded 303.85 points at the end of the year, compared with 269.19 points in 2000. Also, total turnover value in the SET increased substantially to 1,577.75 billion baht, up by 70.81 percent from the previous year, reflecting the fact that investor confidence had returned and the Thai economy was on the path to recovery.

Regarding the policy towards capital market development, the government has emphasised the development of the Thai capital market in recent years, aiming to reinforce the strength of the Thai capital market as well as increasing its role as an alternative source of funds for the private sector. By early January 2002, a master plan had been formulated to cover all facets of the development of the Thai capital market: the equity market, the debt market, and the derivative market. It includes a number of measures that strengthen the demand and supply structure of the capital market, including the steady expansion of the investor base in accordance with the enlargement of quality investment choices, continued development of strong intermediary institutions, a standardized structure of supervision, and the promotion of market transparency and good corporate governance. These measures will increase the efficiency as well as enhance the competitiveness of the Thai capital market as a whole.

As a result of the implemented measures and improved economic conditions, the SET index increased gradually in 2002. For the first six months of the year, the SET index averaged 389.10 points with total turnover value of 1,335.61 billion baht. The daily average turnover volume doubled from the previous year. The improvement in the stock market is expected to continue throughout 2002 as various government measures, including privatization and matching funds, start to bear fruit.

Annex I

THAILAND: OVERALL ECONOMIC PERFORMANCE

	1996	1997	1998	1999	2000	2001
GDP and Major Components (percent change, year over year, except as noted						
Nominal GDP (level in $US billion)	183.26	150.86	111.83	122.41	122.13	114.65
Real GDP	5.90	-1.37	-10.51	4.43	4.64	1.81
Consumption						
Private Consumption	5.8	-1.4	-11.5	4.3	4.9	3.4
Government Consumption	12.1	-2.8	3.9	3.2	2.6	1.9
Investment						
Private Investment	3.4	-30.4	-52.3	-3.2	17.2	5.1
Government investment	28.93	10.2	-28.7	-3.1	-9.9	-6.6
Exports of Goods and Services	-0.20	29.80	21.90	7.40	19.60	-6.90
Import of Goods and Service	2.30	4.30	-10.50	17.00	31.40	-2.80
Fiscal and External Balance (percent of GDP)						
Budget Balance	1.61	-1.33	-2.58	-2.84	-2.31	-2.69
Merchandise Trade Balance (Bil. US$)	-16.15	-4.62	12.24	9.27	5.47	2.53
Current Account Balance (Bil. US$)	-14.35	-3.11	14.29	12.47	9.33	6.21
Capital Account Balance (Bil. US$)	19.50	-4.34	-9.74	-7.91	-10.27	-5.53
Economic Indicators (percent change, year on year, except as noted)						
GDP deflator	3.9	4.3	9.2	-4.5	1.7	2.1
CPI	5.9	5.6	8.1	0.3	1.5	1.6
M2	12.7	16.4	9.5	2.1	3.7	4.2
Short-term Interest Rate (Repurchase rate)	N.A.	22.36	13.59	1.48	1.28	2.07
Real Effective Exchange Rate (level, 1997=100)	109.2	102.4	90	93.5	86.9	79.48
Unemployment rate (percent)	1.5	1.5	4.4	4.2	3.6	3.36
Population (millions)	59.9	60.5	61.17	61.78	62.40	63.10

Sources: 1. National Economic and Social Development Board (NESDB)
2. The Ministry of Labor and Social Welfare.

Annex II

THAILAND: FORCAST SUMMARY (Percentage Change from Previous Year)

	2002			2003		
	Official*	IMF	ADB	Official	IMF	ADB
Real GDP	3.5-4.0	3.2	3.7	N.A.	4.0	4.2
Exports	1.7	1.8	N.A.	N.A.	6.0	N.A.
Imports	4.5	2.9	N.A.	N.A.	9.1	N.A.
CPI	1.3	1.7	N.A.	N.A.	N.A.	N.A.

** Source: NESDB, as of June 17, 2002.*

UNITED STATES OF AMERICA

The US economy has displayed remarkable resilience in the face of unprecedented shocks. The economic slowdown that began in mid-2000 turned into a full-blown recession in March 2001. The disruption to economic activity caused by the September 11 attacks contributed to the brief contraction of economic activity. Thanks to timely fiscal and monetary policy responses and the willingness of households and businesses to trust in the future, a recovery in economic activity is underway, making the recent recession one of the mildest on record. Economic growth resumed in the fourth quarter of 2001, accelerated sharply in the first quarter of 2002, and continued in the second quarter, albeit at a slower pace. Key to sustaining the recovery will be a pickup in aggregate final demand, especially business fixed investment.

GDP GROWTH RATE

GDP growth slowed markedly in the second half of 2000 and became negative in the first quarter of 2001. The drop in economic activity worsened in the second quarter as GDP growth reached –1.6 percent at an annual rate. The decline in consumer and business confidence following the September 11 attacks lengthened the recession, though the impact of the attacks was lessened by a series of Federal Reserve interest-rate cuts and the timely arrival of tax relief checks. Third quarter GDP growth actually improved somewhat over the second quarter, but was still negative (-0.3 percent). In the fourth quarter, real GDP grew at 2.7 percent at an annual rate–at a time when almost every observer was expecting further contraction–a testament to the resiliency of the economy. Growth in the first half of 2002 has been stronger, as real GDP at an annual rate grew 5.0 and 1.1 percent in the first and second quarter respectively.

Real personal consumption expenditures grew 2.5 percent in 2001, notably slower than the average rate of 4.7 percent for the previous 3 years. Spending for all types of consumption slowed in 2001. The downward pressure on consumption spending can be traced to the decline in equity markets and deterioration of labor markets, which reduced wealth and consumer confidence. Consumer confidence had been steadily declining before September 11, and further plummeted after the terrorist attacks. After steadily rising from the last quarter of 2001 through May 2002, confidence has since dropped back to levels seen at the end of 2001. Real personal consumption expenditures posted a modest 3.1 and 1.9 increase (annual rate) in the first and second quarters of 2002.

Real private investment shrank 10.7 percent in 2001, marking the sharpest contraction since 1982. Inventory liquidation accounted for most of the decline, although by the first quarter of 2002 the downward phase of the inventory cycle had ended. Real business investment fell 5.2 percent in 2001 – its worst year since 1975 – in contrast to the boom years of 1995–2000. Business investment in computers and peripheral equipment, averaging 40 percent per year from 1995–2000, shrank by 2.6 percent in 2001. The housing sector was a bright spot in 2001. Lower mortgage rates helped support positive growth in residential investment. Investment in multifamily structures rose briskly at a 6.4 percent annual rate.

Government spending increased dramatically in 2001, driven by security and defense expenditures. In 2001, real federal government spending increased at a 4.8 percent annual rate, compared to a 0.3 percent average growth rate from 1995-2000. In the first half of 2002, federal government spending hit a growth rate of 7.6 percent at an annual rate. Defense spending increased by 5.0 percent in 2001–the largest increase since 1986–whereas non-defense spending increased by 4.5 percent. State and local government spending increased by 3.1 percent.

The slowing US and global economies depressed both imports and exports, but the drop in exports was larger. Real exports of goods and services declined in every quarter of 2001, for a total of US$61.1 billion (1996 dollars), mostly because of a decline in exports of capital goods – especially high-technology goods – a result of the global economic slowdown. Real imports also declined in every quarter in 2001, leaving imports US$44.0 billion below the level recorded in 2000. In the first half of 2002, however, both imports and exports have increased again. Imports had their strongest increase on record in the second quarter.

INFLATION

Overall inflation slowed considerably in 2001. The consumer price index (CPI) rose only 1.6 percent for the year, compared to 3.4 percent in 2000. Consumer energy prices tumbled 13.0 percent, in contrast to energy inflation of 14.2 percent in 2000. The core CPI, which excludes volatile food and energy prices, increased 2.7 percent, a bit above the 2.3 percent average rate over the past four years. Broader price measures also remained low – the chain-weighed price indexes for GDP and PCE increased 2.4 and 2.0 percent respectively on a year-over-year basis. As of July, inflation has fallen further, to 1.5 percent, while core CPI inflation has fallen to 2.2 percent.

EMPLOYMENT

Private nonfarm payrolls dropped by roughly 1.9 million in 2001, reflecting the weak economy. The bulk of the decline occurred in manufacturing, especially in durable goods-producing industries, where almost 1 million jobs were shed in 2001. In addition, employment in help supply services, which provide labor to other industries, fell by about 650,000 jobs. However, the health services industry logged strong increases in 2001. Service employment has been hurt by cutbacks in business travel and tourism, which have adversely affected employment in air transportation and travel-related services such as travel agencies, hotels, and amusements and entertainment.

The unemployment rate went from 4.0 percent in December 2000 to 5.8 percent in December 2001, still below the average rate for the past 20 years of 6.2 percent. The average duration of unemployment rose by 2 weeks during 2001, ending the year at 14.5 weeks. More than half of this increase occurred in the last 3 months of 2001. By July 2002, the unemployment rate had inched up to 5.9 percent, and the average duration of unemployment had increased to 16.4 weeks.

The labor force participation rate (the share of the working-age population either working or seeking work) fell 0.4 percentage point over the year. Labor force participation has hovered near 67 percent since 1997, after rising from near 60 percent in 1970. The average number of discouraged and displaced workers has risen nearly 30 percent in 2001, and has continued to rise in the first half 2002.

Despite the economic slowdown, non-farm business sector productivity grew at 1.1 percent in 2001. Although below the 2.5 percent average rate recorded during 1995–2000, productivity growth has been remarkably strong for this stage of the business cycle. Unit labor costs increased 1.6 percent while real wages were unchanged.

TRADE ACCOUNTS

The current account deficit shrank to US$393 billion in 2001, or 3.9 percent of GDP, from 4.2 percent of GDP in 2000. The deficit on goods and services was US$358 billion, as a merchandise trade deficit of US$427 billion was partially offset by a services surplus of US$69 billion.

GROSS EXTERNAL DEBT

Foreign holdings of US Treasury securities increased a modest 2.6 percent in 2001 to US$1.04 trillion. After declining earlier in the year, foreign holdings shot up 22.3 percent (at an annual rate) in the fourth quarter, reflecting the flight-to-quality shock after the September 11 terrorist attacks. Foreign holdings have continued to increase by 4.1 percent in the first half of 2002.

EXCHANGE RATE

The US dollar continued to appreciate steadily in real terms against other major currencies in 2001. The most notable gains came in the second and fourth quarters. In the first eight months of 2002, the dollar has given up these gains, and in real terms against other major currencies it is back to the level it was approximately in the fourth quarter of 2000. In nominal terms against other major currencies, the dollar had its largest appreciation against the yen, roughly 13 percent in 2001. In the first eight months of 2002, the dollar has given up most of these gains, depreciating 9.0 percent against the yen.

FISCAL POLICY

The federal government ran the second largest surplus in history (on a unified budget basis) for fiscal year 2001 of US$127 billion, compared with US$237 billion in 2000. Because of the recession, tax cuts to stimulate the economy (elaborated below), and the war on terrorism, deficits are currently projected for fiscal years 2002–2004, although they are expected to decline from US$165 billion in FY2002 to US$48 billion in FY2004.

MONETARY POLICY

In 2001, the Federal Reserve pursued the most aggressive monetary policy in its history. With clear evidence that economic activity was sharply decelerating at the end of 2000, and that inflation pressures were minimal, the Fed reduced rates in rapid succession seven times by mid-August, from 6.50 percent to 3.50 percent. After September 11, the Fed provided unprecedented liquidity to the markets, and further cut the target rate four more times (for a total of eleven rate cuts) down to 1.75 percent, the lowest rate in more than 40 years, bringing the real target rate close to zero. Through the first eight months of 2002, the Fed has kept the target rate steady at 1.75 percent.

STRUCTURAL CHANGES AND REFORMS

The Economic Growth and Tax Relief Reconciliation Act (EGTRRA) was passed in May 2001, reducing marginal tax rates and improving incentives for saving, investment and capital accumulation. In a series of income tax reductions to be phased in by 2006, the top marginal rate will be reduced from 39.6 percent to 35 percent, while the other rate brackets of 36, 31, and 28 percent will each be dropped 3 percentage points. A new 10 percent rate bracket will be carved out of the 15 percent rate bracket. Higher retirement contribution limits will be phased in over time. In 2010, the estate tax will be eliminated. As well, child tax credits, adoption credits, and contribution limits for education savings accounts are increased.

FOREIGN DIRECT INVESTMENT

In 2001, US net private direct investment abroad was US$128 billion down from US$178 billion in 2000. Foreign direct investment into the United States also fell sharply, from US$308 billion in 2000 to US$131 billion – the largest percentage decrease in 30 years, attributable to the global slowdown.

INTEREST RATES

The aggressive rate cutting by the Federal Reserve led to further declines in short-term and long-term market interest rates. At the end of 2001, short-term market interest rates were below 2.0 percent. The 10-year Treasury yield was 5.2 percent, and 30-year conventional mortgage rates averaged 7.2 percent.

EQUITY MARKETS

Stock markets continued to decline for the year. The S&P 500 ended the year down 13 percent, although it finished 2001 up 19 percent from its post-September 11 low. The NASDAQ fell 21 percent for the year, although it posted an impressive 30 percent gain in the fourth quarter. Stocks have continued to plummet this year, with the S&P 500 down more than 20 percent and the NASDAQ down 33 percent through August 2002.

MEDIUM-TERM OUTLOOK

Looking forward, the economy is picking up momentum to sustain the fledgling recovery. Economic activity grew impressively in the first quarter of 2002 as real GDP logged its best quarterly growth rate since 1999, up 5.0 percent at an annual rate. The sharp slowing in the pace of inventory liquidation accounted for 2.6 percentage points of the growth rate—leaving final sales rising only 2.4 percent for the quarter. Second quarter growth was more modest, at 1.1 percent.

Private forecasters expect business investment to fuel the next leg of the recovery in the next several quarters. To date, however, evidence of a turnaround in investment has been mixed as various sectors of the economy still face lingering effects of the soft 2001 economy. Still, the financial foundations for investment remain positive: real short-term rates are low, there was a recent strong showing in productivity performance, and the expensing provisions in the March 2002 Job Creation and Worker Assistance Act. Business investment in equipment and software grew at 2.9 percent at an annual rate in the second quarter of 2002, after six straight quarters of decline.

As of July, the US Administration projects a growth rate of 2.6 percent this year, in line with private sector forecasters. In addition, private forecasters are predicting a solid growth rate of 3.2 percent in 2003, in line with the Administration's forecast of 3.6 percent.

The Administration forecasts real GDP growth to average 3.1 percent annually during the 11 years through 2012. The growth rate of the economy over the long run is determined primarily by the growth rates of its supply-side components, which include population, labor force participation, productivity and the workweek. Nonfarm labor productivity is expected to grow at 2.1 per year on average, and the labor force is expected to grow at 1.0 percent.

Annex I

UNITED STATES: OVERALL ECONOMIC PERFORMANCE

	1996	1997	1998	1999	2000	2001
GDP and Major Components (percent change, year over year - earlier period, except as noted)						
Nominal GDP (level in billion US$)	7,813.2	8,318.4	8,781.5	9,274.3	9,824.7	10,082.2
Real GDP	3.6	4.4	4.3	4.1	3.8	0.3
Consumption	2.7	3.2	4.2	4.6	4.1	2.7
Private Consumption	3.2	3.6	4.8	4.9	4.3	2.5
Government Consumption	0.5	1.8	1.4	2.9	2.8	3.7
Investment	8.1	10.9	10.7	6.8	5.6	-8.6
Private Investment	9.0	12.1	11.8	6.6	6.2	-10.7
Government Investment	3.9	5.0	4.5	8.2	2.3	3.3
Exports of Goods and Services	8.2	12.3	2.1	3.4	9.7	-5.4
Imports of Goods and Services	8.6	13.7	11.8	10.9	13.2	-2.9
Fiscal and External Balances (percent of GDP)						
Budget Balance	-1.5	-0.3	1.0	1.6	2.3	0.4
Merchandise Trade Balance	-2.4	-2.4	-2.8	-3.7	-4.6	-4.2
Current Account Balance	-1.5	-1.5	-2.3	-3.2	-4.2	-3.9
Financial Account Balance	1.8	2.6	0.7	2.9	4.2	3.8
Economic Indicator (percent change, year over year - earlier period, except as noted)						
GDP Deflator	1.9	2.0	1.2	1.4	2.1	2.4
CPI (12 months ending in December)	3.3	1.7	1.6	2.7	3.4	1.6
M2	4.8	4.9	7.3	7.5	6.1	8.7
Short-term Interest Rate (percent)[1]	5.15	5.20	4.91	4.78	6.00	3.47
Real Effective Exchange Rate (level, 1997=100)[2]	92.1	100.0	105.5	104.8	111.4	119.5
Unemployment Rate (percent)	5.4	4.9	4.5	4.2	4.0	4.8
Population (millions)	269.4	272.6	275.9	279.0	282.1	284.8

Notes: [1] Short-term interest rate refers to average 3-Month Treasury Bill Market Bid Yield at Constant Maturity (%)
[2] Real trade-weighted exchange value of the US dollar vs. major currencies

Annex II

UNITED STATES: FORECAST SUMMARY (percent change from previous year)

	2002					2003				
	Official	**IMF**	**Link**	**ADB**	**OECD**	**Official**	**IMF**	**Link**	**ADB**	**OECD**
Real GDP	2.6	2.5	2.4	N.A.	2.5	3.6	3.3	3.4	N.A.	3.5
Exports	N.A.	-2.6	-2.9	N.A.	-2.8	N.A.	6.1	4.2	N.A.	7.3
Imports	N.A.	2.6	2.4	N.A.	2.3	N.A.	8.4	7.2	N.A.	8.8
CPI	1.7	1.4	2.0	N.A.	1.8	2.5	2.4	2.5	N.A.	2.4

Sources:
Official: Mid-Session Review, FY 2003 Budget, Office of Management and Budget, July 2002
IMF: Article IV Consultation, July 2002
Link: UN Global Economic Outlook, April 2002
OECD: OECD Economic Outlook, June 2002

Annex III

UNITED STATES: MEDIUM-TERM TREND FORECAST (percent)

	Period*
Real GDP	3.1
CPI	2.3

Source: 2003 Budget

*Average 2002-2012

VIET NAM

During implementation of "*The strategy on stabilization and socio-economic development up to the year of 2000*", the Viet Nam economy has gained significant achievements. First of all, the inflation rate has declined from 67 percent in 1990 to nearly 0 percent in 1999–2000. Secondly, the average economic growth rate was 7.6 percent per annum during 1991–2000 and 7.0 percent in 1996–2000 years despite the financial crisis in the region. It facilitates the improvement of the population's living standards. Poverty reduction also gained many achievements included a doubling of the average monthly income per capita from 1994 to 1999. In addition, the gap between the lowest income quintile and the highest one increase from 6.5 times in 1994 increased to 8.9 times in 1999.

In 2001, the economy has recovered with growth rate of 6.8 percent after it grew only 4.8 percent in 1999 and 6.7 percent in 2000. It was one of the highest growth rates in the region. In 2002, because of new difficulties in international trade, especially impacts after the September 11 events in America, foreign direct investment (FDI) has decreased. However, in 2002 and 2003, a more optimistic economic situation is expected in the agriculture, the domestic market and services sectors. Meanwhile the industry sector continues to grow at a rate of 14.0 percent per year. Manufacturing increased by 9.2 percent in 2001 and the same rate is estimated in 2002, while construction recorded a robust performance of 13.0 percent as result of the implementation of infrastructure projects and urban development projects in major cities.

REAL GROSS DOMESTIC PRODUCT

In 1999, under the financial crisis situation in the region, the GDP growth rate of Viet Nam's economy slumped to the lowest in the last decade, only 4.8 percent. The average rate during 1996–2000 was about 7 percent per annum. There had been declining tendency in the economic growth during 1995 to 1999, growth being: 9.5 percent in 1995, 9.3 percent in 1996, 8.2 percent in 1997, 5.8 percent in 1998 and 4.8 percent in 1999. However, there are a signs of recovery, as the growth rate increased from 4.8 percent in 1999 to 6.7 percent in 2000 and 6.8 percent in 2001. A higher growth rate can be achieved this year and in coming years.

Agriculture is an important economic sector, employing 62 percent of the labor force and producing 23.6 percent of GDP in the year 2001. Value-added of agriculture production increased by 4.8 percent in 1999 to 6.8 percent in 2000 and 2001. In 2002 a growth rate of nearly 4.0 percent of value added in agriculture sector can be achieved. Based on a structural adjustment in cultivation, food production accounts for 63 percent in 1996 and less than 60 percent in 2001 with greater food security. Rice exports remained steady at about 3.7 million tons in 2001 and about more 3 million tons of rice export this year. Fishery increased rapidly at growth rate of over 5 percent and fishery export contributed US$2 billion to GDP in 2001.

The industry and construction sectors accounted for 28 percent of GDP in 1995 and this proportion increased to 38 percent in 2001. However, this sector is facing the difficulties of low efficiency and competitiveness. Industrial gross output increased by 14.2 percent in 2001, of which the public sector increased by 15.3 percent, the local private sector increased by 20.3 percent and the foreign invested sector grew slowly at only about 12.1 percent due to the international market. In 2001, the foreign invested sector accounted for 35.0 percent of industrial production and also contributed to improvements in efficiency and competitiveness.

Total development investment in 2001 increased slightly, VN$163500 billion or US$11 billion, from VN$145333 billion in 2000 (more US$10 billion). Total development investment increased by

12.2 percent per year in 2001, of which public sector investment increased by 13.4 percent (accounting for 58 percent), the non-public sector increased by 11 percent (accounting for 23.6 percent) and FDI by 10.1 percent (accounting for 18.3 percent). FDI inflow has been increasing during past few years with some big projects such as gas pipeline, power plants and industrial factories.

Service sector growth rates also increased over the last two years from 2.2 percent in 1999 to 5.3 percent in 2000 and 6.1 percent in 2001. In the first six months of 2002, service sector growth increased only 5.9 percent due to the international market. However, retail sales of goods and services in the domestic sector reached VN$238,123 billion in 2001, an increase of 8 percent and in the first six months of 2002, it increased by 12.5 percent. The main reason was the low inflation rate of 2.9 percent in the factor market and good domestic policy.

Major features of Viet Nam’s economic performance in the first half of 2002 are described below:

- It is estimated that GDP grew at 6.7 percent, of which value-added the agriculture sector increased by 4.0 percent, the industry sector by 9.4 percent and the service sector by 5.9 percent;
- Gross industry value increased by 13.9 percent. Non-public sector value increased rapidly by 20.0 percent per year in 2000–2001 and 19.1 percent in the first half of 2002 after the implementation of a new law on “business”. Public sector value increased more than 11 percent, contributing about 40 percent of gross industrial value and FDI contributed 36.1 percent.
- Total investment increased by between 11 and 12 percent per year in 2000–2001, contributing 33.7 percent of GDP and it still continues to increase. Many big and important projects such as power plants, transportation system, bridges, telecommunication, etc, were developed.
- The transportation sector increased by less than 6 percent, even though the railway had many improvements.
- Local market and tourism is developing quickly with growth rate of over 12 percent.

Alongside these achievements, there were many difficulties such as slow growth rate and weak competitiveness in the service sector. International trade fell to –5.9 percent, but exports from FDI projects increased to 14.5 percent.

INFLATION

Inflation in terms of the domestic CPI was low with a rate of 0.1 percent in 1999, –0.6 percent in 2000 and 0.8 percent in 2001. In the first six months of 2002, the consumer price index increased by 2.9 percent compared to last year:

	2001 (percent)	**First half of 2002 (percent)**
TOTAL	0.8	2.9
- Foods and foodstuff	-1.7	-5.7
- Beverage	-1.1	-1.3
- Garment, shoes and sandals	0.8	0.5
- Housing and building materials	0.8	0.7
- Domestic tolls and equipment	0.9	0.5
- Pharmacy	-0.2	0.4
- Transport, post and communications	-4.7	0.0
- Education	3.6	-0.8
- Culture and sports	0.2	-0.3
- Other services	1.4	0.9
- Gold	5.0	16.0
- USD	3.8	1.3

POPULATION, LABOR FORCE AND EMPLOYMENT

During the last ten years, Viet Nam has achieved significant progress in reducing the growth rate with average annual growth rate of only 1.7 percent. The population growth rate in 2001 was 1.35 percent.

Poverty by new food security standards now affects for only 16 percent of population and will affect to less than 10 percent by the year 2005. However, living standards in mountain areas and ethnic groups were very low.

The total employed labor force in the economy in 2000 was 36.7 million persons with 3.5 million persons employed in the public sector. The number of urban unemployed and rural underemployed is increasing due to reductions in the growth rates of production and businesses and the entry of more than one million youths into the labor force last year.

According to a recent survey, the unemployed and under-employed situation is described as follows:

- The unemployment rate in urban areas was 6.44 percent in 2000 and 6.28 percent in 2001. In the Red River Delta was 7.34 percent in 2000 and 7.07 percent in 2001.
- Rural under-employment is evaluated through time-use rate is about 26.1 percent in 2000 and 25.6 percent in 2001. The rates reflect the effects of low investment in rural areas.

EXPORT AND IMPORT

Exports in 2000 were US$14.5 billion and in 2001 were US$15.0 billion, while the value of exports in the first half of 2002 was US$7.25 billion or growth rate in the first half of 2002 was –5.9 percent, with exports from the FDI sector increasing by 14.8 percent and from local areas decreasing by 6.8 percent. The main elements of the decrease in exports were that the crude oil export value was US$1.5 billion (down by 16.7 percent) and other export volume were down: in fishery was US$816 million (down 2.4 percent); electronics to US$226 million (down 28.4 percent): coffee to US$137 million (down 45.6 percent). At same time, prices of some goods decreased.

Imports in the first half of 2002 were US$8.4 billion, increase by 8.1 percent.

Exports for 2002 will increase slightly and reach about US$16 billion. Imports are estimated to be a total of US$17 billion, which means the trade balance will be US$1 billion.

FOREIGN INVESTMENT

By the end of June 2002, Viet Nam had 3348 effective FDI projects with total capital of US$38.58 billion. Disbursement reached more US$20 billion, which contributed significantly to improvements in the efficiency and competitiveness of the economy. In the industrial sector, FDI has over 2100 projects with total capital of more than US$20 billion. At present, FDI projects produce about 13 percent of GDP and 36 percent of gross industrial production output and employ 450,000 workers. However, from 1997, FDI inflows to Viet Nam decreased since Viet Nam's main FDI partners come from East Asia, which was suffering from the financial crisis. FDI inflows in the first half of 2002 fell by 55 percent to less than USD 500 million. In 2000, the National Assembly approved the New Revised Law on Foreign Direct Investment, which has many improved articles with improvements relating to:

- foreign currency;
- taxes and import duty;
- land-use rights and mortgage of land-use rights;
- management of joint venture companies; and
- approvals and licensing.

In July 2000, the Securities Trading Center was opened in Ho Chi Minh City and there will be a similar center in Hanoi. After two years of trading, we have gained much experience in this new market.

Through the conferences, donors have committed US$20 billion. The three largest donors, Japan, the World Bank and the Asian Development Bank, contributed 70 percent of the total capital committed. Disbursement from the Overseas Development Agency (ODA) has improved, total disbursement during recent years being US$10 billion. ODA projects focus on the improvement of legal frameworks, human resource training, environmental protection, improvement of economic and social infrastructure and the promotion of economic sector development.

EXCHANGE RATE

In the context of devaluation of regional currencies, Viet Nam has to make adjustments. In the last few years, the realignment resulted in a depreciated Vietnamese dollar (VN$) and now the VN$ has stablised around 15000 VN$ per US$. The government of Viet Nam continues to implement foreign exchange controls, export-import controls and controls of commercial credit for imports, in order to avoid debt shocks. The government also controls foreign borrowings more strictly, including government borrowings and private borrowings, because of their relationship to the debt servicing capacity of the country. At present, as a result of negotiations at the Paris Club, London Club, with Russia, and strict control of borrowings and debt serviceing, the total debt is about US$12 billion equivalent.

POLICY ADJUSTMENT

During 1997 to 2002, the government issued many policy measures in order to stabilize the economy and stop the process of economic recession.

Facing a continuous decline in growth rates, the government has issued a series of new policies in order to bring about internal forces and to effectively mobilize foreign resources. They aim to:

- Focus on agricultural and rural development, where 75 percent of Viet Nam population lives and one fourth of GDP is produced; and at the same time to favorably facilitate all economic sectors' investment into production and business development. From 2000 with business law, domestic investment from private sector has been increasing;

- Expand markets by promoting demand in domestic markets and improving export efficiency—and by expanding to new markets. Currently, exports take 45 percent of GDP and their share of international trade with GDP is 100 percent;

- Address urgent needs in financial, monetary, and banking sectors in order to improve the effectiveness of the banking activities;

- Reorganize and renovate of the targets for state-owned enterprises (SOEs): including a reduction in the number of SOEs by 3000 units in 2003 and by 2000 units in 2005.

- Implement poverty alleviation programs and job generation. National program for poverty people with 1.5 billion USD is implementing. In May 2002, Prime Minister's office has approved *"The comprehensive poverty reduction and growth strategy" (CPRGS) for 2010;* and

- Continue to implement administration reform and to improve capacity in governance and execution.

SHORT-TERM OUTLOOK

Economic growth in 2002 is expected to be between 6.5 percent and 7.0 percent, and for 2001–2005 at about 7.0 percent, of which:

	2002 (percent)	2001-2005 (percent)
GDP	7.0	7.0 or more
Agriculture	3.5-4.0	3.5 or more
Industry and construction	9.0-9.5	9.5 or more
Service	6.0-6.5	7.0 or more
And industrial output	14.0	13.0 or more
Agricultural output	4.0-4.5	4.0 or more

Major obstacles to high growth rates include both subjective and objective reasons.

The regional economic recovery is complicated and will take place slowly. The prices of some Vietnamese export products are continuing to decline. In addition, demand by international and regional markets is increasing, but competitiveness will be stronger. China is now a member of the WTO and in 2002–2003 the Asean Free Trade Agreement (AFTA) was completed in six ASEAN economies; Singapore, Brunei, Indonesia, Malaysia, the Philippines and Thailand. It required Viet Nam to implement the following objectives:

- Promote rapid and sustainable economic growth coupled with attainment of social progress and equity;
- Create an equal business environment for all types of enterprises from all economic sectors; and
- Continue with structural reforms to bring about a transformation of the nation's economic structure, and SOEs reform.

The lower fiscal deficit earlier projected in 2001 gives room for implementing SOE and banking reform. The government also took steps to strengthen expenditure management. In September 2001, the Master Plan of Public Administration Reform for 2001–2010, which includes suggestions for public finance reform, was approved by the government. The government initiated, also in March 2001, a three-year SOE reform framework that provides for the equitation, liquidation and merger of around 1,800 small and medium-sized SOEs. Significant progress was made in trade reform in 2001 and 2002.

At the same time, however, efficiency and the competitiveness of Vietnamese goods are still low, and the prices of some commodities produced in Viet Nam are double those of imported goods. Meanwhile, during the process of implementing of commitments necessary for AFTA integration, from now to 2006 Viet Nam has to reduce tariffs to between 0 and 5.0 percent, which makes improving competitiveness even more difficult. Viet Nam is now participating in the ASEAN competitiveness study with the aim of improving the economy. A bilateral trade agreement between Viet Nam and America was approved at the end of 2001 and Viet Nam has now started toward the goal of accession to the World Trade Organisation by 2004.

ANNEX 1

VIET NAM: OVERALL ECONOMIC PERFORMANCE

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Nominal GDP (billion VN$)	228891	272037	313624	361016	399942	441646	484493	565958	635000
Exchange rate(VN$/US$)	11100	11500	12938	13980	14000	14280	14565	15500	16000
Nominal GDP(billion US$)	20.62	23.655	24.24	25.824	28.567	30.927	33.264	36.513	39.7
Real GDP Growth rate (percent)	9.5	9.3	8.2	5.8	4.8	6.8	6.8	7.0	7.5
GDP per capita(US$/per)	287	323	326	342	372	398	422	458	490
Population (Millions)	71.962	73.16	74.358	75.556	76.597	77635	78686	79700	80800
Revenue of State Budget	53374	62387	65352	73000	78000	91000	101.4	105.2	125
Revenue and grants (percent of GDP)	23.0	23.0	21.0	20.0	20.0	21.0	21.0	20.5	21.0
Expenditure of State Budget	62679	70539	78057	80820	82500	103000	115000	133.9	145000
Deficit (percent of GDP)		-0.2	-1.7	-0.1	-1.6	-2.8	-2.9	-2.5	-2.0
Debt Service Ratio					12.8	11.2	10.2	9.0	8.0
CPI	12.7	4.5	3.6	9.2	0.1	-0.6	0.8	4.0	4.5

Annex II

VIET NAM: FORECAST FOR 2002-2003

	Official	IMF	ADB	WB
GDP growth rate 2002	7.0	5.2	6.2	5.3
GDP growth rate 2003	7.5		6.8	

Annex III

VIET NAM: MEDIUM-TERM FORECAST 2003-2005

Real GDP	7.0-7.5
CPI	3.0-4.0

APPENDIX AIII

ACRONYMS

APEC ECONOMIC OUTLOOK 2002: ACRONYMS

ADB	Asian Development Bank
ABC	Agricultural Bank of China
AFTA	ASEAN Free Trade Area
AIM	Amanah Ikhtiar Malaysia
APEC	Asia-Pacific Economic Cooperation
ARMS	APEC Actions Report Monitoring Systems
B2B	Business-to-business
B2C	Business-to-consumer
BAAC	Bank for Agriculture and Agricultural Cooperatives
BCA	Bank Central Asia
BIR	Bureau of Internal Revenue
BNM	Bank Negara Malaysia
BOC	Bureau of Customs
BoP	Balance of Payments
BoT	Bank of Thailand
BOT	Build-Operate-Transfer
BPIMB	Bank Pembamguan dan Infrastruktur Malaysia Berhad [Malaysia]
BRI	Bank Rakyat Indonesia
BSP	Bangko Sentral ng Pilipinas
BTA	Bilateral Trade Agreement
CAD	Current Account Deficit
CDA	Cooperative Development Authority [Philippines]
CDIC	Central Deposit Insurance Corporation [Chinese Taipei]
CGAP	Consultative Group to Assist the Poor
CGC	Credit Guarantee Corporation [Malaysia]
CNBV	National Banking and Securities Commission
CODI	Community Organization Development Institution [Thailand]
COFIDE	Corporación Financiera de Desarrollo [Peru]
COPEME	Proyecto Iniciativa Microfinanza (Microfinance Initiative Project) [Peru]
CORFO	Manufacturing Promotional Corporation [Chile]
CPI	Consumer Price Index
CTF	Common Trust Funds
DIF	Deposit Insurance Fund [Peru]
DPP	Demonstration Partnership Program [United States]
EC	Economic Committee
EDB	Economic Development Board
EDPYME	Entidad de Desarrollo para la Pequeña y Microempresa [small business and micro-enterprise development institutions]
EGTRRA	Economic Growth and Tax Relief Reconciliation Act [United States]
EMA	Energy Market Authority of Singapore
EPF	Employees Provident Fund
EU	European Union
FAs	Fishermen’s Associations [Chinese Taipei]
FDI	Foreign Direct Investment
FDIC	Federal Deposit Insurance Corporation [United States]

FECRECOOP	Federation of Savings and Loan Cooperatives [Federación de Cooperativas de Ahorro y Crédito] [Chile]
FENACREP	Federation of Savings and Loans Cooperatives [Peru]
FIU	Financial Intelligence Unit [Indonesia]
FOSIS	Solidarity and Social Investment Fund [Chile]
FTA	Free Trade Agreements
FY	Fiscal Year
G-7 / G8	Group of Seven // Group of Eight
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GDRs	Global Depository Receipts
GIR	Gross International Reserves
GNP	Gross National Product
GSB	Government Savings Bank
GVA	Gross Value-Added
HRD	Human Resources Development
IADB	Inter-American Development Bank
IBRA	Indonesian Bank Restructuring Agency
ICCC	Independent Consumer and Competition Commission [Papua New Guinea]
ICT	Information and Communication Technology
IGR	Intergenerational Report
ILO	International Labour Organisation
ILRs	Indicator Lending Rates
INDAP	Institute of Agricultural Development [Chile]
IPBC	Independent Public Business Commission [Papua New Guinea]
IPO	Initial Public Offering
IRC	Internal Revenue Commission [Papua New Guinea]
Irnet	World Council of Credit Unions, Incs' international remittance service
ITC	Information and communication technology
IWI	Import Weighted Index
JBIC	Japanese Bank for International Corporation
JITF	Jakarta Initiative Task Force
KAMCO	Korea Asset Management Corporation
KBE	Knowledge-based Economy
KBI	Knowledge-based Industry
KBS	Knowledge-intensive Business Services
KDIC	Korea Deposit Insurance Corporation
KFR	Kina Facility Rate [Papua New Guinea]
KLSE	Kuala Lumpur Stock Exchange
KSI	KBE Status Indicator
LDKP	Rural Fund and Credit Institutions
LFPR	Labour Force Participation Rate
LLDT	The Lik Lik Dinau Abitore Trust [Papua New Guinea]
LMI	Low- and Moderate- Income
LNG	Liquid Natural Gas

M&A	Mergers and Acquisitions
M&E	Machinery and Equipment
M0	Cash In Circulation
M1	Narrow Money Supply
M2	Broad Money Supply
MARA	Majlis Amanah Rakya [Malaysia]
MAS	Monetary Authority of Singapore
MBIs	Microbanking Institutions
MED	Micro-Enterprise Development
MRDC	Mineral Resources Development Company
NAFTA	North American Free Trade Agreement
NBSC	National Banking and Securities Commission [Mexico]
NCC	National Credit Council [Philippines]
NCUA	National Credit Union Administration [United States]
NCUSIF	National Credit Union Share Insurance [United States]
NESDB	National Economic and Social Development Board [Thailand]
NFPE	Non-financial Public Enterprise
NGOs	Non-Governmental Organizations
NID	Net Income Deficit
NPLs	Non-Performing Loans
NSRDP	North Simbu Rural Development Project [Papua New Guinea]
NWCP	National Women Credit Program [Papua New Guinea]
OCR	Official Cash Rate
ODA	Overseas Development Agency
OECD	Organisation for Economic Cooperation and Development
OFW	Overseas Filipino Workers
OPEC	Organisation of Petroleum Exporting Countries
Pahnal	Patronato del Ahorro Naciona [Mexico]
PBC	People’s Bank of China
PC	Personal Computer
PCE	Personal Consumption Expenditure
PDTF	People’s Development Trust Fund [Philippines]
PHBK	Pengembangan Hubungan Bank dengan Kelompok Swadaya Masyarakat
PIDC	Philippine Deposit Insurance Corporation
PIU	A Survey of People’s Internet Usage in the Chinese Taipei Area
PKM	Proyek Kredit Mikro
PNGBC	Papua New Guinea Banking Corporation
PnK	Putim na Kisim [Papua New Guinea]
PPP	Purchasing Power Parities
PRONAFIDE	National Program to Finance Development
PRONAFIM	Programa Nacional de Financiamiento al Microempresario
PUT	Peoples Unit Trust [Papua New Guinea]
R&D	Research and Development
REER	Real Effective Exchange Rate
RI	Research Institutes
ROSCA	Rotating Savings and Credit Association

S&T	Science and Technology
SAFTA	South American Free Trade Agreement/Area
SAP	Structural Adjustment Program
SBA	Small Business Administration
SBFI	Superintendency of Banking and Financial Institutions [Chile]
SDI	Subsidy Dependence Index
SENCE	National Training and Employment Service [Chile]
SERCOTEC	Technical Cooperation Service [Chile]
SET	Stock Exchange of Thailand
SFI	Specialized Financial Institution
SIBOR	Singapore Interbank Offered Rate
SMBCGF	Small and Medium Business Credit Guarantee Fund [Chinese Taipei]
SMEs	Small and Medium Enterprises
SOC	System-on-a-chip
SOE	State-owned Enterprise
TAMC	Thai Asset Management Corporation
T-bill	Treasury Bill
TDA	Tasa de Desempleo Abierto
TNTS	The New Tax System [Australia]
TOFA	Trust And Other Fiduciary Liabilities
TRIS	Thai Rating and Information Service
UNESCO	United Nations Educational, Scientific and Cultural Organization
VAT	Value Added Tax
WCY	World Competitiveness Yearbook
WOCCU	World Council of Credit Unions
WTO	World Trade Organization