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ECONOMIC PERFORMANCE AND PROSPECTS
IN THE APEC REGION

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FOREWORD

Since its establishment by APEC Ministers in Jakarta in November 1994, the Economic Committee has undertaken a broad range of research and analysis in support of APEC's work both on trade and investment liberalization and facilitation and on economic and technical cooperation.

The annual *Economic Outlook* has become an important part of that work program. Not only has it has provided a review of economic developments and prospects in the region and in individual member economies, but also it has addressed topical structural issues that are key to understanding these developments and trends. In both respects, it provides an analytical foundation for policy-oriented work and discussions by APEC senior officials and other APEC fora.

The *1997 APEC Economic Outlook* is the third in the series of *Outlooks* by the Economic Committee. It has been prepared under the leadership of the Republic of Korea and more specifically by the Korea Institute for International Economic Policy (KIEP). This practice builds upon the tradition established in the Committee's first two years whereby individual APEC economies take on the responsibility for coordinating development of the document. The *1995 APEC Economic Outlook* (APEC Economic Committee, November 1995) was produced under the leadership of Japan's Economic Planning Agency while the *1996 APEC Economic Outlook* (APEC Economic Committee, November 1996) was produced with the United States Council of Economic Advisers taking overall responsibility.

The preparation of this year's *Outlook* has involved particular challenges. Economic developments in the region have been significantly affected by the currency instability that affected some APEC member economies. This major event, which is without precedent in this region, unfolded in the third quarter of 1997 during the final stages of preparation of the document. With the close cooperation of the APEC Finance Ministers' process, a review and brief analysis of these events has nevertheless been reflected in this document. However, the situation continues to unfold as the document goes to press; a full considered perspective will only be possible several months hence.

A second challenge has involved the structural analysis in this year's *Outlook*. The theme chosen --"open regionalism"-- has close links to three trade and investment-related analytical projects that have been finalized by the Economic Committee this year. These include *The Impact of Trade Liberalization in APEC*, for which Japan and Singapore took primary responsibility, a study that uses computable general equilibrium (CGE) model simulations to assess the impact of APEC's trade and investment liberalization and facilitation measures as set out in the Manila Action Plan for APEC (MAPA); *The Impact of Investment Liberalization in APEC,* the preparation of which was led by Chinese Taipei, a study which draws on member economy policy reviews and industry case studies to draw some general conclusions about the motivations for and efficacy of investment rule-making and liberalization; and *The Impact of*

Subregionalism on APEC, responsibility for which was also taken by Chinese Taipei, a study that examines in both theoretical and empirical terms the interaction between trade and investment liberalization on a subregional basis through agreements such as NAFTA, AFTA and CER as well as through informal "growth triangles," and more broadly-based liberalization through APEC and the WTO. The structural chapter of the *Outlook* attempts to pull these various strands of work together, including by providing some supporting evidence also drawn from CGE model simulations on comparative benefits of alternative approaches to APEC trade liberalization. It is intended that this body of work provide analytical support for APEC's continuing, high-priority work on trade and investment liberalization and facilitation.

As an institution that has been created at the dawn of the information age, APEC has pioneered a "virtual" mode of operation. It functions with a very small Secretariat and relies accordingly on the voluntary contributions of the time and energy of experts in member economies to carry out the large majority of its work.

In the case of the present study, particular thanks are due to Dr. Jong Nam Oh who chaired the APEC Economic Committee Task Force that developed this report as well as to Dr. Soogil Young, the newly-appointed and very active President of KIEP and his team of researchers, most particularly Dr. Sangkyom Kim, who developed successive drafts of the document for consideration by the Task Force. Thanks are also due to Tom Engle, Program Director at the APEC Secretariat, who has provided both logistical and technical support to the Economic Committee in this work and, in particular, taken responsibility for seeing the study through to publication; and to Dan Ciuriak, Coordinator, Asia Pacific Research at the Department of Foreign Affairs and International Trade in Canada, who has assisted me in my role as Chair of the Committee and taken particular responsibility for the final editing of the text.

John M. Curtis

Chair
APEC Economic Committee
Ottawa, November 1997

EXECUTIVE SUMMARY

In 1996, APEC member economies averaged 3.7 percent real growth, the highest annual growth rate since 1991. Strengthened growth in the region's two largest economies, the *United States* and *Japan,* led the way, but the other developed economies in the region also had solid results overall and the developing economies on both sides of the Pacific sustained high growth. A notable success during 1996 was the rebound from recession in *Mexico* and *Papua New Guinea,* which meant that all APEC members registered positive results for the year.

At the same time, the easing of inflationary pressures due to the combined effect of this more balanced growth region-wide and generally tight financial policies reduced the risk of overheating in the region as a whole, laying the basis for sustained expansion in 1997. However, widening current account deficits in some member economies, which were identified as a concern in the *1996 APEC Economic Outlook*, became increasingly an issue over the course of the year, particularly in the context of an unexpectedly sharp slowdown in export growth.

In 1997, the APEC region has witnessed more variability in growth than it did in 1996, with abrupt shifts of growth momentum within the region from quarter to quarter and from economy to economy. This situation has reflected a combination of the normal progression of some economies through their business cycles, the impact of singular events such as Japan's consumption tax increase in April, and the exchange and financial market instability of the second half of the year. Nonetheless, the overall growth expected in the APEC region in 1997 of 3.4 percent is only modestly slower than the 3.7 percent of 1996 and indeed equal to the growth rate recorded in the boom of 1994.

On balance, the region is expected to sustain its expansion into 1998, albeit at a somewhat more moderate rate of 3.1 percent. This reflects continued low interest rates and very little evident inflationary pressure in the region as a whole, although the impact of the currency instability could have some impact on inflation in some economies in the near term.

The United States is expected to see growth moderate from the very strong 3.7 percent anticipated in 1997 to the mid-2 percent range in 1998; however, this should be largely offset from a regional perspective by the rebound in growth expected in Japan as implementation of structural economic reforms, including deregulation, supports recovery in that economy. The other developed economies in the region, *Australia, New Zealand* and particularly *Canada* are all well positioned with solid fundamentals to sustain growth into 1998 and beyond, while the newly industrialized economies -- *Hong Kong, China; Korea; Singapore;* and *Chinese Taipei* -- as well as *Chile* appear to be poised for somewhat stronger growth, having passed the low point of their respective business cycles in 1996 or early 1997.

Among the developing economies, *China* is expected to have the highest growth in 1998 and into the medium term. As regards the APEC developing economies in Southeast Asia, while they have seen their growth prospects dampened in the short term by the recent exchange and equity market instability, their fundamentally bright long-term growth prospects have not been altered. Mexico and Papua New Guinea are expected to sustain their respective recoveries over the next several years.

In terms of specific elements of the outlook, the sustained expansion in the APEC region over a period of years has been an important factor in improving conditions for job growth and reducing unemployment rates. In this respect, the labor market situation in the region has remained better than elsewhere in the world.

With respect to trade, APEC as a whole has, over the past decade, experienced rapid growth, raising its share of world trade to 50.6 percent in 1996, a gain of more than 7 percent over this period. In 1996, however, notwithstanding the overall acceleration of growth in the APEC region, export growth slowed sharply to 4.6 percent, partly due to last year's semiconductor price slump, which led to a sharp terms-of-trade deterioration for many APEC member economies. With respect to investment, the APEC region again witnessed large flows of FDI in 1996, with China and the United States continuing to be major destinations.

However, external imbalances continue to be an issue in the region. In 1996, eleven APEC member economies evidenced current account deficits while seven economies had surpluses. In total, the region had a net deficit approaching US$120 billion or about 0.75 percent of the total GDP of member economies. Amongst the individual member economies, eight had deficits exceeding 3 percent of GDP, including six above 4 percent of GDP.

In principle, current account deficits need not be a problem, particularly in economies that are growing rapidly. If the capital inflows needed to finance deficits are in fact underwriting an expansion in the productive capacity of an economy, current account deficits need not be associated with an increase in the difficulty of servicing foreign debt. This is particularly true if the capital flows are long-term in nature. However, if deficits in current transactions represent unproductive investments or consumption, the consequent build-up in foreign debt can create problems for an economy. These problems can be exacerbated if the debts are predominantly short-term in nature, as creditors become unwilling to roll over the loans. Moreover, if the banking sector is under stress or if prudential supervision is weak, problems for the domestic economy can be made worse. In these cases, a period of consolidation and slower growth may be necessary to restore stability.

In 1997, a number of Southeast Asian economies that had been growing rapidly and maintaining current account deficits experienced instability. Many of these economies that had maintained fixed or managed floating exchange rates moved to a much more flexible exchange rate system. Weaknesses in many of the currencies in the region have been accompanied by volatility and large declines in regional stock markets. The instability emerged first in Thailand and then spread to several neighboring economies, notably Indonesia, Malaysia, and the Philippines, reflecting spillover effects, and was exacerbated by speculative pressures that doubtless contributed to the volatility in foreign exchange and equity markets. This experience illustrates the increased economic interdependence in the region and the mutual interest in maintaining financial stability.

The process of arresting and recovering from a period of instability can be speeded by the adoption of policies to address the underlying causes. In this regard, the instability has underscored the importance of sound macroeconomic policies and pointed clearly to the need to strengthen financial sectors and to increase transparency regarding economic and financial policies so that markets can differentiate between economies and their respective prospects. Moreover, to the extent that the currency turbulence has contributed to the resolution of unsustainable policy mixes and currency misalignments in the region, it may have even enhanced longer-term prospects, provided economies do not allow the recent depreciation to lead to a ratcheting up of inflation rates.

In addition to resolving these current issues, APEC member economies face structural challenges in areas such as underdeveloped financial markets, inadequate infrastructure, shortages of skilled workers and the need to open up domestic markets to greater competition. APEC member economies are undertaking reforms along these lines, including market deregulation, opening up of trade and capital markets, and reducing the size of the government sector through expenditure cuts and privatization. However, the pace of reforms may need to be accelerated to maintain the confidence of markets. In this respect, strengthening of economic and technical cooperation in areas such as human resource development and small and medium-sized enterprises to build capacities of member economies to implement reforms can contribute significantly to the improvement of economic fundamentals that is needed to pre-empt future instances of instability.

One key area for continued action to strengthen the long-term sustainable growth prospects for the region is continued trade and investment liberalization and facilitation. In the APEC region, the process of liberalizing markets has been sustained with a combination of progress towards the Bogor goals through ongoing improvements in member economies' Individual Action Plans, new initiatives such as the APEC Trade Ministers' call for early voluntary sectoral liberalization, global initiatives through the WTO, and the broadening and deepening of subregional trading arrangements such as NAFTA, AFTA and CER.

In a series of companion studies being published simultaneously with this *Outlook*, and in the structural chapter of this document, the Economic Committee has assessed the importance to the region of sustaining this record. *The Impact of Trade Liberalization in APEC* shows that, with implementation of the Manila Action Plan for APEC (MAPA), real GDP in APEC as a whole would increase by 0.4 percent (US$68.5 billion), and in the world by 0.2 percent (US$70 billion), on a sustained basis. Overall effects of MAPA on the global GDP are estimated to be about one-fourth of the impact of the Uruguay Round. Meanwhile, *The Impact of Investment Liberalization in APEC* documents the benefits of foreign direct investment and the impact of the gradual move in the region towards more open investment regimes. As the study notes, investment liberalization appears to be especially effective in the context of broader market-oriented economic reforms. Finally, the study on *The Impact of Subregionalism on APEC* concludes that the emergence of powerful integrative forces on a subregional basis, although strictly speaking inconsistent with the concept of open regionalism, has led to stronger trade creation than trade diversion and has helped generate momentum for global liberalization and thus, on balance, worked towards a more open global trading environment.

The structural chapter of this *Outlook* complements these studies by directly examining the benefits of open regionalism as adopted by APEC and specifically by comparing the estimated impact of APEC trade liberalization under unilateral liberalization to the likely impacts under alternative approaches such as preferential agreements, conditional liberalization with reciprocation by trade partners, and global trade liberalization. The results confirm that the most beneficial scenario for both APEC and the world involves the realization of global free trade. Under this scenario, the APEC region gains over US$67 billion in income while the world as a whole gains over US$168 billion. While this conclusion is not necessarily surprising, what is striking is the large opportunity cost to non-APEC economies should they choose to "free ride" on APEC trade liberalization measures rather than to reciprocate them. The results indicate that these costs could be as high as US$47 billion, suggesting that non-APEC economies could gain substantially by eliminating distortions in their import markets.

Another interesting finding is that the estimated benefits to APEC of unilateral (or unconditional) trade liberalization--over US$62 billion--are very similar to if not greater than the gains under the conditional liberalization scenarios. This suggests that while global free trade produces the most favorable results for APEC economies, unilateral liberalization by the APEC region captures the main part of the potential benefits for its member economies, regardless of whether non-APEC regions reciprocate or not. By contrast, the benefits to APEC emanating from a preferential trade area, while sizable, are smaller--about US$52 billion.

These quantitative results support the view that APEC's concept of open regionalism, with its core principle of non-discrimination, forms a sound basis for economic cooperation within APEC and for sustained and equitable long-term economic growth in the region.

Chapter 1
Economic Performance and Prospects in the APEC Region

1. Recent Developments and Prospects

Regional growth sustained but shocks change mix

In 1996, the average real GDP growth rate for all APEC member economies was recorded at 3.7 percent.[1] This was the highest annual growth rate since 1991, albeit 0.7 percentage points short of the 4.4 percent average during 1986-1990.

A key to the solid output growth for the area as a whole was the strengthened growth in the *United States* and *Japan.* Economic growth accelerated in both economies to 2.8 percent in the *United States* (0.8 percentage points higher than in 1995) and to 3.5 percent in *Japan* (2.1 percentage points higher than in 1995). Among other APEC developed economies, *Australia's* growth in 1996 remained in the mid-3 percent range while *New Zealand* experienced a moderation of growth to 2.7 percent from the rapid pace of the preceding several years. *Canada* also had lower annual average growth in 1996 but experienced a gain in growth momentum in the second half of the year.

The APEC developing economies in East Asia sustained in 1996 the rapid expansion that they had enjoyed since the mid-1980s, in the process of which several of these economies -- namely *Hong Kong, China* along with *Korea, Singapore, and Chinese Taipei* (the Newly Industrialized Economies or NIEs) -- emerged as advanced economies in terms of GDP per capita and other characteristics.[2]

The NIEs overall, however, witnessed a moderation in growth in 1996 from 7.3 percent in 1995 to 6.3 percent in 1996. Korea and Singapore slowed markedly, by 1.8 percentage points in each case. Chinese Taipei slowed marginally (by 0.3 percentage points) while Hong Kong, China grew modestly faster (by 0.4 percentage points). A key factor behind this overall slowdown in the NIEs was the downturn in the electronics industry in 1996.

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[1] Regional averages are calculated using 1994 nominal GDP weights.

[2] As noted by the IMF, these economies now share a number of characteristics of industrialized economies, including per capita income levels well within the range exhibited by the industrialized economies, well-developed financial markets and high degrees of financial intermediation, and diversified economic structures with relatively large and rapidly growing services sectors. IMF, *World Economic Outlook*, (IMF, May 1997).

Growth in China moderated to 9.7 percent in 1996 from the torrid, double-digit rates experienced in the preceding several years.[3] The soft landing has enhanced China's prospects for steady growth in the coming years.

The APEC developing economies in Southeast Asia, which also ranked amongst the world's fastest growing economies, continued to exceed the APEC average in 1996 at 7.2 percent. However, in contrast with the moderate upturn in developed economies, the high growth pattern that these economies had maintained began to show signs of change. More specifically, with the notable exception of *Brunei Darussalam* and the *Philippines,* growth in 1996 in these economies moderated by between 0.3 to 1.9 percentage points. In *Indonesia, Malaysia and Thailand,* this easing reflected weakening of export performance and tightening of domestic financial policies.

The Latin American APEC members experienced strong growth in 1996. *Mexico* rebounded dramatically from recession in 1995 to record 5.1 percent GDP growth. *Chile* saw growth moderate to a still-strong 7.2 percent from 8.5 percent in the preceding year.

Papua New Guinea also rebounded from recession in 1995 to record 1.9 percent growth in 1996 on the basis of preliminary estimates.

In 1997, the APEC region has witnessed more turbulence in growth than it did in 1996, with abrupt shifts of growth momentum within the region from quarter to quarter and from economy to economy. This has reflected a combination of the normal progression of some economies through their business cycles, the impact of singular events such as Japan's consumption tax increase in April, and the exchange and financial market instability of the second half of the year. Nonetheless, the overall growth expected in the APEC region in 1997 of 3.4 percent is only modestly slower than the 3.7 percent of 1996 and equal to the growth rate recorded in the boom of 1994. Moreover, world economic conditions are currently broadly favorable for sustained growth into 1998. This reflects continued low interest rates and very little evident inflationary pressure in major economies, along with the structural reforms undertaken by many economies to enhance the role of market forces.

In the *United States,* growth momentum strengthened in the first half of 1997, as GDP rose at a revised 4.9 percent annualized rate in the first quarter (on a quarter-over-quarter basis) and a more moderate 2.2 percent annualized rate in the second quarter. The preliminary estimate of third quarter growth of 3.5 percent supports the expectation that GDP will grow in the mid-3 percent range for 1997 as a whole. In 1998, growth is expected to moderate to the mid-2 percent range.

In *Japan,* growth trends in the first half of 1997 were strongly affected by the increase in the consumption tax from 3 percent to 5 percent on April 1, which induced a shift in consumer expenditure into the fourth quarter of 1996 and the first quarter of 1997 from

[3] This continued the sustained, rapid expansion of the past decade, which has raised China's GDP to over US$800 billion in 1996, amongst the ten largest in the world.

the second quarter. This boosted annualized growth to 5.7 percent in the first quarter (on a quarter-over-quarter basis), but contributed to a sharp decline in economic activity in the second quarter. A rebound in growth is expected for the second half of 1997, and the implementation of structural economic reforms, including deregulation, is expected to support the recovery thereafter.[4]

Growth has also strengthened in *Canada* in 1997, with annualized real GDP growth of 3.7 percent in the first quarter (on a quarter-over-quarter basis) and 4.9 percent in the second quarter; forecasters on average are now predicting real GDP growth of 3.7 percent for 1997 as a whole.

The developed economies in Oceania are well positioned for sustained growth. In *Australia*, the pace of expansion stepped up markedly in the first half of 1997 with real GDP growth averaging about 1 percent per quarter. For the year as a whole, and indeed for the period 1997-2000, 3.5 percent growth is expected, underpinned by the structural soundness of the household and corporate sectors. In *New Zealand*, the brisk rebound in the second quarter of 1997 appears to have marked a turning point in the cycle following a period of slowing growth in response to monetary restraint. It is anticipated that lower interest rates, increased government spending and an income tax reduction will spur growth to 4.2 percent for fiscal year 1998/1999, following a moderate expansion of 2.4 percent in fiscal year 1997/1998.

Among the Asian NIEs, trends in 1997 have so far been mixed. *Chinese Taipei* and *Hong Kong, China* have enjoyed firming growth due to a recovery of export growth and expansion of domestic demand. Growth strengthened to 6.1 percent year-over-year in Hong Kong, China in the first quarter of 1997 and to 6.6 per cent year-over-year in the first half in Chinese Taipei. In *Korea and Singapore,* the growth slowdown that started in 1996 appears to have bottomed out in the first quarter with the stronger second quarter results pointing to improving prospects over the course of this year. In Korea, second quarter growth accelerated to 6.3 percent from 5.4 percent in the first quarter; in Singapore, the recovery was even stronger to 7.8 percent in the second quarter from 4.1 percent in the first. Reflecting these trends and developments, the overall growth rate of the four NIEs in 1997 and 1998 is expected to remain on average close to the 6.3 percent achieved in 1996.

Among the Asian developing economies, *China* is expected to have the highest growth in the medium term. The ongoing efforts to curtail inflationary pressure by means of tight fiscal and monetary policy have laid the basis for sustained annual average GDP growth rate in the 9.0 percent range for the period 1997 to 2000. In the first three quarters of 1997, GDP grew by 9.0 percent (year-over-year), consistent with the expected medium-term growth path.

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[4] The IMF, in its September 1997 *World Economic Outlook*, reduced its forecast for Japan in 1997 to 1.1 percent for calendar year 1997, down from 2 1/4 percent in the May edition. These calendar year forecasts, which were the most recent available at the time of the preparation of this report, are not comparable to the official forecast by the Japanese government, which is based on fiscal years.

The near-term growth prospects for the APEC developing economies in Southeast Asia have been dampened by the recent exchange and financial market instability in some of these economies. However, as discussed below, the fundamentally bright long-term growth prospects for the region have not been altered. Growth in *Thailand* is expected to slow significantly in the short run but to recover subsequently to its longer-term trend. The *Philippines, Indonesia and Malaysia,* which have experienced spillover effects, are also likely to experience an economic slowdown in the near term.

In the Western Hemisphere, *Mexico* has sustained its recovery from the downturn in 1995 with five consecutive quarters of strong growth through the second quarter of 1997. Real GDP is expected to grow by 6.5 percent for 1997 as a whole and to average 5 percent over the medium term, with strong export performance and a pickup in foreign capital inflows. In *Chile*, a rebound in growth to 5.8 percent in the second quarter of 1997 marked a turning point from the the slowing trend of 1996 which had continued into the first quarter of 1997 and reflected the increase in interest rates to address the risk of overheating. For 1997 as a whole, real GDP is expected to expand by 6 percent.

Papua New Guinea also is on a firming trend with growth expected to increase to the 3 percent range in 1997 and 1998.

In summary, APEC member economies vary as regards the stage of their business cycle. However, average growth for the region is expected to remain in the 3 percent range in 1997, albeit with a different mix than in 1996. Against a general background of low inflation and strengthening export growth (as discussed below), the APEC region as a whole has good prospects for sustained moderate growth in the medium term, with risks to this outlook primarily related to the working out of financial sector difficulties and/or the implementation of structural reforms in some member economies in Asia.

Inflationary pressures continue to abate with a few setbacks due to shocks

Inflation in the APEC region in 1996, as measured by the increase in consumer prices, slowed to 3.2 percent, back to the average of 1992-1994 and well below the 3.6 percent recorded in 1995.[5] This reflected the more balanced economic growth within the region and tight financial policies. The easing of inflationary pressures has reduced the risk of overheating in the region, laying the basis for sustained expansion.

In *Japan* and the *United States,* inflation in 1996 was held in check despite strengthening growth. In fact, Japan achieved a second consecutive year of price stability as inflation remained at almost zero; and, in the United States, price growth was held below 3 percent as a moderate tightening of monetary policy and a responsive labor market amongst other factors helped keep inflationary pressures less pronounced than at similar stages of previous cycles.

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[5] Regional averages were calculated using 1994 nominal GDP levels as weights.

In the other APEC developed economies, price growth was also broadly stable in 1996 and indeed inflation rates were somewhat below 1995 rates. In *Canada,* core inflation in 1996 was 1.5 percent, down from 2.2 percent in 1995. It is believed that Canada's output gap is sufficiently large to accommodate continued growth without igniting inflationary pressure. In *Australia,* inflation is also being held in check by the significant degree of slack that remains in product and labor markets. In *New Zealand*, firm monetary policies contributed to a moderation of price growth to 2.6 percent in 1996 from 2.9 percent the preceding year.

Among the NIEs, inflationary pressures for the most part eased in 1996. *Hong Kong, China* managed a significant reduction in price growth from 8.7 percent in 1995 to 6 percent in 1996. *Singapore* and *Chinese Taipei* also recorded slowdowns in inflation of 0.3 and 0.6 percentage points, respectively. *Korea* experienced a modest increase in price growth of 0.4 percentage points to 4.9 percent, reflecting both wage pressures and high import prices due to the depreciation of the currency.

Among the APEC developing economies, the pattern of stable or decelerating inflation rates was also in evidence in 1996. *Brunei Darussalam* recorded the lowest inflation rate within this group in 1996 at only 2 percent, down from 6 percent in 1995. Malaysia successfully curtailed inflationary pressures and the CPI remained in the mid-3 percent range, as in 1995.

Five of these economies -- *Chile, China, Indonesia, the Philippines* and *Thailand* -- registered inflation rates in the 5 to 8 percent range. The Philippines and Thailand registered a marginal increase while the others witnessed significant deceleration in inflationary pressures. China, after three years of double-digit inflation, successfully managed a soft landing in 1996. The retail price index rose only 6.1 percent in 1996, sharply down from the 14.8 percent recorded in 1995. The more broadly-based CPI mirrored this deceleration, falling to 8.3 percent in 1996 from 17.1 percent in 1995. Chile and Indonesia also effected substantial declines in inflation in 1996, by 1.6 and 2.1 percentage points, respectively. In the case of Chile, the inflation rate was the lowest in 36 years.

Mexico and *Papua New Guinea* brought about declines in inflation over the course of 1996, although both remained in the double-digit range. In Mexico, the deceleration during 1996 brought the inflation rate down to 27.7 percent in December on a year-over-year basis, compared to the annual average for 1996 of 34.4 percent. In Papua New Guinea, the inflation rate fell to 11.6 percent in 1996 from 17.3 percent in the preceding year.[6]

Inflationary trends in 1997 continue to be broadly positive, although the impact of the currency instability will result in setbacks in some economies.

In the *United States,* inflation has further receded in 1997 (indeed, wholesale prices fell through the first half of the year) and is expected to decline to the mid-2 percent range

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[6] IMF, *International Financial Statistics*, September 1997.

for the year as a whole. In *Japan,* the increase in the consumption tax on April 1, 1997, caused a spike in the CPI in that month which is expected to result in annual average inflation of 1.6 percent this year.[7]

Among the other developed economies, price performance in the first half of 1997 has been excellent. *Australia, Canada and New Zealand* all have seen price growth slow to a crawl and are likely to have inflation rates in the 1 percent range for the year as a whole.

The NIEs have also improved their overall inflation performance through the first half of 1997. In *Chinese Taipei,* CPI growth fell sharply to the mid-1 percent range in the first half of 1997. *Hong Kong, China* along with *Korea* have had marginally lower inflation rates in the first half of 1997 than the pace recorded in 1996, while *Singapore* has had marginally higher rates so far this year.

In the developing economies, the continued rapid deceleration of inflation in *China* represents a key development in 1997. The retail price index rose only 1.4 percent on a year-over-year basis in the first half of the year while the CPI slowed to 4.1 percent in the same period. The decelerating trend continued into the third quarter pointing to very good results for the year as a whole.[8]

Overall inflation performance in 1997 in the APEC developing economies in Southeast Asia will be strongly affected by the currency instability. In *Indonesia, Malaysia, the Philippines* and *Thailand,* inflation rates in the second half of 1997 will move higher under the impact of the depreciation of their currencies, offsetting the gains in reducing inflation that each of these economies made in the first half of the year.

Chile and *Mexico* also sustained their trends towards lower inflation in the first half of 1997. CPI growth fell to 5.3 percent in Chile in the 12 months to June 1997 (compared to the 1996 annual average of 6.6 percent), while in Mexico year-over-year inflation was down to 20.3 percent in the second quarter of 1997 (compared to the 1996 annual average of 34.4 percent).

Taken as a whole, inflation performance in the APEC region is expected to improve in 1997, with consumer prices in the region growing by only 2.9 percent, the best so far in the 1990s, down from 3.2 percent in 1996. The decelerating trend is projected to continue, on balance, in 1998, with price growth falling on average by a further 0.2 percentage points to only 2.7 percent.

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[7] This is based on the IMF, *World Economic Outlook* (September 1997) as the most recent calendar-year forecast available; it is not comparable to the official forecasts which are on a fiscal-year basis.

[8] The IMF *World Economic Outlook* (September 1997) forecasts inflation in China in the 4 percent range in 1997. This may be on the high side given the continuing deceleration.

Sustained growth reduces unemployment

The sustained expansion in the APEC region has been an important factor in improving conditions for job growth and reducing unemployment rates. In this respect, the labor market situation in the region has remained better than elsewhere, particularly continental Europe. For APEC as a whole, the average unemployment rate in 1996 fell to 3.8 percent, 0.2 percentage points lower than in the preceding year.

As regards performance in individual member economies, employment conditions in the *United States* have been very dynamic, with the unemployment rate falling to 5.4 percent in 1996 and further to a 24-year low of 4.8 percent in May 1997. In *Japan,* signs of employment recovery have recently emerged, but the unemployment rate has remained in the mid-3 percent range, up from the 2 percent range of the first half of the 1990s.

In the other APEC developed economies, performance has varied. In *New Zealand,* the unemployment rate fell rapidly from 10.6 percent in 1991 to 5.9 percent in 1996 before rising somewhat to the mid-6 percent range in the first quarter of 1997. In *Australia,* growth in employment slowed in 1996, and the unemployment rate remained largely unchanged in the mid-8 percent range. However, recent job vacancy data point to stronger employment growth in the near term. In *Canada,* the unemployment rate has stayed high in recent years despite sustained job growth, reflecting equally rapid increases in the labor force. However, 1997 has seen an improved situation with the unemployment rate falling to the 9 percent level in mid-year from 9.7 percent in 1996.

As a group, the NIEs have maintained very low unemployment on a consistent basis. For these economies, wage moderation remains the greatest challenge in maintaining healthy labor market conditions. In 1996, *Hong Kong, China* along with *Korea and Singapore* maintained unemployment rates in the 2 to 3 percent range. In *Chinese Taipei,* employment growth slowed to 0.3 percent as the restructuring process continued in 1996. As a result, the unemployment rate rose to 2.6 percent, the highest in ten years.

Among the developing economies, most were able to reduce their unemployment rates in 1996 compared to the previous year. These reductions ranged from a remarkable 2 percentage point reduction in *Indonesia* and 1 percentage point gains in *Chile* and *the Philippines* to more modest reductions in other economies.

Although there is still a significant component of cyclical unemployment in some member economies, overall labor market conditions in the region can be expected to improve given the overall growth prospects for the region, provided wage moderation continues to be maintained.

Current account imbalances persist

In a dynamic and rapidly integrating region such as APEC, featuring economies at widely different stages of economic development and large and rapidly growing trade and investment flows, imbalances in current and capital accounts are to be expected. In 1996, 11 APEC member economies evidenced current account deficits while seven economies had surpluses.[9] In total, the region had a net deficit approaching US$120 billion or about 0.75 percent of the total GDP of member economies. Amongst the individual member economies, eight had deficits exceeding 3 percent of GDP, including six above 4 percent of GDP.

Amongst developed economies in the APEC region, only two of the five had current account surpluses in 1996. *Japan* has consistently had a current account surplus, although this has been declining as a share of GDP since 1993 due to ongoing structural adjustment and the strength of the yen. In 1996, Japan's current account surplus fell to 1.4 percent of GDP. However, *Canada's* current account has significantly improved since 1993, as the balance has shifted from a deficit of almost 4 percent of GDP in 1993 to a surplus of 0.5 percent of GDP in 1996.

Trends among the other developed economies were mixed. The *United States* had a deficit of 1.9 percent of GDP in 1996, a position which has been maintained since 1994 and which has continued in the first half of 1997. Given the size of the U.S. economy, this translated into a deficit of approximately US$145 billion in 1996 which was the largest in absolute terms within the APEC region. *Australia* narrowed its current account deficit in 1996 to 3.8 percent of GDP from 5.3 percent in 1995, thanks to a strengthening of agricultural exports from the drought-related lower levels of the preceding year. *New Zealand,* however, saw a marginal widening of its deficit.

In contrast to some broad similarities that the NIEs exhibit in terms of growth and inflation, there is no common pattern in terms of current account performance. Singapore and Chinese Taipei have maintained consistent surpluses while Korea and Hong Kong, China have tended to have deficits. *Singapore's* surplus fell marginally in 1996 to 15 percent of GDP from 16.9 percent recorded in 1995. *Chinese Taipei,* however, increased its current account surplus to 3.8 percent of GDP as falling imports more than offset low export growth. The current account position of *Korea* deteriorated during 1995 and 1996, reaching a deficit of 4.9 percent of GDP in 1996 from 2 percent of GDP in 1995. By contrast, *Hong Kong, China* reduced its deficit from 3.6 percent of GDP in 1995 to only 1 percent in 1996.

Amongst the APEC developing economies, rapid economic growth in recent years has tended to widen external deficits. In 1996, the current account deficit of *Thailand* was 8.0 percent of GDP while *Malaysia and Philippines* were at 4.9 percent and 4.3 percent, respectively. *Indonesia* followed with a deficit of 4 percent of GDP. As discussed below, large current account deficits were linked to the financial market pressures experienced by some member economies.

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[9] Official 1996 current account data were not available for Brunei Darussalam as of the writing of this report. However, Brunei Darussalam has persistently maintained current account surpluses exceeding 50 percent of GDP and it is expected that this remained the case in 1996.

Mexico, which had effected a major reduction in its current account deficit in 1995 as a result of the recession and the peso devaluation, maintained the deficit at a very low level of 0.6 percent of GDP in 1996. In 1997, the deficit is expected to widen somewhat as import growth accelerated to over 20 percent year-over-year in the first quarter of 1997 in response to the strong domestic economic expansion, while export growth moderated to 16 percent year-over-year in the same period.[10] *Chile* experienced a deficit in 1996, compared with a surplus in 1995, due to the fall of international prices of copper and cellulose, two major export items. The current account position of Chile is expected to improve in 1997.

Intra-regional trade and investment flows continue to rise

Rapid trade growth of APEC member economies has raised its share of world trade from 43.4 percent in 1986 to 50.6 percent in 1996, a gain of more than 7 percent. In 1996, however, notwithstanding the overall acceleration of growth in the APEC region, export growth slowed sharply to 4.6 percent in terms of total exports of member economies. One factor was last year's semiconductor price slump, which led to a sharp terms-of-trade deterioration for many APEC member economies.

Rapid APEC-wide growth in trade over the past decade could not have been achieved without a sharp increase in trade within the region itself. In fact, between 1986 and 1996, the share of trade of APEC economies with other APEC partners, or the "dependency ratio," increased from 68.8 percent to 71.6 percent for exports, and from 68.3 percent to 73.2 percent for imports. Table 8 shows that, in 1996, the share of intra-regional trade exceeded 60 percent for all APEC economies except Chile.

The increased dependency ratio indicates that economic linkages among member economies have deepened over this period. In particular, as economic integration within the various sub-regional groups within APEC intensified, the region was able to take better advantage of vertical and horizontal linkages.[11]

In terms of the balance of trade, APEC economies as a whole recorded a trade deficit of US$110 billion in 1996, a sharp deterioration from the US$83 billion deficit in 1995. Seven member economies have tended to have persistent trade deficits. The United States; Hong Kong, China; Singapore; and Thailand have recorded trade deficits in each of the past five years. Korea, the Philippines and Australia have also tended to run trade deficits. On the other hand, Canada, China, Japan, Chinese Taipei, Brunei Darussalam, Indonesia and New Zealand have tended to show consistent trade surpluses. The United States' trade deficit as a share of GDP has remained at around 1.5 percent for the last several years. However, reflecting the size of its economy, the trade deficit is the largest in the region in absolute terms. Meanwhile, Japan has consistently run the largest trade surplus in the region, and indeed in the world.

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[10] IMF, *International Financial Statistics*, September 1997.

[11] See APEC Economic Committee, *The Impact of Subregionalism on APEC* (APEC, 1997).

As trade and investment liberalization and facilitation have advanced, investment flows among APEC member economies have also grown rapidly. Inflow of foreign direct investment (FDI) has been an important factor for the developing economies in the APEC region to sustain their economic development; continuous efforts have been made by most APEC member economies to attract foreign capital.[12]

The APEC region witnessed large flows of FDI in 1996 (see Table 11 for a complete breakdown). A number of developments are particularly noteworthy. China continued to be a major destination, attracting US$41.8 billion in 1996, up 11.2 percent from the previous year. Korea also saw a significant increase as inflows rose 68 percent to US$3.2 billion in 1996 from US$1.9 billion in 1995. Korea also continued to be an important source of FDI, with flows directed in particular to the United States and Southeast Asia, among others. Chile also saw a major surge of inflows in 1996 as FDI rose to US$6.2 billion, a 42.4 percent increase from 1995. Of this investment, 51 percent took place in the service sector.

2. Key Issues and Challenges Facing APEC Member Economies

Current account deficits and financial market instability in mid-1997

Sizable current account deficits have characterized a number of APEC economies in recent years. In principle, such a situation need not be a problem, particularly in economies that are growing rapidly. If the capital inflows needed to finance the deficit are in fact underwriting an expansion in the productive capacity of the economy, the current account deficit need not be associated with an increase in the difficulty of servicing foreign debt. This is particularly true if the capital flows are long-term in nature. However, if the deficit in current transactions represents unproductive investments or consumption, the consequent build-up in foreign debt can create problems for the economy. These problems can be exacerbated if the debts are predominately short-term in nature, as creditors become unwilling to roll over the loans, as was the case in the Mexican peso crisis of 1994-1995. Moreover, if the banking sector is under stress or if prudential supervision is weak, problems for the domestic economy can also be made worse. In these cases, a period of consolidation and slower growth may be necessary to restore stability.

The recent exchange and equity market instability in some Southeast Asian economies has dampened growth prospects in the near term. A number of Southeast Asian economies that had maintained fixed or managed-floating exchange rates -- usually relative to a (sometimes unpublished) basket of currencies -- moved to a much more flexible exchange rate system. Weaknesses in many of the currencies in the region have

[12] See APEC Economic Committee, *The Impact of Investment Liberalization in APEC* (APEC, 1997).

been accompanied by volatility and large declines in most regional stock markets.

This instability originated in Thailand, where in recent years a currency peg resulted in increasingly distorted incentives for capital flows. For the decade leading up to 1993, the Thai economy, aided by a strong record of prudent macroeconomic policies, enjoyed robust growth. In the period after 1993, however, growth in aggregate demand was too strong to be sustained, as evidenced by widening current account deficits and growing inflation pressures. Excessive capital inflows, which exacerbated demand pressures, were also encouraged by the high domestic interest rates needed to defend the pegged exchange rate and combat overheating pressures. The capital inflows led to a growing burden of international indebtedness, much of which was short-term.

At the same time, there was excessive exposure to the property sector and a lack of appreciation that large and unhedged foreign currency liabilities posed significant risk if the exchange rate regime were to change. These factors, combined with a rise in the value of the U.S. dollar against the Japanese yen, a sharp slowing in Thailand's export growth, a sharp fall in the stock market, and political uncertainty, led to growing market sentiment that Thailand's currency peg was unsustainable. This expectation then became self-fulfilling as domestic participants moved to hedge uncovered exposures and as speculators sold the baht short. This uncertainty then spread to several neighboring economies, notably Indonesia, Malaysia, and the Philippines.

In periods of currency instability, such spillovers generally operate through two channels, both of which have probably been at play in the current episode. First, economies in the region are closely linked. Changes in growth and exchange rate prospects in one economy will naturally tend to have repercussions for other economies in the region. Second, in periods of instability, investors tend to look at economies whose economic situation appears to be similar to that in the economy where the instability first emerged. Thus, economies with large current account deficits and significant growth in property investment seem to have been particularly vulnerable to speculative attacks.

Moreover, in periods of uncertainty speculative pressures can exacerbate instability and lead to overshooting behavior. In the recent episode, such pressures have doubtless contributed to the volatility in foreign exchange and equity markets.

The process of arresting and recovering from a period of instability can be speeded by the adoption of policies to address the underlying causes. In the case of the Mexican peso crisis in 1994-1995, for example, growth resumed and Mexican authorities were able once again to attract funds in private capital markets within months of having undertaken comprehensive policy reforms to address the crisis. In the current episode, full implementation by the Thai government of the policy and financial reforms agreed to in connection with the Stand-By Arrangement negotiated with the IMF will go a long way toward restoring confidence.

In looking at the present episode, a number of considerations should be borne in mind.

First and most important, the current period of stability does not alter the fundamentally bright long-term growth prospects for the region. Indeed, to the extent that the currency turbulence has contributed to the resolution of unsustainable policy mixes and currency misalignments in the region, it may have even enhanced longer-term prospects, provided economies do not allow the recent depreciation to lead to a ratcheting up of inflation rates.

Second, while speculative behavior may have aggravated the instability, at its heart the recent crisis reflected the response of markets to macroeconomic imbalances and policy deficiencies. It therefore underscores the importance of sound macroeconomic policies.

Third, there is clearly a need to strengthen financial sectors in the APEC region with increased reliance on markets and enhanced prudential and regulatory arrangements. The slowdown in economic growth, falling asset prices and declining profitability have increased the number of non-performing loans – the origins of which stem from over-investment in property markets and lax lending practices in the financial sector. In many instances, banks assumed more credit, exchange rate, interest rate and other market risks than was prudent.

Fourth, the spillover effects that have accompanied the current crisis illustrate both the increased economic interdependence in the region and the desirability of a high degree of transparency regarding economic and financial policies to enable markets to differentiate between economies and their respective prospects.

Structural reform and deregulation for sustained higher growth

Despite the strong record of sustained growth in the APEC region, questions have arisen concerning the region's long-term growth prospects and the ability of individual economies to realize their long-term potential. In particular, questions have been raised as to whether APEC member economies can meet the challenges that many continue to face in areas such as external imbalances, underdeveloped financial markets, inadequate infrastructure and shortages of skilled workers. Moreover, questions surround the ability of firms that have long enjoyed protection to cope with the challenges of increased competition as APEC's market-opening measures are implemented.

It is generally agreed that, to cope with all these challenges in a context of rapidly changing conditions created by increased international competition and sustained technological change, economies need continually to improve and adapt economic and social structures. APEC member economies are undertaking reforms along these lines, including market deregulation, opening up of trade and capital markets, and reducing the size of the government sector through expenditure cuts and privatization (See Box for details). If reforms and deregulation measures such as these are successfully implemented, APEC's prospects for achieving the vision created at Bogor will be considerably enhanced. However, as discussed above, the pace of reforms may need to be accelerated to maintain the confidence of markets. In this respect, strengthening of economic and technical cooperation in areas such as human resource development and small and medium-sized enterprises to build capacities of member economies to implement reforms can contribute significantly to the improvement of economic fundamentals that is needed to pre-empt future instances of instability.

Recent Structural Reforms Undertaken by Member Economies

Australia: In 1996, the Australian Government announced and conducted a major review into the Australian financial system. The Financial System Inquiry was charged with providing a stocktake of financial deregulation, an analysis of the forces driving change and recommendations on the key issues in regulatory reform, in particular to promote a more efficient and cost-effective financial system, consistent with stability, prudence, integrity and fairness.

Canada: The Federal Government has taken steps to ensure that the economic and fiscal conditions are in place for sustained growth and job creation. It has made major structural reforms to ensure labor market flexibility, to increase investments in technology and knowledge, and to improve market access to Canadian exports and investment. Substantial progress has been made on the deficit front, and inflation remains at low levels.

Chile: Structural reforms include the improvement of the educational system, increasing involvement of private investment in physical infrastructure, liberalization and internationalization of the financial markets, and the strengthening of trade and financial relations with the rest of the world through free trade agreements.

China: Reform of the state-owned enterprises (SOEs) is a key to supporting the on-going restructuring of China's industrial sector. Reforms are oriented towards establishing a modern enterprise system, with clear ownership, clearly defined powers and responsibilities, separation of enterprise from administration (in particular by shifting social welfare responsibilities from the enterprise sector to the social security system), and the application of sound management principles. The reforms include increasing the number of cities allowed to experiment with bankruptcies and mergers from 58 in 1995 to 110 in 1997 and tripling the amount of funds used for clearing debts of bankrupt firms.

Hong Kong, China: On July 1, 1997, Hong Kong became a Special Administrative Region of the People's Republic of China and is now referred to within APEC as Hong Kong, China. The Basic Law provides for continuation of free, open and competitive markets that are not controlled by state planning or state direction; establishes economic autonomy in the important spheres of public finance, monetary and financial affairs, trade and investment; prescribes budgetary prudence and a low tax regime; and offers a commitment to Hong Kong, China's continuing role as a center for international business.

Indonesia: A deregulation package introduced in June 1996 included measures to reduce and eliminate import duties and surcharges, streamline import trading schemes, improve incentives for exporters in priority sectors, and simplify licensing procedures for domestic and foreign investment. A follow-up package in July 1997 covered six fields, namely (i) imports, (ii) exports, (iii) regional taxes and regional levies, (iv) non-tax state revenues, (v) capital investments, and (vi) monetary affairs. The prominent aspect is the continuing of import duty rates on 1,600 tariff headings, reducing the unweighted average tariff from 13 percent to 11.9 percent. More than half of the total tariff headings (62.5 percent) are now subject to duties of 10 percent or less.

Japan: Steady implementation of deregulation measures is a prerequisite for sustaining mid- and long-term growth of the Japanese economy. The Government further revised its Deregulation Action Plan in March 1997. This plan contains comprehensive deregulation measures in the following major areas: (i) housing and land; (ii) information and telecommunications; (iii) distribution; (iv) standards, certifications and import procedures; (v) financial services, securities and insurance; (vi) energy; (vii) employment and labor; (viii) matters related to pollution, wastes, environmental protection, dangerous articles, disaster prevention and public safety; and (ix) education.

Korea: With its accession to the OECD in 1996, the Government began to accelerate financial market reform. Short-term steps towards reform addressed the further deregulation of this sector and the consolidation of business lines for specialized lending-only financial firms. The improved efficiency of local financial firms alone is expected to lower interest rates. The mid- and long-term measures emphasized making local financial firms larger and promoting specialization in self-selected business areas, thus resulting in a reorganization of the domestic financial industry as a whole.

Mexico: The Government has broadened its structural reform in key sectors of the economy. The Social Security reform, which consists of the transition from a publicly provided pay-as-you-go plan to a privately-managed and publicly-regulated defined-contribution system, has been undertaken. A comprehensive reform in tax administration, aimed at increasing its effectiveness through the creation of a new career stream in tax administration and implementation of new systems and procedures for collecting taxes, has been in effect since July 1997. Other relevant aspects of the structural reform include the opening up of long-distance telephone service to competition, new auctions in the radio spectrum, de-monopolization of the natural gas sector, and privatization of satellites, the railroad system, ports and airports.

Papua New Guinea: A series of structural reforms were initiated under the Economic Recovery Program to re-establish fiscal and monetary stability and the basis for stable medium-term growth. The program included shifting to a market-determined floating exchange rate and market-determined interest rates, tightening banking sector prudential rules, commitments to fiscal discipline, and a variety of measures to enhance competitiveness and to restore business confidence. Measures were also taken to improve public services, especially in education, health and agriculture; upgrade economic infrastructure; and channel development resources to the rural sector.

Philippines: Implementation of structural reforms continued in 1997. The average tariff has been reduced from 15.6 percent to 13.4 percent. The downstream oil industry has been fully deregulated, effective 8 February 1997. Restrictions on domestic borrowing of foreign firms have been lifted, effective 1 January 1997. Good progress has been made towards the passage of the third tranche of the comprehensive tax reform program (reform of the individual and corporate income tax systems) to broaden the tax base and remove areas of discretion. This follows the expanded value-added tax and reform of the excise tax system. Privatization efforts continue in the infrastructure area (through the Build Operate Transfer scheme and other similar schemes in the energy, road networks and other sectors) and in social sectors such as pension funds and education.

Chinese Taipei: Economic liberalization has been accelerated under a comprehensive program to develop the economy as an Asia-Pacific regional operations center (APROC) which, as of June 1997, has involved passage of 39 bills and amendment of 87 regulations. Average tariffs have been reduced from 7.7 percent in 1985 to 3.6 percent in 1996 and non-tariff barriers substantially lowered. Capital market development has been advanced through step-by-step liberalization of interest rates and the establishment of off-shore banking units and a foreign currency call-loan market. Among other service sector measures, a new telecommunications law was enacted in 1996 to build an environment of fair competition and equal access to networks and services and to pave the way for the opening of the telecommunications market.

Thailand: To stimulate economic development, Thailand‘s Eighth Plan, launched in 1997, calls for: (i) reducing the current account deficit as a percentage of GDP, (ii) controlling inflation, (iii) increasing household savings to at least 10 percent of GDP, (iv) reducing the percentage of the population below the defined poverty level to less than 10 percent, (v) improving the development of human resources and the quality of life, (vi) utilizing, preserving and rehabilitating the natural environment, and (vii) increasing the quantity and quality of basic infrastructure in rural areas.

United States: A major Government policy goal is the long-term stability and growth of the economy. This goal informs numerous areas of policy, including education, health care, social welfare and poverty alleviation, deregulation, and research and development. To increase the returns to employment for working families of modest means and help combat increased income inequality and persisting poverty, the Earned Income Tax Credit has been expanded and the minimum wage raised. As well, the Welfare Reform Act of 1996 replaced the Aid to Families with Dependent Children entitlement program with a block grant to the states fixed at $16.4 billion per year for fiscal years 1996-2001. The Act sets up time limits for welfare assistance: families on the rolls for five cumulative years become ineligible for cash aid. It also requires that 50 percent of the welfare caseload be working or in work-related activities by 2002.

Table 1
Real GDP Growth in the APEC Region

(percent change per annum, except as indicated)

	1994 GDP Share	1991	1992	1993	1994	1995	1996	*1997*	*1998*
Western Hemisphere	**53.42**	**-0.6**	**2.7**	**2.3**	**3.6**	**1.6**	**2.9**	***3.9***	***2.8***
Canada	3.67	-1.8	0.8	2.2	4.1	2.3	1.5	*3.7*	*3.2*
Chile	0.35	7.3	11.0	6.3	4.2	8.5	7.2	*6.0*	*6.3*
Mexico	2.82	4.2	3.6	2.0	4.4	-6.2	5.1	*6.5*	*5.0*
United States	46.58	-0.9	2.7	2.3	3.5	2.0	2.8	*3.7*	*2.6*
Northeast Asia	**40.20**	**4.8**	**2.8**	**2.2**	**2.5**	**2.95**	**4.4**	***2.5***	***3.3***
China	3.63	9.2	14.2	13.5	12.6	10.5	9.7	*9.3*	*9.0*
Hong Kong, China	0.88	5.1	6.3	6.1	5.4	4.5	4.9	*5.5*	*5.0*
Japan	31.52	3.8	1.0	0.3	0.6	1.4	3.5	*1.1*	*2.1*
Korea	2.55	9.1	5.1	5.8	8.6	8.9	7.1	*6.4*	*6.7*
Chinese Taipei	1.62	7.6	6.8	6.3	6.5	6.0	5.7	*6.6*	*6.7*
Southeast Asia	**3.83**	**7.3**	**6.5**	**7.4**	**8.0**	**8.0**	**7.2**	***5.4***	***5.8***
Brunei Darussalam	0.04	4.0	-1.1	0.5	1.8	2.0	3.5	*3.0*	*4.5*
Indonesia	1.18	8.9	7.2	7.3	7.5	8.1	7.8	*6.5*	*6.0*
Malaysia	0.49	8.6	7.8	8.3	9.2	9.5	8.6	*8.0*	*7.0*
Philippines	0.43	-0.6	0.3	2.1	4.4	4.8	5.7	*5-5.5*	*6-7*
Singapore	0.73	7.3	6.2	10.4	10.5	8.8	7.0	*6-7*	*7.1*
Thailand	0.96	8.5	8.1	8.3	8.8	8.6	6.7	*2.5*	*3.5*
Oceania	**2.57**	**-0.8**	**2.5**	**4.3**	**5.3**	**3.4**	**3.3**	***3.2***	***3.8***
Australia	2.18	-0.8	2.6	3.95	5.2	3.5	3.4	*3.5*	*3.75*
New Zealand	0.35	-1.7	0.9	5.0	6.0	3.5	2.7	*1.2*	*3.9*
Papua New Guinea	0.04	9.6	11.6	16.6	3.5	-2.9	1.9	*3.0*	*3.0*
APEC (w/o Japan & US)	**21.90**	**4.9**	**5.9**	**6.1**	**7.1**	**4.9**	**5.7**	***5.9***	***5.7***
APEC	**100.00**	**1.85**	**2.9**	**2.5**	**3.4**	**2.5**	**3.7**	***3.4***	***3.1***

1. Historical data for individual economies for the period 1991-1996 were provided by member economies except those for Papua New Guinea, which are drawn from IMF and ADB sources.

2. Forecasts for 1997 and 1998 are from official sources where available on a calendar year basis. The exceptions are as follows: for Canada, Chile and Singapore the 1998 forecast is the average of the surveyed forecasts; for Japan and New Zealand, the 1997 and 1998 figures are drawn from the IMF, *World Economic Outlook* (September 1997), as the most recent calendar year forecasts available -- these cannot be directly compared to the official fiscal-year-based forecasts provided in the individual economy reports in this document. For Papua New Guinea, the forecast is based on IMF estimates as reported in the Asian Development Bank, *Country Economic Review*: *Papua New Guinea* (March 1997); for the USA, the 1997 and 1998 forecast figures are drawn from the IMF, *World Economic Outlook* (September 1997), as the most recent available.

3. Regional averages were calculated using 1994 nominal GDP levels as weights. For economies providing a range as the forecast, the mid-point was taken for the point estimates of regional growth.

Table 2

Increases in CPI in APEC Member Economies

(percent change per annum)

	1991	1992	1993	1994	1995	1996	*1997*	*1998*
Western Hemisphere								
Canada	5.6	1.5	1.8	0.2	2.1	1.6	*1.8*	*1.8*
Chile	18.7	12.7	12.2	8.9	8.2	6.6	*5.5*	*4.6*
Mexico	22.7	15.5	9.7	6.9	35.0	34.4	*20.6*	*12.2*
United States	4.0	2.9	3.0	2.6	2.8	2.9	*2.4*	*2.8*
Northeast Asia								
China	3.4	6.4	14.7	24.1	17.1	8.3	*3.5*	*6.1*
Hong Kong, China	12.0	9.4	8.5	8.1	8.7	6.0	*6.5*	*6.5*
Japan	3.3	1.6	1.3	0.7	-0.1	0.1	*1.6*	*0.7*
Korea	9.3	6.2	4.8	6.2	4.5	4.9	*4.4*	*4.5*
Chinese Taipei	3.6	4.5	2.9	4.1	3.7	3.1	*1.7*	*2.7*
Southeast Asia								
Brunei Darussalam	1.6	1.3	4.3	2.4	6.0	2.0	*3.0*	*3.0*
Indonesia	9.5	4.9	9.8	9.2	8.6	6.5	*9.0*	*9.0*
Malaysia	4.4	4.7	3.6	3.7	3.4	3.5	*3.0*	*3.7*
Philippines	18.7	8.9	7.6	9.0	8.1	8.4	*6-6.5*	*6.5-7*
Singapore	3.4	2.3	2.3	3.1	1.7	1.4	*2.1*	*2.2*
Thailand	5.7	4.1	3.3	5.0	5.8	5.9	*7.0*	*8.0*
Oceania								
Australia	3.2	1.0	1.8	1.9	4.6	2.6	*0.8*	*2.3*
New Zealand	0.9	1.3	1.4	2.8	2.9	2.6	*1.8*	*2.4*
Papua New Guinea	7.5	4.3	5.0	2.9	17.3	11.6	*7.0*	*4.8*
APEC	**4.7**	**3.1**	**3.2**	**3.1**	**3.6**	**3.2**	***2.9***	***2.7***

1. Historical data for individual economies for the period 1991-1996 were provided by member economies except in the case of Papua New Guinea, where the figures are drawn from IMF and ADB sources.

2. Forecasts for 1997 and 1998 are from official sources where available on a calendar year basis. For Canada; China; Hong Kong, China; and Malaysia, the 1998 forecast is the average of the surveyed forecasts; for Mexico, New Zealand and Singapore, both 1997 and 1998 figures are averages of the surveyed forecasts (in Mexico's case, the official projections are on a December-over-December basis, and hence not comparable to the figures on an annual average basis presented in this table); for Japan, the 1997 and 1998 figures are drawn from the IMF, *World Economic Outlook* (September 1997), as the most recent calendar year forecasts available -- these cannot be directly compared to the official fiscal-year-based forecasts provided in the individual economy reports in this document. For Papua New Guinea, the forecast is based on IMF estimates for year-end inflation as reported in the Asian Development Bank, *Country Economic Review*: *Papua New Guinea* (March 1997); for the USA, the 1997 and 1998 forecast figures are drawn from the IMF, *World Economic Outlook* (September 1997), as the most recent available.

3. Regional averages were calculated using 1994 nominal GDP levels as weights. For economies providing a range as the forecast, the mid-point was taken for the point estimates of regional growth.

Table 3

Unemployment Rates in APEC Member Economies

(percent)

	1991	1992	1993	1994	1995	1996
Western Hemisphere						
Canada	10.4	11.3	11.2	10.4	9.5	9.7
Chile	8.2	6.7	6.6	7.8	7.3	6.4
Mexico	2.7	2.8	3.4	3.6	6.3	5.5
United States	6.8	7.5	6.9	6.1	5.9	5.4
Northeast Asia						
China	2.3	2.3	2.6	2.8	2.9	3.0
Hong Kong, China	1.8	2.0	2.0	1.9	3.2	2.8
Japan	2.1	2.2	2.5	2.9	3.2	3.4
Korea	2.3	2.4	2.8	2.4	2.0	2.0
Chinese Taipei	1.5	1.5	1.5	1.6	1.8	2.6
Southeast Asia						
Brunei Darussalam	4.7	4.5	4.1	3.6	4.9	5.0
Indonesia	2.5	2.7	3.1	4.4	7.0	4.9
Malaysia	4.3	3.7	3.0	2.9	2.8	2.6
Philippines	10.5	9.8	9.3	9.5	9.5	8.6
Singapore	1.8	2.0	1.9	2.0	2.0	2.0
Thailand	3.1	3.0	2.6	2.6	2.6	2.0
Oceania						
Australia	9.6	10.8	10.9	9.7	8.5	8.6
New Zealand	10.6	10.2	9.2	7.3	6.2	5.9
Papua New Guinea	n/a	n/a	n/a	n/a	n/a	n/a
APEC	3.26	3.35	3.51	3.65	3.95	3.75

1. Figures for individual economies for the period 1991-1996 were provided by governments.

2. APEC total averages were derived using 1994 labor force as weights.

Table 4

Current Account Balances as a Share of GDP [1]

(percent, except as indicated)

	1991	1992	1993	1994	1995	1996	1996 Balance [3] (US$ billions)
Western Hemisphere							
Canada	-3.8	-3.7	-3.9	-2.7	-1.0	0.5	2.8
Chile	0.3	-1.6	-4.6	-1.2	0.2	-4.1	-2.9
Mexico	-4.6	-6.7	-5.8	-7.0	-0.6	-0.6	-1.9
United States	-0.1	-0.9	-1.4	-1.9	-1.8	-1.9	-145.0
Northeast Asia							
China	3.0	1.3	-2.0	1.4	0.2	0.9	7.2
Hong Kong, China	6.6	5.3	7.0	1.2	-3.6	-1.0	-1.6
Japan	2.0	3.0	3.1	2.8	2.2	1.4	65.9
Korea	-3.0	-1.5	0.1	-1.2	-1.9	-4.9	-23.7
Chinese Taipei	6.9	4.0	3.2	2.7	2.1	3.8	11.0
Southeast Asia							
Brunei Darussalam	76.9	66.4	62.9	68.6	57.6	50.0 [2]	3.7
Indonesia	-3.4	-2.2	-1.5	-1.7	-3.4	-4.0	-8.9
Malaysia	-8.8	-3.8	-4.8	-6.3	-10.0	-4.9	-4.9
Philippines	-1.9	-1.6	-5.6	-4.6	-4.5	-4.3	-3.6
Singapore	11.2	11.3	7.5	17.1	16.9	15.0	14.1
Thailand	-7.0	-5.7	-5.1	-5.6	-8.1	-8.0	-14.7
Oceania							
Australia	-3.1	-3.4	-3.4	-5.0	-5.3	-3.8	-14.7
New Zealand	-2.2	-2.7	-1.2	-2.5	-3.7	-4.2	-2.7
[4] Papua New Guinea	-4.1	2.2	12.8	10.8	14.3	5.2	0.3

1. Percentage shares of GDP for 1991-1996 are provided by member economies.

2. 1996 estimate for Brunei is by the Economic Committee.

3. Balances in 1996 are as provided by member economies; in those cases where levels were not reported, figures cited are calculated consistent with reported shares of GDP and reported nominal GDP levels.

4. Papua New Guinea data are drawn from the individual economy report in section 3 of this chapter.

Table 5
Merchandise Trade Balances as a Share of GDP [1]

(percent)

	1991	1992	1993	1994	1995	1996
Western Hemisphere						
Canada	-0.7	-0.5	-0.1	1.0	3.0	3.9
Chile	4.6	1.8	-2.2	1.4	2.1	-1.6
Mexico	-2.3	-4.4	-3.3	-4.4	2.5	2.0
United States	-0.5	-0.6	-1.1	-1.5	-1.4	-1.5
Northeast Asia						
China	2.0	0.9	-2.0	1.0	2.4	1.5
Hong Kong, China	-2.4	-4.3	-3.3	-8.4	-14.0	-11.8
Japan	2.8	3.3	3.3	3.1	2.6	1.8
Korea	-2.4	-0.7	0.6	-0.8	-1.0	-3.2
Chinese Taipei	8.7	6.0	5.2	4.9	5.1	6.5
Southeast Asia						
Brunei Darussalam	36.9	31.2	26.9	10.1	8.3	1.9
Indonesia	2.6	4.8	5.4	4.6	2.8	1.5
Malaysia	1.1	5.8	5.0	2.4	0.04	4.1
Philippines	-7.1	-8.9	-11.4	-12.3	-12.1	-13.4
Singapore	-5.8	-7.9	-8.5	-1.5	-1.5	-0.6
Thailand	-6.0	-3.6	-3.4	-2.6	-4.9	-4.8
Oceania						
Australia	1.2	0.5	-0.1	-1.0	-1.2	-0.2
New Zealand	5.0	4.1	4.1	2.7	1.5	0.8
Papua New Guinea [2]	2.1	14.8	29.9	25.1	29.8	19.2

1. Data provided by member economies.

2. Papua New Guinea data are drawn from the individual economy report in section 3 of this chapter.

Table 6

Non-Merchandise Trade Balances as a Share of GDP [1]

(percent)

	1991	1992	1993	1994	1995	1996
Western Hemisphere						
Canada	-3.1	-3.2	-3.8	-3.7	-4.0	-3.4
Chile	-4.3	-3.4	-2.4	-2.6	-1.9	-2.5
Mexico	-2.3	-2.3	-2.5	-2.6	-3.1	-2.6
United States	0.4	-0.3	-0.3	-0.4	-0.4	-0.4
Northeast Asia						
China	1.0	0.4	0	0.4	-2.2	-0.6
Hong Kong, China	9.0	9.6	10.3	9.6	10.4	10.8
Japan	-0.8	-0.3	-0.2	-0.3	-0.4	-0.4
Korea	-0.6	-0.8	-0.5	-0.4	-0.9	-1.7
Chinese Taipei	-1.8	-2.0	-2.0	-2.2	-3.0	-2.7
Southeast Asia						
Brunei Darussalam	40.0	35.2	36.0	58.5	49.3	48.1
Indonesia	-6.0	-7.0	-6.9	-6.3	-6.2	-5.5
Malaysia	-9.9	-9.6	-9.8	-8.7	-10.0	-9.0
Philippines	5.2	7.3	5.8	7.7	7.6	9.1
Singapore	17.0	19.2	16.0	18.6	18.4	15.6
Thailand	-1.0	-2.1	-1.7	-3.0	-3.2	-3.2
Oceania						
Australia	-4.3	-3.9	-3.3	-4.0	-4.1	-3.6
New Zealand	-7.2	-6.8	-5.3	-5.2	-5.2	-5.0
Papua New Guinea	-6.2	-12.6	-17.1	-14.3	-15.5	-14.0

1. Services trade balance plus net investment income and net transfers as a share of GDP; this table is derived as the current account balance as provided in Table 4 minus the merchandise trade balance as provided in Table 5.

Table 7

Growth of Exports and Imports in Real Terms: 1995-1996 [(1)]

(percent change per annum)

	Real GDP		Exports		Imports	
	1995	1996	1995	1996	1995	1996
Western Hemisphere						
Canada	2.3	1.5	12.0	4.5	8.7	5.1
Chile	8.5	7.2	11.4	10.9	22.2	11.7
Mexico	-6.2	5.1	33.0	18.7	-12.8	27.8
United States	2.0	2.8	11.1	8.3	8.9	9.1
Northeast Asia						
China	10.5	9.7	22.9	1.5	14.2	5.1
Hong Kong, China	4.5	4.9	11.9	4.9	13.0	4.1
Japan	1.4	3.5	5.4	2.3	14.3	10.5
Korea	8.9	7.1	24.1	14.1	22.1	14.8
Chinese Taipei	6.0	5.7	12.8	7.1	9.8	5.1
Southeast Asia						
Brunei Darussalam	2.0	3.5	-0.1	8.3	27.6	21.8
Indonesia	8.1	7.8	4.3	6.5	16.8	12.9
Malaysia	9.5	8.6	20.2	6.5	24.6	1.5
Philippines	4.8	5.7	12.0	20.3	16.0	21.1
Singapore	8.8	7.0	13.7	5.2	12.7	5.0
Thailand	8.6	6.7	23.6	-0.2	30.5	2.3
Oceania						
Australia	3.5	3.4	4.4	10.2	9.6	8.6
New Zealand	3.5	2.7	2.7	4.5	8.7	7.2
Papua New Guinea	-2.9	2.2	n/a	n/a	n/a	n/a

1. Data provided by member economies.

Table 8

Shares of Intra-APEC Trade: 1993 and 1996

(percent)

	1993	1996
Western Hemisphere		
Canada	84	87
Chile	48	50
Mexico	84	88
United States	64	65
Northeast Asia		
China	71	74
Hong Kong, China	80	80
Japan	69	71
Korea	69	67
Chinese Taipei	75	74
Southeast Asia		
Brunei Darussalam	87	90
Indonesia	77	75
Malaysia	80	67
Philippines	76	79
Singapore	74	74
Thailand	69	70
Oceania		
Australia	73	71
New Zealand	65	60
Papua New Guinea	n/a	n/a
APEC	71	72

Table 9
Regional Shares of World Trade
(percent)

	1986	1996	2010
APEC	43.4	50.6	53.5
NAFTA	22.2	19.8	19.2
United States	16.2	14.2	12.6
East Asia	19.1	28.6	32.4
Japan	9.0	10.3	7.7
China	1.4	2.5	3.6
Hong Kong, China	1.6	3.6	4.6
Chinese Taipei	1.6	2.2	2.6
Korea	1.7	2.9	3.9
ASEAN 4	2.4	4.6	6.1
Singapore	1.2	2.6	3.8
EU	44.3	39.2	36.8

Source: DRI.
Note: Papua New Guinea and Brunei are excluded due to data availability. The "ASEAN 4" are Indonesia, Malaysia, the Philippines and Thailand.

Table 10
Gross External Debt as a Percentage of GNP

	Chile	Indonesia	Korea	Malaysia	Mexico	Philippines	Thailand
1986	134.0	55.9	42.2	84.5	82.9	96.4	43.8
1987	113.5	72.6	26.7	77.1	82.1	91.3	40.9
1988	88.3	63.9	17.3	56.7	59.8	77.3	35.8
1989	68.8	61.3	13.3	45.6	46.9	68.2	32.9
1990	67.4	64.0	12.6	40.1	43.8	68.7	33.2
1991	55.1	64.9	13.4	40.7	40.4	70.5	39.0
1992	46.9	66.2	14.0	36.8	34.6	60.7	38.3
1993	46.8	58.7	13.3	43.8	36.9	64.9	34.9
1994	49.1	57.2	15.0	44.0	38.4	60.8	34.4
1995	43.3	56.9	17.5	42.6	69.9	51.5	34.9
1996	36.5	45.0	21.7	30.0	42.0	48.1	47.0

Source: *World Debt Table*, 1996. Note: Data for 1996 are from individual economies' official publications.

Table 11

Foreign Direct Investment Flows in APEC Member Economies

(US$ millions)

	Inward FDI					Outward FDI				
	1991	1992	1993	1994	1995	1991	1992	1993	1994	1995
Western Hemisphere										
Canada	2,740	4,517	4,997	6,043	11,182	5,655	3,635	5,825	4,781	4,782
Chile	523	699	841	2,518	3,021	123	378	431	883	644
Mexico	123	378	431	883	644	167	730	16	1,045	597
United States	22,020	17,580	41,128	49,760	60,236	33,456	38,978	68,978	45,640	95,509
Northeast Asia										
China	4,366	11,156	27,515	33,787	37,500	913	4,000	4,400	2,000	3,467
Hong Kong, China	538	2,051	1,667	2,000	2,100	2,825	8,254	17,713	21,437	25,000
Japan	1,730	3,490	234	908	39	1,730	3,490	234	908	39
Korea	1,180	727	588	809	1,500	1,500	1,208	1,361	2,524	3,000
Chinese Taipei	1,271	879	917	1,375	1,470	1,854	1,869	2,451	2,460	3,822
Southeast Asia										
Brunei Darussalam	1	4	14	6	7	n/a	n/a	n/a	n/a	n/a
Indonesia	1,482	1,777	2,004	2,109	4,500	13	52	-31	15	12
Malaysia	3,998	5,183	5,006	4,348	5,800	389	514	1,325	1,817	2,575
Philippines	544	228	1,025	1,457	1,500	-26	5	-7	28	9
Singapore	4,879	2,351	5,016	5,588	5,302	1,024	1,317	1,784	2,177	2,799
Thailand	2,014	2,116	1,726	640	2,300	167	147	221	493	904
Oceania										
Australia	4,903	4,912	2,687	4,423	13,094	3,126	113	1,611	5,842	5,372
New Zealand	1,698	1,090	2,200	2,796	2,483	1,475	392	-1,370	2,041	1,310
Papua New Guinea	203	291	1	4	15	n/a	n/a	n/a	n/a	n/a

Source: UNCTAD, *World Investment Report*, 1997

Table 12

Share of Foreign Direct Investment Stock in GDP

(percent)

	Inward FDI				Outward FDI			
	1980	1985	1990	1995	1980	1985	1990	1995
Western Hemisphere								
Canada	20.4	18.5	19.7	21.7	8.5	11.7	13.7	18.3
Chile	3.2	14.1	33.1	23.1	0.2	0.6	0.6	4.1
Mexico	4.2	10.2	13.2	25.6	0.1	0.3	0.2	1.1
United States	3.1	4.6	7.2	7.7	8.1	6.2	7.9	9.2
Northeast Asia								
China	n/a	1.2	3.6	18.2	n/a	n/a	0.6	2.3
Hong Kong, China	6.3	10.5	18.7	22.7	0.5	7.0	18.5	88.8
Japan	0.3	0.4	0.3	0.3	1.8	3.3	7.0	6.0
Korea	1.8	1.9	2.3	2.3	0.2	0.6	0.9	2.2
Chinese Taipei	5.8	4.7	6.2	7.3	0.2	0.3	8.2	11.2
Southeast Asia								
Brunei Darussalam	0.4	0.9	1.1	2.2	n/a	n/a	n/a	n/a
Indonesia	14.2	28.6	36.6	25.2	n/a	0.1	n/a	0.3
Malaysia	24.8	27.2	33.0	52.1	1.7	2.4	5.3	12.6
Philippines	3.8	4.2	4.7	9.2	0.5	0.6	0.4	1.6
Singapore	52.9	73.6	76.3	67.4	47.7	35.3	25.8	38.4
Thailand	3.0	5.1	9.3	10.3	n/a	n/a	0.5	1.4
Oceania								
Australia	8.7	15.6	25.9	30.8	1.5	4.1	10.2	11.9
New Zealand	10.5	9.0	18.7	43.9	5.8	8.1	7.7	12.0
Papua New Guinea	27.1	31.1	46.8	48.2	0.4	1.0	0.2	0.1

Source: UNCTAD, *World Investment Report*, 1997

Australia

Background Information	
Capital	Canberra
Population	18.52 million (June quarter, 1997)
Language	English
Major Industries	manufacturing, wholesale trade, primary, property and business services, retail trade, construction
Major Exports	coal, gold, wheat, iron ore, alumina, wool, travel services
Major Imports	motor vehicles, computing equipment, petroleum, telecommunication equipment

GDP

Real GDP growth was 3.4 percent in 1996, broadly unchanged from 3.5 percent in 1995, as very strong growth in business investment and net exports offset slower growth in private consumption, weak conditions in the housing sector and weaker public final demand. There was a marked step-up in pace in the first half of 1997, with real GDP growth averaging around 1 percent per quarter, largely reflecting stronger private final demand.

The outlook for 1997 and 1998 is for strong growth, underpinned by an overall supportive international environment, low inflation and the structural soundness of the household and corporate sectors. Growth is expected to remain around 3.5 percent in 1997 as a deterioration in Australia's net export position broadly offsets continued strong business investment growth and a recovery in the housing sector. Real GDP growth is expected to accelerate to around 3.75 percent in 1998 supported by strong growth in private final demand.

An uncertainty surrounding the outlook is the possible impact of weather conditions related to the El Nino effect on agricultural output and hence GDP growth. Another uncertainty relates to the consequences for regional growth of the currency instability in some APEC member economies. However, these risks should not be overstated. Farm product accounts for less than 5 per cent of Australia's GDP and, while developments in East Asia are important for Australian trade, the outlook for growth in Australia's other major trading partners remains bright.

Business investment grew very strongly in 1996 reflecting sound economic fundamentals and the deferral of some investment from 1995 into 1996. Non-residential construction rose 17 percent reflecting very strong growth in investment in infrastructure and strong investment in buildings. Plant and equipment investment rose 16 percent reflecting solid economic fundamentals and falling import prices due to exchange rate appreciation.

Strong business investment growth is expected to continue in 1997 and 1998, reflecting the continued influence of very positive investment fundamentals. Business confidence is rising; capacity utilization is high; the price of investment goods has fallen, driven by declines in import prices; nominal interest rates have fallen; and profitability is high.

The housing sector, after making a sizable detraction from growth through 1995 and early 1996, began to recover in late 1996 and is expected to strengthen in 1997, consistent with the very favorable level of housing affordability.

Private consumption growth slowed during 1996 below the growth of real household disposable income as households consolidated their financial position with increased savings. Prior to rising in 1996, the household saving rate had generally followed a downward trend since the mid-1970s before holding steady over most of the 1990s.

Public consumption growth moderated slightly in 1996, reflecting fiscal consolidation at the Commonwealth level.

Public investment, after falling in 1996, is expected to pick up in 1997 as public trading enterprise investment strengthens and some States embark on major infrastructure programs.

The main impact of fiscal consolidation at the Commonwealth level is expected to be realized in 1998 and both public investment and public final demand are likely to ease in that year.

INFLATION

Underlying inflation fell through 1996 to 2.1 percent in the year to the December quarter. This reflected the impact of the exchange rate appreciation and widespread competitive pressures throughout the economy. In the year to the June quarter 1997, underlying inflation was 1.7 percent, slightly below the Reserve Bank's medium-term monetary policy target range of 2 to 3 percent. Underlying inflation is expected to increase in 1998 but to remain well within the Reserve Bank's target range.

Headline inflation was significantly lower than underlying inflation in 1996 and should be lower again in 1997, reflecting the impact of past declines in mortgage interest rates. Headline inflation fell to 0.3 percent in the year to the June quarter 1997.

EMPLOYMENT

Employment growth slowed in 1996 as a lagged response to slower GDP growth in 1995 and an acceleration in real wage growth. Nonetheless, the unemployment rate remained largely unchanged at around 8.6 percent. However, consistent with the recent strength of job vacancies data, employment growth is expected to pick up in 1997, underpinned by recent strong output growth and the very strong growth in prospect, and the unemployment rate should gradually decline through 1997 and 1998.

CURRENT ACCOUNT

The current account deficit fell to 3.8 percent of GDP in 1996 from 5.3 percent in 1995, reflecting an improvement in net exports and a slight decline in net income and transfer payments. The improved net export position reflects strong export volume growth, especially in rural and manufactured products, and an improved terms of trade. The current account deficit is expected to widen slightly to 4 percent of GDP in 1997 as a modest decline in net exports and an increase in the net income deficit are only partly offset by further improvement in the terms of trade. Overall, rising national investment is almost fully accommodated by higher national saving.

EXCHANGE RATE

The Australian dollar appreciated in nominal terms during 1996 by 7 percent against the U.S. dollar and by 17 percent against the yen. This strong appreciation was in response to improved commodity prices and relative real interest rates. These gains have been partly reversed in 1997 as the Australian dollar has eased against the U.S. dollar and the yen over the first part of the year.

MONETARY POLICY

The Reserve Bank of Australia has responsibility for the conduct of monetary policy. The objectives of monetary policy are to maintain currency stability and contribute to full employment. The former objective is given operational status by maintaining the underlying inflation rate at between 2 and 3 percent, on average, over the course of the economic cycle. In fact, in the period since 1993, underlying inflation averaged less than 2.5 percent.

To achieve this objective, the Reserve Bank targets the **overnight cash rate** at a publicly announced rate. Intermediate financial aggregates are not specifically targeted by the Bank. Following five reductions of one-half percentage point each to the officially targeted interest rate since mid-1996, most recently on July 30, 1997, the Reserve Bank has been targeting a cash rate of 5 percent.

FOREIGN DIRECT INVESTMENT

Net foreign debt was 39.9 percent of GDP (or US$158.6 billion) at end December 1996, down from a peak of 42.7 percent at the end of September 1993. The general government sector accounts for just over 30 percent of this total, while approximately 65 percent of Australia's net foreign debt is owed by private sector borrowers. The build-up in foreign debt is a result of ongoing current account deficits reflecting a structural saving-investment imbalance. Fiscal policy is focused on reducing the public sector's call on national saving while other policies have been implemented to improve the efficiency and effectiveness of investment.

Foreign direct investment in Australia was US$122.4 billion as of the end of December 1996.

Reform of the Australian Financial System

Last year, the Australian government announced and conducted a major review into the Australian financial system. The Financial System Inquiry was charged with providing a stocktaking of financial deregulation, an analysis of the forces driving change and recommendations on the key issues in regulatory reform, in particular to promote a more efficient and cost-effective financial system, consistent with stability, prudence, integrity and fairness.

The report of the Financial System Inquiry was released in April 1997. The Report notes that the financial system has entered an era of accelerated change that is likely to continue into the next century and, at the same time, the financial system is shifting from the predominance of traditional intermediary institutions and their products towards financial markets and managed funds. In the face of these changes, the Inquiry found that regulation must be re-focused to ensure that it does not slow down improvements in the financial system. The Report identifies ways of unlocking this potential for the Australian financial system without compromising its safety and performance.

It proposes that regulation be organized according to broad regulatory functions, instead of on institutional lines; consumer protection and market integrity regulation for the financial system should be brought together in a single agency; prudential regulation, aimed at promoting the safety of financial institutions and superannuation funds, should be combined in a single agency; and the Reserve Bank should retain its responsibilities for monetary policy, and strengthen its oversight role in overall financial stability and the payments system. The Report also considered measures to encourage more competition and means of reducing costs in the financial sector.

The Federal Government announced its response to the Report on 2 September 1997. Consistent with the recommendations of the Financial System Inquiry, the Federal Government has decided:

- to establish a new framework for the conduct of regulation in the financial system;
- subject to the agreement by the States and Territories, to include in the new framework regulatory responsibility for credit unions, building societies, friendly societies (and to consider also the transfer of regulatory responsibility for trustee companies and cooperative housing societies to the Federal Government if the State and Territory Governments agree); and
- to reform a range of regulation to facilitate greater financial sector innovation, competition and efficiency while at the same time maintaining financial sector stability, prudence and safety.

Key Indicators: Australia	1991	1992	1993	1994	1995	1996
Output						
Nominal GDP *(US$ bn)*	296.7	290.6	282.8	325.2	350.8	391.4
Real GDP *(% change)*	-0.8	2.6	4.0	5.2	3.5	3.4
Private Consumption *(% change)*	0.9	3.6	2.7	4.5	4.6	3.0
Private Investment *(% change)*	-11.1	4.5	6.3	13.8	1.6	7.4
Government Consumption *(% change)*	2.5	1.6	0.3	5.3	2.8	2.5
Government Investment *(% change)*	-4.5	-5.2	-5.8	4.3	1.4	-3.6
Exports *(% change)*	13.1	5.3	7.5	8.8	4.4	10.2
Imports *(% change)*	-2.6	7.8	5.5	15.6	9.6	8.6
Prices and Labor Market						
GDP Deflator *(% change)*	2.3	1.3	1.3	1.1	2.5	2.1
Headline CPI *(% change)*	3.2	1.0	1.8	1.9	4.6	2.6
Underlying CPI *(% change)*	3.9	2.5	2.0	2.0	2.7	2.7
Unemployment Rate *(%)*	9.6	10.8	10.9	9.7	8.5	8.6
Financial Markets						
M3 *(% change)*	5.6	5.4	7.5	8.2	8.3	9.4
Short-term Interest Rate *(%)*	10.15	6.45	5.14	5.74	7.73	7.12
Exchange Rate *(annual average A$/US$)*	1.28	1.36	1.47	1.37	1.35	1.28
Balance of Payments						
Merchandise Trade Balance *(b.o.p. % of GDP)*	1.2	0.5	-0.1	-1.0	-1.2	-0.2
Current Account Balance *(% of GDP)*	-3.1	-3.4	-3.4	-5.0	-5.3	-3.8
Budget Balance *(% of GDP)*	-2.3	-4.4	-4.5	-3.4	-2.1	-0.9
Population *(millions)*	17.31	17.52	17.69	17.88	18.10	18.34

Source: Data are as submitted by member economies, unless otherwise specified. For Australia, sources are Australian Bureau of Statistics Catalogue Nos. 5206.0, 5302.0, 3101.0, 6203.0. The budget balance is the Total General Government net lending (National Accounts basis).

Summary of Forecasts	1997					1998-2000				
	Official	IMF	PECC	DRI	WEFA	Official	IMF	PECC	DRI	WEFA
Real GDP	3.5	3.2	3.5	2.8	2.7	3.5	4.0	4.0	2.7	4.2
Real Exports	6.0	n/a	7.1	3.4	5.0	n/a	n/a	9.0	5.3	8.7
Real Imports	9.0	n/a	9.8	6.3	6.0	n/a	n/a	8.2	5.0	9.2
CPI	0.75	1.7	1.8	1.4	1.8	2.25	2.1	3.0	2.3	4.0

Notes: The official forecasts are sourced from the 1997-98 Budget released on 13 May 1997. These forecasts and projections are calendar year equivalents of the official forecasts and projections, which are made on a fiscal year basis (1 July to 30 June). The 1998 real GDP growth forecast is 3.75 percent, while in 1999, it is 3.5 percent. The IMF forecast is from the *World Economic Outlook* (IMF, September 1997); figures for the period 1998-2000 refer to 1998 only. The PECC forecast is from the *Pacific Economic Outlook 1997-1998* (PECC, 1997); 1998-2000 figures refer to 1998 only. The DRI forecast is from *World Market Executive Overview* (3rd Quarter, 1997). The WEFA forecast is from *Asia Economic Outlook* (August, 1997). Note: DRI and WEFA figures for real export and real import growth include services.

Brunei Darussalam

Background Information	
Capital	Bandar Seri Begawan
Population	18.52 million (June quarter, 1997
Language	Malay
Major Industries	oil and gas, textiles, food and beverages, building materials
Major Exports	oil and gas, ready-made garments
Major Imports	machinery and transport equipment, manufactured goods, food and chemicals

GDP

Real GDP growth increased to 3.3 percent in 1996 from 2.0 percent in 1995, as 6 percent growth in the non-oil sector, including both Government and the non-oil private sector, offset a decline in the oil sector. This increase raised the non-oil sector share of nominal GDP to 64 percent in 1996 from 46 percent in 1990.

The services sector grew particularly strongly in 1996, including community and personal services (10 percent), transport and communication (8 percent), construction (8 percent), banking, finance and insurance (7.8 percent), and wholesale and retail trade, restaurants and hotels (6.5 percent).

Manufacturing sector growth increased to about 4 percent in 1996, up from 3.7 percent in 1995.

The primary sector (agriculture, forestry, fishery) witnessed an acceleration in growth to 5 percent in 1996 compared to 2.2 percent in 1995. Both manufacturing and the primary sector are still comparatively small in terms of their share of GDP, and accelerating the development of these sectors is part of the national objective to diversify the economy in the face of the continuous decline in the contribution of the oil and gas sector.

Brunei Darussalam embarked on **the Seventh National Development Plan** (1996-2000) by pursuing more balanced socio-economic development. A sum of US$7.2 billion has been allocated to implement several development programs and projects.

The various projects and programs also aim to facilitate the development of the private sector.

Outlook: The economy is expected to grow by around 3 percent in 1997 and 4.5 percent in 1998.

INFLATION

Inflation, as measured by the rate of increase in the Consumer Price Index (CPI) fell to only 2 percent in 1996 from 6 percent in 1995.

As Brunei Darussalam is a net importer of almost all items, including 40 percent of machinery and transport equipment, 28 percent of manufactured items, and 13 percent of food, its inflation performance is influenced significantly by import prices. Thus, the exceptionally high inflation rate in 1995 was partly due to significant increases in import duty rates on cigarettes imposed in December 1994 and on motor vehicles in February 1995. Conversely, the substantial reduction of import duties on almost 700 consumer items in April 1995 contributed significantly to lowering the rate of inflation to 2 percent in 1996.

Price controls on some basic necessities have also helped contain price increases. Prices of sugar and rice are set by the authorities. Indicative price ceilings on items such as basic foods, household goods, automobiles and tobacco goods have also been set by the authority concerned. Other factors include the annual Brunei Grand Sales held during the festive seasons, which also helps in reducing CPI growth, as well as gas and utility subsidies.

EMPLOYMENT

The labor force grew 4.6 percent in 1996, well above the growth rate of the population, which stood at 3.1 percent. Total employment stood at around 134,000, or 44 percent of the total population which was estimated to be around

305,000 people in 1996. Of the total population, 52 percent were male and 48 percent female.

Migrant workers constitute almost half of the working population. The majority come from the neighboring ASEAN economies to meet a shortage of local workers particularly in the construction and related industries. Migrant workers accounted for 65 percent of unskilled laborers, 38 percent of professionals and 22 percent of the administrative and managerial workforce. The inflow of migrant workers contributes to the more rapid expansion of the labor force compared to population growth.

Women's labor force participation has also been on the increase, which is another factor contributing to more rapid labor force growth as compared with population increase. The participation rate of women rose from 31 percent in 1981 to 48 percent in 1991. The total number of women classified as employees and employers increased from 14,200 employees and 70 employers in 1981 to 33,100 employees and 160 employers in 1991.

The growing presence of women in the job market is particularly felt in the services sector, including community, social and personal services; wholesale and retail trade; hotels and restaurants; finance and insurance; and real estate and business services.

EXCHANGE RATE

The Brunei dollar is pegged at par to the Singapore dollar. In the 1990s, both nominal and real effective exchange rates have appreciated by more than 10 percent. Since there is no government regulation or prescription of exchange rates or exchange rate margins, the commercial banks are free to set the exchange rates for currencies other than the Singapore dollar in their dealing with the general public.

FISCAL POLICY

Government expenditure will be moderate during the current Plan period through public sector reforms. Some of the Government agencies/ activities have been identified as feasible to be privatized. Steps will continue to be taken to increase Government revenue from various sources, such as from the non-oil activities. In view of the small market size and labor shortage problem, industrialization through proxy will also be pursued.

MONETARY POLICY

Brunei Darussalam has no central bank or monetary authority. The Ministry of Finance, through a number of agencies and departments under it performs the various functions of a central monetary authority. The Brunei Currency Board is responsible for the issuance and management of the currency. The Financial Institution Division of the Ministry of Finance is responsible for licensing and regulating financial institutions. The Minimum Cash Balance requirement is one of the latest measures introduced in carrying out this function. There are no credit or interest rate restrictions imposed, and the Brunei Association of Banks determines daily interest rates.

MEDIUM-TERM OUTLOOK

Outlook: GDP is projected to grow in the range of 3.5 to 5.0 percent over the period 1998 to 2000. The oil sector is expected to stabilize while the non-oil sector, particularly the service-related and construction activities, will continue to be buoyant.

During the same period, inflation is expected to be held at around 3 percent per annum. In addition, maintaining tight monetary and fiscal policies to prevent further build up of inflationary pressures, Government efforts will focus on minimizing supply-side bottlenecks that might create inflationary pressures, and enforcing regulations governing prices of essential goods and services.

The terms of trade is expected to be favorable during this period with an improved outlook for hydro-carbon exports. The hubbing and trans-shipment activities of Muara Port, which aims to serve the BIMP-IAGA area, will provide a steadying influence on the trade balance.

Key Indicators: Brunei Darussalam	1991	1992	1993	1994	1995	1996
Output						
Nominal GDP *(US$ bn)*	6.62	6.57	6.59	6.69	7.07	7.45
Real GDP (*% change*)	4.0	-1.1	0.5	1.8	2.0	3.5
Exports (*% change*)	6.7	-9.5	-5.6	-7.1	-0.02	8.3
Imports (*% change*)	6.4	-0.4	4.0	26.5	27.6	21.8
Prices and Labor Market						
GDP Deflator (*% change*)	-2.2	0.3	-0.2	-0.3	3.6	2.5
Headline CPI (*% change*)	1.6	1.3	4.3	2.4	6.0	2.0
Unemployment Rate *(%)*	4.7	4.5	4.1	3.6	4.9	5.0
Financial Markets						
M2 (*% change*)	4.5	4.3	10.7	38.6	7.3	-2.3
Short-term Interest Rate *(%)*	7.0	6.0	5.8	6.0	6.5	6.3
Exchange Rate *(annual average BR$/US$)*	1.73	1.63	1.60	1.53	1.42	1.41
Balance of Payments						
Merchandise Trade Balance *(% of GDP)*	36.9	31.2	26.9	10.1	8.3	1.9
Current Account Balance *(% of GDP)*	76.9	66.4	62.9	68.6	57.6	50.0
Budget Balance *(% of GDP)*	-1.1	-5.0	0.3	0.5	0.1	3.1
Population *(millions)*	0.26	0.27	0.28	0.28	0.29	0.30

Source: Data are as submitted by member economies, unless otherwise specified. In the case of the current account balance, data for 1991-1995 are drawn from the 1996 APEC Economic Outlook; the 1996 figure is an estimate based on partial data by the Economic Committee.

Canada

Background Information	
Capital	Ottawa
Population	29.94 million (1996 Census)
Language	English and French
Major Industries	automobile manufacturing, pulp and paper, iron and steel, machinery and equipment manufacturing, mining, extraction of fossil fuels, forestry and agriculture, aeronautics
Major Exports	automobile vehicles and parts, machinery and equipment, high-technology products, oil, natural gas, metals, and forest and farm products
Major Imports	machinery and industrial equipment including communications and electronic equipment, vehicles and automobile parts, industrial materials (metal ores, iron and steel, precious metals, chemicals, plastics, cotton, wool and other textiles), along with manufactured products and food

GDP

GDP growth slowed from 2.3 percent in 1995 to 1.5 percent in 1996, largely due to weakness in the first half of the year. The cause for the first half weakness was sluggish domestic demand that resulted from the interest rate increases of 1994 and early 1995.

Inventory decumulation also played a major role in this weakness as businesses worked off an unintended accumulation of inventories (in fact the largest two-quarter increase in inventories in seven years) that occurred when demand weakened unexpectedly in early 1995 due to increased interest rates. Inventory investment subsequently subtracted from growth from the third quarter of 1995 right through the second quarter of 1996, when there was an actual decumulation.

Fiscal drag also subtracted from growth in 1996, as governments at all levels took strong action to cut deficits. The total government structural deficit as a share of GDP is estimated to have been reduced by almost 2.5 percentage points in 1996.

Consumer spending was restrained for much of 1996 as the slower growth in output coupled with the ongoing job cutbacks in the public sector restrained growth in employment. This in turn led to slow growth in personal income which, despite some decline in the personal savings rate, held back the recovery in consumer spending until the fourth quarter when it grew by over 5 percent at annual rates.

Net exports, in contrast to previous years, also subtracted from growth in 1996. This reflected the waning effect of the currency depreciation over the 1992 to 1994 period and strong domestic demand in the second half of 1996.

Investment led the pick up in the second half of 1996, responding to the steep descent in interest rates, which had begun in 1995 and had continued through most of 1996.

Business investment in machinery and equipment soared in the second half of 1996. M&E growth exceeded 30 percent at annual rates in both the third and fourth quarters while residential investment grew by 20 percent at annual rates in the fourth quarter of 1996.

INFLATION

Targets for core inflation (the CPI excluding food, energy and the effect of indirect taxes) were announced jointly by the Bank of Canada and the Department of Finance in February 1991. Core inflation has since been kept in or below the target band. In 1996, core inflation was 1.5 percent, down from 2.2 percent in 1995. The current target band is 1 to 3 percent

Headline inflation slowed to 1.6 percent in 1996 and has remained in the 1 to 2 percent range through the first half of 1997.

EMPLOYMENT

Employment growth slowed to 1.3 percent in 1996 as labor market conditions reflected the overall less favorable economic conditions.

The unemployment rate rose marginally to 9.7 percent in 1996 as employment growth failed to keep pace with labor force growth (which at 1.5 percent was the strongest in the 1990s). The pick up in labor force growth reflected the stabilization of the participation rate after 6 years of decline. The unemployment rate is expected to fall as employment growth strengthens with accelerating output growth and work disincentives are reduced by the reforms to employment insurance (see box). The rate of decline will depend on the reaction of the aggregate participation rate to the improving economic conditions.

CURRENT ACCOUNT

The current account has significantly improved since 1993 with a shift from a deficit of 4 percent of GDP in 1993 to a surplus of 0.5 percent of GDP in 1996. This improvement has been primarily due to a sharp increase in the merchandise trade surplus. Lower interest rates also helped reduce net investment outflows.

The terms of trade have improved steadily over the past five years, providing underlying support for the merchandise trade balance. The improvement in terms of trade reflects higher prices for commodity exports and the growing share of office machinery in imports.

FISCAL POLICY

Since 1994, the federal government and most provincial governments have adopted explicit short-term deficit targets and have reduced the total government deficit from over 7 percent of GDP in 1993 (national accounts basis) to only 1.8 percent in 1996. It is expected that the fiscal situation will continue to improve, as most provinces have set balanced budget targets. Measures to improve Canada's child-support system have also been announced.

MONETARY POLICY

Improved public finances enabled the Bank of Canada to achieve a balance of **monetary conditions** that was appropriately more expansionary in 1996.

The Canadian dollar was broadly stable in the neighborhood of 72-73 U.S. cents over the course of 1996 and the first three quarters of 1997; a modest appreciation late in 1996 was reversed in 1997 as the U.S. dollar rose globally.

Interest rates fell through 1996 and stabilized at low levels in the first three quarters of 1997. The 3-month treasury bill rate declined from 5.1 percent in the first quarter of 1996 to 2.9 percent in the fourth quarter before stabilizing at about this level through the first 3 quarters of 1997, more than 200 basis points below comparable U.S. rates. Indeed, in 1997 the Canadian yield curve has traded below the U.S. yield curve out to a maturity of 30 years.

OUTLOOK

The growth momentum developed in the latter part of 1996 continued to build in the first half of 1997: quarterly growth accelerated to 3.7 percent at annual rates in the first quarter and to 4.9 percent in the second quarter. On average, private-sector economists now forecast real GDP growth of 3.7 percent in 1997. With unemployment still high, this robust growth can be accommodated without igniting inflationary pressures. However, as fiscal drag wanes further and the output gap closes, some tightening of monetary conditions will be appropriate.

Recent Structural Policy Reforms in Canada

The federal government has made major structural reforms to ensure labor market flexibility, to increase investments in technology and knowledge, and to improve market access for Canadian exports and investment.

The *Employment Insurance Act* of July 1996 made numerous changes to the Unemployment Insurance system. Changes are designed to strengthen work incentives, to accommodate the changing structure of the labor market (i.e., include more part-time workers), and place more emphasis on proactive measures for re-employment.

To create enduring jobs in the new economy, investments in knowledge and technology are being made. The Technology Partnerships Canada program represents a risk-sharing approach to investment in technology and helps promote technical diffusion, job creation and economic growth. The School Net and Community Access programs are being expanded to more and more Canadians. The CANARIE program provides funding on a cost-shared basis to projects that will lead to the development of advanced networks and associated technologies and applications in Canada. Somewhat related is the Investment Partnerships Canada program, a strategy designed to target key multinational companies to secure high profile, strategic investments in key economic sectors.

Market framework policies in the areas of competition, bankruptcy, and copyright have been revamped to improve conditions for investment in the Canadian economy and to build a fair, efficient and competitive marketplace for businesses and consumers.

Measures to enhance export development and financing, with emphasis on developing new products and new exporters and attracting new foreign investment have been undertaken. Efforts to expand NAFTA and to promote more world trade liberalization have continued with the Canada-Chile FTA, negotiations with the MERCOSUR countries, and ongoing multilateral negotiations on investment and select services areas.

To further reduce barriers to interprovincial trade and strengthen the Canadian economy, the federal government is working with the provinces and the private sector to achieve a more open Internal Trade Agreement.

Efforts to secure a sustainable social safety net for the future are underway. Federal transfers under the Canada Health and Social Transfer will provide block funding designed to give provinces enhanced flexibility in providing social services, particularly health care. The Canada Pension Plan has been made sustainable for future generations by moving towards fuller funding. And measures that reach into the communities to improve Canada’s child support system have been announced.

Special efforts are also being aimed at providing employment opportunities to young Canadians including measures to double the number of federal summer student jobs and initiatives to enhance youth job opportunities.

Key Indicators: Canada	1991	1992	1993	1994	1995	1996
Output						
Nominal GDP *(US$ bn)*	590.4	571.0	552.6	547.2	565.6	585.1
Real GDP *(% change)*	-1.8	0.8	2.2	4.1	2.3	1.5
Private Consumption *(% change)*	-1.6	1.3	1.6	2.9	1.4	2.4
Private Investment *(% change)*	-4.0	-1.7	0.5	5.9	-0.6	7.8
Government Consumption *(% change)*	2.7	1.0	0.5	-1.7	-0.7	-1.8
Government Investment *(% change)*	4.9	-0.1	0.7	6.4	2.7	-2.8
Exports *(% change)*	1.4	7.6	10.4	14.7	12.0	4.5
Imports *(% change)*	3.3	5.6	8.8	11.5	8.7	5.1
Prices and Labor Market						
GDP Deflator *(% change)*	2.9	1.2	1.0	0.7	1.5	1.3
Headline CPI *(% change)*	5.6	1.5	1.8	0.2	2.1	1.6
Unemployment Rate *(%)*	10.4	11.3	11.2	10.4	9.5	9.7
Financial Markets						
Short-term Interest Rate *(%)*	8.7	6.6	4.8	5.5	6.9	4.2
Exchange Rate *(annual average C$/US$)*	1.146	1.209	1.290	1.366	1.372	1.364
Balance of Payments						
Goods and Services Balance *(% of GDP)*	-0.7	-0.5	-0.1	1.0	3.0	3.9
Current Account Balance *(% of GDP)*	-3.8	-3.7	-3.9	-2.7	-1.0	0.5
Budget Balance *(% of GDP)*	-6.6	-7.4	-7.3	-5.3	-4.1	-1.8
Population *(millions)*	28.08	28.49	28.90	29.93	29.58	29.94

Source: Data are as submitted by member economies, unless otherwise specified. The goods and services trade data are on a Balance of Payments basis. The short-term interest rate is the 3-month Treasury Bill Rate. The budget balance is on a National Accounts basis.

Summary of			1997					1998-2000		
Forecasts	Official	IMF	PECC	DRI	WEFA	Official	IMF	PECC	DRI	WEFA
Real GDP	3.7	3.7	2.9	3.6	3.1	n/a	3.5	2.7	2.7	3.8
Real Exports	n/a	n/a	5.1	8.3	6.7	n/a	n/a	5.2	6.0	2.8
Real Imports	n/a	n/a	6.5	11.6	7.7	n/a	n/a	5.0	5.9	1.3
CPI	1.8	1.5	2.2	2.3	1.4	n/a	1.6	2.3	1.8	1.3

Notes: The official figures are the average of private sector forecasts (September 1997). Higher interest rates and lower nominal GDP growth are assumed for prudent fiscal planning purposes. The IMF forecast is from the *World Economic Outlook* (IMF, September 1997); figures for the period 1998-2000 refer to 1998 only. The PECC forecast is from the *Pacific Economic Outlook 1997-1998* (PECC, 1997); 1998-2000 figures refer to 1998 only. The DRI forecast is from *World Market Executive Overview* (3rd Quarter, 1997). The WEFA forecast is from *Asia Economic Outlook* (August, 1997). Note: DRI and WEFA figures for real export and real import growth include services.

Chile

Background Information	
Capital	Santiago
Population	14.50 million (1996)
Language	Spanish
Major Industries	non-ferrous metal products, food and beverages, cellulose and paper, chemicals, petroleum refining, iron and steel, textiles
Major Exports	copper, food and beverage products, fruit, other mining products, cellulose and paper, chemicals, wood products
Major Imports	machinery, electronic and electrical equipment, transport equipment, chemical products, oil and derivatives and coal

GDP

Real GDP expanded in 1996 for the thirteenth consecutive year. During this period, i.e. since 1984, real GDP expanded at an annual average rate of 6.6 percent, including 4.9 percent in per capita terms. This record has established Chile as one of the most dynamic economies in the world.

In 1996, growth slowed to 7.2 percent from 8.5 percent in 1995, reflecting the adoption of an adjustment policy by the authorities to avoid overheating of the economy. A sharp decline in the price of important Chilean exports, such as copper and cellulose, and the appreciation of the peso against the dollar, which affected the terms of trade and the trade balance, also worked to slow growth. The non-tradable sectors of GDP, however, continued to be robust, especially construction, retail and wholesale trade and catering, and transport and communications.

The slowing trend continued into the first quarter of 1997, with real GDP growth hitting a low of 3.1 percent annual growth. However, the second quarter witnessed a turnaround, with growth strengthening to 5.8 percent, bringing the first half average up to 4.5 percent. For the year as a whole, real GDP is expected to expand by 6 percent.

Gross fixed capital formation continued strong despite the adjustment policy, increasing its share of GDP from 27.2 percent in 1995 to 28.1 percent in 1996. In 1997, this ratio is expected to reach a record of about 28.7 percent.

Private investment continued to be the principal motor of the economy in 1996, rising 7.4 percent, while **government investment** growth reached 15.7 percent.

The high investment levels have been financed increasingly with domestic **savings**. In 1990-96, the average total saving rate reached 26.9 percent of GDP, with contributions of 24.8 percent from national saving and 2.1 percent from external saving. This latter figure compares to the nearly 5.8 percent recorded in the period 1984-89. Recourse to external financing has, however, increased recently: after being negative in 1995, the external saving rate rose to 3.3 percent in 1996, and is expected to reach 3.5 percent in 1997.

Exports of goods and services rose by 10.9 percent. Merchandise export volumes grew 13.7 percent in 1996, of which manufactures grew by 8.5 percent. Services exports also grew robustly.

INFLATION

CPI growth has declined steadily in line with the Central Bank targets (12-month CPI increase targets), falling from 8.9 percent in 1994 to 8.2 percent in 1995 and to 6.6 percent in 1996. The latter was the lowest inflation rate in Chile in the last 36 years. The Central Bank target for 1997 is 5.5 percent.

Both the non-tradable and tradable sectors contributed to the disinflationary trend. The non-tradable goods inflation rate diminished from 10.0 percent in 1995 to 7.8 percent in 1996, while the tradable goods inflation rate declined from 5.6

percent to 4.9 percent. Price pressures declined further at the beginning of 1997, with CPI growth falling to 5.3 percent in the 12 months to June 1997.

EMPLOYMENT

Employment grew by 1.7 percent (86,800 new jobs), reducing the unemployment rate from 7.3 percent in 1995 to 6.4 percent in 1996, its lowest level in the last 25 years. The non-tradable sectors contributed the most to employment growth in 1996, particularly the electricity, gas and water, construction, financial services and personal services sectors. The youth unemployment rate (i.e., for persons between 15 and 24 years old) fell over the course of the year to 12.8 percent in the fourth quarter, from 17 percent in the first quarter.

Nominal wages grew by 9.5 percent in 1996 while real wages grew by 2.7 percent, well below labor productivity growth of 4.4 percent.

CURRENT ACCOUNT

The current account registered a deficit of 4.1 percent of GDP in 1996 following a surplus of 0.2 percent in 1995. This reflected a shift in the goods trade balance into deficit and continuation of negative balances in services trade and transfers.

The merchandise trade deficit of 1.6 percent of GDP (US$1.3 billion) reflected a 4.6 percent decline in the value of exports due to the negative evolution of the terms of trade during the year, caused largely by the reduced prices of copper, cellulose and some industrial products. Meanwhile imports grew by 12.7 percent in value, led by consumer goods, which grew 17.6 percent, and capital goods, which grew 13.7 percent.

EXCHANGE RATE

The Central Bank has a mixed exchange-rate regime under which it allows the nominal exchange rate to float around a reference rate that is pegged to a basket of currencies (dollar, mark and yen) and is adjusted according to a set of indicators (past inflation and an estimated 2 percent annual appreciation of the real exchange rate due to improvements in productivity). At the beginning of 1997, the band was widened to plus or minus 12.5 percent, and the relative weight of the dollar in the basket of currencies was raised in order to reflect the growing importance of that currency for Chile.

The peso depreciated by 3.4 percent in nominal terms in 1996, reaching 422 pesos/US$ in December. However, the real exchange rate appreciated by about 4.5 percent, continuing the trend of the previous six years. The exchange rate has appreciated in the first three quarters of 1997 in both nominal and real terms, reaching 416 pesos/US$ in September 1997.

The peso has appreciated in real terms by 4.6 percent on an annual average basis since 1990. However, Chile has maintained its competitiveness, as labor productivity growth has averaged 4.7 percent per year in this period.

FISCAL POLICY

The central government balance was in surplus in 1996 (2.2 percent of GDP). It is expected to remain in surplus in 1997, as the austere fiscal policy aimed at reducing inflation is continued.

MONETARY POLICY

Monetary policy is oriented towards achieving an inflation rate target set every year by the Central Bank. This policy approach has been successful in bringing down inflation steadily since 1990.

The interest rate is the primary instrument used by the Central Bank. At the end of 1995, the Central Bank raised the real interest rate in order to avoid inflationary pressures, pushing the short-term interest rate to 7.25 percent in 1996, compared to 6.1 percent in 1995. The Central Bank's overnight real interest rate was lowered three times in 1997, to 7.0 percent in February, to 6.75 percent in April and to 6.5 percent in August.

The Central Bank does not set targets for the **monetary aggregates.** M2 growth remained relatively high in 1996, recording an increase of 26.9 percent compared to 22.5 percent in 1995.

FOREIGN INVESTMENT

Foreign investment inflows reached a record of US$6.2 billion in 1996, up 42.4 percent over 1995.

Of this total, US$4.6 billion was introduced via the Decree Law 600 (a preferential regime for foreign direct investment), with the services sector receiving the main share (50.9 percent), followed by mining (19.4 percent) and manufacturing (17.8 percent). The main sources of FDI were the United States (48.8 percent), Spain (10.7 percent) and Canada (7.0 percent).

An additional US$1.2 billion came in via the American Depository Receipts, an instrument for portfolio investments.

MEDIUM-TERM OUTLOOK

The perspectives for the Chilean economy are fundamentally very good. In 1997, GDP growth is expected to slow modestly to 6 percent. Low terms of trade are also expected to result in a current account deficit of 3.5 percent of GDP. Over the medium term, the Chilean government expects to maintain economic growth close to the potential growth rate, estimated within 6 and 7 percent.

Uncertainties are primarily related to the terms of trade, since the prices of the main Chilean exports, copper, fishmeal and pulp, and that of the principal import, crude oil, tend to be very volatile. Copper prices, in particular, have a significant impact on fiscal revenues.

Another uncertainty relates to the impact of foreign capital inflows on the evolution of the real exchange rate. Induced by high economic growth rates and a favorable investment environment, foreign capital inflows have increased rapidly as a percentage of GDP over the last six years, reaching 9.9 percent of GDP in 1996. These flows have led to a persistent appreciation of the Chilean peso in real terms with resulting potential implications for trade.

Structural Reforms in Chile

Chile has, for two decades, pursued a set of structural reforms in order to increase the competitiveness of the Chilean economy and improve income distribution. The current reform agenda includes:

- Improvement of the educational system in order to increase labor productivity and achieve a more equitable income distribution. This reform is focused on infrastructure investment, extension of the daily schedule, and up-grading of the curricula and teacher's training.

- Increasing incorporation of private capital in infrastructure development, especially in highways, airports, railways, sewage, water treatment and ports, through concession contracts signed after a competitive bidding process. Under these contracts, private companies agree to the construction, conservation and management of a national property, being paid by the user (in accordance with the bidding guidelines, the State can guarantee a minimum income).

- Fostering financial market liberalization by allowing the establishment of new foreign financial institutions in the Chilean territory and of Chilean subsidiaries abroad, and direct lending in external markets.

- Strengthening trade and financial relations with the rest of the world under the principle of open regionalism. In line with its APEC commitments, Chile has signed free trade agreements with two APEC economies. The agreement with Canada (1997) was the first to include disciplines on trade in services and investment, and the FTA with Mexico signed in 1991 is being enlarged to cover these new areas. Chile has also signed free trade agreements under the aegis of the Latin American Integration Association (LAIA) with MERCOSUR, Colombia, Venezuela and Ecuador. Finally, the government is negotiating with Bolivia, Panama and Peru and, through the Frame Agreement on Political and Economic Cooperation signed in June 1996, the European Union.

Key Indicators: Chile	1991	1992	1993	1994	1995	1996
Output						
Nominal GDP *(US$ bn)*	34.41	42.75	45.66	52.16	67.30	71.91
Real GDP *(% change)*	7.3	11.0	6.3	4.2	8.5	7.2
Private Consumption *(% change)*	8.9	11.6	8.1	4.4	11.7	8.8
Private Investment *(% change)*	1.6	26.0	12.5	1.0	19.0	7.4
Government Consumption *(% change)*	4.3	5.3	3.3	2.3	2.3	2.5
Government Investment *(% change)*	26.1	24.6	21.7	11.9	7.3	15.7
Exports *(% change)*	10.7	13.5	4.2	8.2	11.4	10.9
Imports *(% change)*	8.5	23.5	11.2	5.1	22.2	11.7
Prices and Labor Market						
GDP Deflator *(% change)*	20.9	16.2	12.0	13.9	12.2	3.5
Headline CPI *(% change)*	18.7	12.7	12.2	8.9	8.2	6.6
Unemployment Rate *(%)*	8.2	6.7	6.6	7.8	7.3	6.4
Financial Markets						
M2 *(% change)*	31.1	39.7	33.3	30.1	22.5	26.9
Short-term Interest Rate *(%)*	5.8	5.5	6.5	6.4	6.1	7.3
Exchange Rate *(annual average Peso/US$)*	349.2	362.6	404.2	420.2	396.8	412.3
Balance of Payments						
Trade Balance *(f.o.b. - % of GDP)*	4.6	1.8	-2.2	1.4	2.1	-1.6
Current Account Balance *(% of GDP)*	0.3	-1.6	-4.6	-1.2	0.2	-4.1
Budget Balance *(% of GDP)*	1.5	2.2	1.9	1.7	2.5	2.2
Population *(millions)*	13.39	13.60	13.81	14.03	14.24	14.42

Source: Data are as submitted by member economies, unless otherwise specified.

Summary of Forecasts	1997					1998-2000				
	Official	IMF	PECC	DRI	WEFA	Official	IMF	PECC	DRI	WEFA
Real GDP	6.0	5.5	5.6	5.4	5.1	n/a	n/a	6.3	6.7	5.9
Real Exports	11.0	n/a	7.6	7.6	10.4	n/a	n/a	11.5	10.3	7.4
Real Imports	6.0	n/a	7.1	8.8	10.9	n/a	n/a	8.8	10.4	7.1
CPI	5.5	6.0	5.5	6.2	6.2	n/a	n/a	4.5	4.3	5.0

Notes: IMF forecast is from the *World Economic Outlook* (IMF, September 1997); figures for the period 1998-2000 refer to 1998 only. The PECC forecast is from the *Pacific Economic Outlook 1997-1998* (PECC, 1997); 1998-2000 figures refer to 1998 only. The DRI forecast is from *World Market Executive Overview* (3rd Quarter, 1997). The WEFA forecast is from *Asia Economic Outlook* (August, 1997). Note: DRI and WEFA figures for real export and real import growth include services.

The People's Republic of China

Background Information	
Capital	Beijing
Population	1,233.9 million (1996)
Language	Chinese
Major Industries	coal mining and processing, food processing, textiles and clothing, chemical products, metal and nonmetal products, machinery and transportation equipment
Major Exports	food, textiles and clothing, footwear, mining products, machinery, electronic and electrical equipment
Major Imports	minerals, chemicals, plastics, textile materials, iron and steel, transportation equipment, machinery and electric equipment

GDP

Real GDP grew 9.7 percent in 1966, 0.8 percent less than the 10.5 percent recorded in 1995. The growth rate of primary industry was 5.1 percent, of secondary industry 12.3 percent, and of tertiary 8 percent.

In 1997, real GDP growth slowed somewhat to 9.0 percent through the first three quarters, on a year-over-year basis, consistent with the expected medium-term growth path.

Industrial production came in above plan. **Coal:** 1.3 billion tons, 6.2 percent above plan; **electricity**: 1,075 billion kw, 0.5 above plan; **steel**: 101 million tons, 5.3 percent above plan; **fertilizer**: 26.6 million tons, 8.8 percent above plan.

Supported by industrial policy, the electronics, transportation, communication and other industries grew faster. Production of **integrated circuit boards** rose to 436 million units, 39.3 percent more than in 1995; **total air freight** was 8 billion tons & kilometers, 12.9 percent more than in 1995; and the turnover of post service was 134 billion Yuan, 35.4 percent more than in 1995.

The output of crops reached a new historical high, above 504 million tons, 37.4 million tons more than that last year, reflecting agricultural investment, enlargement of land under cultivation, restructuring of planting areas, use of appropriate technologies, maintenance of the prices of agricultural machinery, and raising of purchase prices of crops.

Township enterprises developed as usual. The development in the northwest area started up.

The population living in poverty decreased to 58 million from 65 million in 1995. There was progress in the project of poverty assistance.

Capital investment grew 18.2 percent to 2,366 billion Yuan. Above average growth was recorded in agriculture, forestry, water resources, energy, transportation, communication and electronics. The investment in the agriculture, forestry and water resources sectors was 82.6 percent of total new planned investment.

International trade continued to rise, with total imports and exports of US$289.9 billion, an increase of 3.2 percent compared to that in 1995.

Total exports rose 1.5 percent to US$151.1 billion, and **total imports** rose 5.1 percent to US$ 138.8 billion. **The trade surplus** was US$12.3 billion

INFLATION

After 3 years of double-digit inflation, a soft landing was successfully achieved in 1996. The retail price index (RPI) rose only 6.1 percent, substantially lower than the planned 10 percent rate, and 8 percentage points less than in 1995.

At the same time, the more comprehensive CPI slowed to 8.3 percent from 17.1 percent in 1995. The deceleration in inflation reflected tighter fiscal and monetary policies implemented to restrain the pace of expansion and efforts to strengthen price control. In 1997, inflation has slowed further, with the RPI rising only 1.4 percent through the first half of the year on a year-over-year basis and the CPI only 4.1 percent.

EMPLOYMENT

Employment grew 1.3 percent in 1996 compared with 1.2 percent in 1994 and 1.1 percent in 1995.

However, the **unemployment rate** went up as well to 3 percent in 1996 from 2.8 percent in 1994 and 2.9 percent in 1995. The number of employees in primary industry continued to fall, while those in secondary and tertiary industries continued to rise.

In 1997, employment growth is expected to rise slightly based on continued strong economic growth. However, the unemployment rate is expected to increase to 4 percent in 1997, even as the government pursues its "re-employment" policy, which aims to make more job opportunities available for the unemployed.

CURRENT ACCOUNT

The current account surplus rose to US$7.24 billion in 1996 or 0.9 percent of GDP, up from US$1.6 billion or 0.23 percent of GDP in 1995. In 1997, the current account surplus is expected to reach approximately US$20 billion.

EXCHANGE RATE

The Yuan appreciated from 8.35/US$ to 8.30 in 1996, reflecting high demand for Yuan in the domestic capital market. With rapid growh of the capital market continuing, the demand for Yuan is expected to remain high. The exchange rate was steady through the first three quarters of 1997.

Foreign reserves rose by US$31.4 billion to US$105 billion at the end of 1996, and further to US$123 billion at mid-year 1997.

FISCAL POLICY

The budget registered a deficit of US$6.6 billion or 0.8 percent of GDP in 1996. **Total revenues** rose 18 percent to US$88.7 billion in 1996, while **total expenditures** rose 16 percent to US$95.3.

The deficit was financed through the issue of state bonds to avoid creating inflationary pressure. People's Bank of China strengthened financial management and supervision. Two interest rate reductions lowered financing costs to the government and the enterprises.

In 1997, the government will tighten fiscal policy and enforce tax law for tax collection, focusing especially on improving management of personal tax collection. The growth rate of expenditures should be under the growth rate of revenues to make the budget balanced.

MONETARY POLICY

The M2 growth rate reached the planned target in 1996, with an increase of 25.3 percent compared to 29.5 percent in 1995. Reflecting the decline in inflation, the People's Bank of China cut its official lending rates twice in 1996, the first reductions since July 1993.

In view of the stable growth and inflation outlook, the Bank has indicated that it will maintain the current monetary policy stance. The Bank has also indicated strict adherence to debt financing for fiscal deficits and continued enforcement of the adjustment of debt structure.

Meanwhile, financial institutions policy will focus on supervising the operations, financial balances and degrees of risks of financial institutions that apply for access to capital markets.

FOREIGN DIRECT INVESTMENT

FDI inflows reached a record of $41.7 billion in 1996, up 10 percent from US$37.8 billion in 1995. At the same time, the number of investments fell to 24,556 cases from the 37,011 cases registered in 1995, suggesting a trend towards larger investments.

The government is promoting FDI for agricultural development, infrastructure construction and resource utilization, as well as to develop high technology.

Given the regional income disparities within China, the government is also encouraging FDI aimed at agricultural development, water resources and infrastructure in the middle and western areas.

MEDIUM-TERM OUTLOOK

The 15th Congress of the Communist Party of China held in Beijing in September 1997 supported President Jiang Zemin's economic reform program. This program is intended to speed up the reform of SOEs, maintain prudent fiscal and monetary policies (including balanced budgets), restrain inflation, strengthen agricultural development, cultivate new economic growth areas, promote new markets, and enhance the level of market openness.

The economy is projected to grow at about 9 percent per annum for the period 1997 to 2000, based on assumptions of growth in the world economy of around 3.5-4 percent per year and of inflation rates stabilizing around 2 percent per year.

Reform of China's State-Owned Enterprises

With the sustained rapid growth of the economy, China's industrial sector has been undergoing a significant restructuring. The reforms agreed by the government are aimed at accelerating this restructuring by further reforming the state-owned enterprise (SOE) sector.

The SOE sector faces serious problems in terms of quality and efficiency of production and management, a bad financial situation, factories without contracts and redundant workers. Some workers and staff of problem enterprises have temporary difficulties with their daily life, which in turn affects the steady development of the economy and social stability.

The SOE reforms are oriented towards establishing a modern enterprise system according to the principles of clear ownership, well defined powers and responsibilities, separation of enterprise from administration and sound management principles.

Building on a series of reforms over the past several years, the following steps are contemplated for the coming three years:

- to establish govenrment asset-management departments and holding companies to improve management of SOE assets;
- to convert large and medium-sized SOEs into standard corporations, which are either shareholding companies or limited corporations;
- to allow other enterprises to diversify ownership by issuing shares and accepting foreign and institutional investors;
- to set up a new social security system to shift social welfare responsibility from enterprises to society;
- to permit existing and newly-established capital funds and even some social security funds to invest in SOEs;
- to increase the number of cities allowed to experiment with bankruptcies and mergers from 58 in 1995 to 110 in 1997; and
- to triple the amount of funds used for clearing debts of bankrupt firms to 30 billion Yuan in 1997 from 10 billion Yuan in 1996.

Key Indicators: China	1991	1992	1993	1994	1995	1996
Output						
Nominal GDP *(US$ bn)*	406.1	483.0	601.1	540.9	697.7	816.7
Real GDP *(% change)*	9.2	14.2	13.5	12.6	10.5	9.7
Exports *(% change)*	15.7	18.2	8.0	31.9	22.9	1.5
Imports *(% change)*	19.6	26.3	29.0	11.2	14.2	5.1
Prices and Labor Market						
GDP Deflator *(% change)*	6.8	7.9	14.6	19.5	13.1	6.1
Headline CPI *(% change)*	3.4	6.4	14.7	24.1	17.1	8.3
Unemployment Rate *(%)*	2.3	2.3	2.6	2.8	2.9	3.0
Financial Markets						
M3 *(% change)*	26.5	31.3	32.4	34.5	29.5	25.3
Short-term Interest Rate *(%)*	8.1	8.1	8.8	9.0	9.0	9.7
Exchange Rate *(annual average yuan/US$)*	5.3	5.5	5.8	8.6	8.4	8.3
Balance of Payments						
Trade Balance *(f.o.b. - % of GDP)*	2.0	0.9	-2.0	1.0	2.4	1.5
Current Account Balance *(% of GDP)*	3.0	1.3	-2.0	1.4	0.2	0.9
Budget Balance *(% of GDP)*	-0.9	-1.0	-0.9	-1.2	-1.3	-0.8
Population *(millions)*	1,158.2	1.171.7	1.185.2	1.198.5	1,211.2	1,233.9

Source: Data are as submitted by member economies, unless otherwise specified.

Summary of	1997						1998-2000				
Forecasts	Official	IMF	PECC	ADB	DRI	WEFA	Official	PECC	ADB	DRI	WEFA
Real GDP	9.3	9.5	9.8	9.0	9.7	9.8	9.0	9.0	8.0	8.9	8.9
Real Exports	18	n/a	12.0	10.0	8.6	15.1	n/a	8.5	12.0	9.4	13.6
Real Imports	3	n/a	2.1	15.0	13.8	8.4	n/a	11.3	14.0	10.9	14.2
CPI	3.5	4.5	6.3	6.0	10.8	5.1	n/a	5.6	8.0	n/a	4.8

Notes: The IMF forecast is from the *World Economic Outlook* (IMF, September 1997); figures for the period 1998-2000 refer to 1998 only. The PECC forecast is from the *Pacific Economic Outlook 1997-1998* (PECC, 1997); 1998-2000 figures refer to 1998 only. The ADB forecast is from the ADB, *Asia Economic Outlook, 1997-1998*; figures for the period 1998-2000 refer to 1998 only. The DRI forecast is from *World Market Executive Overview* (3rd Quarter, 1997). The WEFA forecast is from *Asia Economic Outlook* (August, 1997). Note: DRI and WEFA figures for real export and real import growth include services.

Hong Kong, China

Background Information

Capital	Not applicable
Population	6.50 million (mid-1997)
Language	Chinese (spoken mostly in Cantonese) and English
Major Industries	textiles and clothing, electrical and electronic products, fabricated metal products, printing
Major Exports	textile yarn, fabrics, made-up articles, apparel and clothing accessories; electrical machinery, apparatus and appliances; telecommunications and automatic data processing machines; miscellaneous manufactured articles
Major Imports	electrical machinery, apparatus and appliances; telecommunications and sound recording and reproducing appratus; textile yarn, fabrics, and made-up articles; articles of apparel and clothing accessories; office machines and automatic data processing machines; miscellaneous manufactured articles

GDP

Real GDP grew by 4.9 percent in 1996, slightly faster than the 4.5 percent increase in 1995. Growth was on a steady upward trend during the course of last year, rising from 4.0 percent in the first quarter to 4.6 percent in the second quarter, and further to 5.2 percent and 5.7 percent in the third and fourth quarters, respectively. This revival in economic growth was largely led by domestic demand. The strengthening trend continued into 1997, with real GDP growing by around 6.1 percent in the first quarter on a year-over-year basis. The momentum was likely maintained in the second quarter.

Consumer spending strengthened during 1996, with retail sales, especially of consumer durables, showing a distinct turnaround. Sustained income growth and buoyancy in the stock and property markets were the major stimulating factors. In 1997, consumer spending is expected to strengthen further, along with faster real GDP growth and continued tight labor market conditions.

Investment spending went through another year of strong growth in 1996, as work on the Airport Core Programme entered its peak and private sector building activity was reviving along with the buoyant property market. Investment in machinery and equipment also increased notably in 1996. In 1997, notwithstanding the gradual winding down of the Airport Core Programme, building activity and investment in machinery and equipment are expected to remain robust.

Merchandise export growth moderated in 1996 and performance has remained slack so far in 1997, reflecting in part slack import demand in some of the major overseas markets, and in part reduced price competitiveness caused by strengthening of the U.S. dollar.

The ongoing structural shift of exports to offshore trading has also led to a slowdown in merchandise export growth. However, this should be recouped either through higher exports of services or through investment income.

Growth in **exports of services**, though also experiencing some slowing, remained notable in 1996. Further increases in offshore trading and in exports of professional and various other business services are forecast for 1997. There should be a continued sizeable net surplus on the invisible trade account.

The outlook for 1997: taking into account both the domestic and external factors, real GDP is forecast to grow 5.5 percent.

INFLATION

Consumer price inflation has been on a moderating trend with the CPI(A) rising only by 6.0 percent in 1996, substantially improved from the 8.7 percent rise in 1995. Inflationary pressures generated domestically from labor cost and rentals were fairly modest. Imported inflation remained subdued as the H.K. dollar appreciated in tandem with the U.S. dollar against other major currencies. Reduced or low inflation in major supplier economies, notably China and Japan, and generally soft world commodity prices, also contributed.

For 1997 as a whole, consumer price inflation is forecast to edge up to 6.5 percent. However, consumer price inflation has remained moderate so far in 1997. In the first nine months of 1997, the CPI(A) recorded an average increase of 5.9 percent, slightly slower than the annual average of 6.0 percent in 1996.

EMPLOYMENT

Labor market conditions showed a distinct improvement in 1996 as labor demand outpaced growth in labor supply.

Total employment grew 3.5 percent in 1996, against a 3.1 percent increase in the total labor force. Also, there was a surge in job vacancies. Employment in the service sectors continued to grow strongly, more than offsetting the ongoing decline in employment in the manufacturing sector in line with the structural change in the economy.

Reflecting these trends, the seasonally adjusted **unemployment rate** fell to 2.6 percent in the fourth quarter of 1996, from 3.5 percent in the same quarter in 1995.

The **underemployment rate** also declined, from 2.3 percent to 1.6 percent over the same period.

Labor demand is expected to remain strong in 1997, underpinned by the faster economic growth. Both the seasonally adjusted unemployment rate and the underemployment rate edged down further to 2.2 percent and 1.0 percent, respectively, in the third quarter of 1997. The shift in the composition of employment from manufacturing to services should continue.

CURRENT ACCOUNT

In 1996, the combined **visible and invisible trade account** incurred a deficit of HK$12 billion, equivalent to just 1.0 percent of GDP. These were much reduced from the corresponding figures of HK$39 billion and 3.6 percent in 1995.

A narrowing of the visible trade deficit and an enlargement of the invisible trade surplus led to this favorable result. The reduced **visible trade** deficit was mainly attributable to a more rapid deceleration in import growth than in export growth in 1996. To a certain extent, it was also due to improved terms of trade brought about in part by the stronger U.S. dollar. The growing surplus on **invisible trade** reflected the development of Hong Kong as a highly service-oriented economy.

In 1997, the combined visible and invisible trade deficit is projected to increase to HK$36 billion or slightly less than 3 percent of GDP. Underlying the combined deficit is the large increase in retained imports of capital goods. The ongoing process of mechanization and automation should help expand productive capacity in the longer term.

EXCHANGE RATE

In 1996, the **market exchange rate** of the H.K. dollar against the U.S. dollar continued to stay on the strong side of the linked rate fixed at HK$7.80 to US$1. The market exchange rate closed the year at HK$7.736, little changed from HK$7.732 a year earlier.

Comparing end-1996 with end-1995, the **Effective Exchange Rate Index** of the H.K. dollar rose by 2.1 percent, largely due to the strengthening of the U.S. dollar against other major currencies over the period. The H.K. dollar continued to hold firm so far in 1997, with the Effective Exchange Rate index rising further by 4.2 percent during the first nine months of the year.

FISCAL POLICY

In FY1996/97, the government attained a fiscal surplus of around HK$15.1 billion, equivalent to 1.3 percent of GDP. For **FY1997/98**, a fiscal surplus of HK$31.7 billion, equivalent to 2.4 percent of GDP, is budgeted.

MONETARY POLICY

The primary objective of monetary policy continues to be maintaining stability in the external value of the H.K. dollar against the U.S. dollar, at a fixed rate of HK$7.80 to US$1.

FOREIGN DIRECT INVESTMENT

The stock of **inward FDI** grew to HK$533 billion (US$69 billion) at year-end 1995, representing an increase of 7 percent over the end of 1994.

As regards **sources of inward FDI**, the United Kingdom accounted for 27 percent of the total, followed by China (20 percent), Japan (16 percent), and the United States (13 percent).

The non-manufacturing sectors accounted for 91 percent of this investment, particularly banking and finance and the wholesale, retail and import/export trades.

There are no official statistics in Hong Kong, China on **outward FDI**. Based on statistics released by some of the host economies, Hong Kong, China is known to have invested heavily in East Asia, particularly in China. By the end of 1996, the cumulative value of Hong Kong, China's realized direct investment in China amounted to US$99 billion, accounting for 57 percent of the total FDI in China.

MEDIUM-TERM OUTLOOK

The medium-term economic outlook remains good. Real GDP is forecast to grow by an average of 5 percent per annum for the period up to 2000, with an average inflation rate of 8 percent.

External trade in both goods and services is expected to grow further, benefiting from continued improvement in the global trading environment, with trade liberalization and sustained revival and expansion of the major industrialized economies. In particular, the mainland of China is expected to maintain its growth momentum over the medium term.

Domestically, consumer spending is projected to show steady growth, while fixed asset investment is likely to continue to receive support from the ongoing process of automation and mechanization as well as the massive housing and infrastructure development programs.

Transfer of Sovereignty from the United Kingdom to China in 1997

Hong Kong had been a dependent territory under British Administration for 150 years. On 1 July 1997, it became a Special Administrative Region of the People's Republic of China. Accordingly, it is now referred to as Hong Kong, China.

The Basic Law promulgated by China is the constitutional document for the Hong Kong Special Administrative Region (HKSAR). It defines the constitutional framework, political institutions and the shape of the future of the HKSAR from 1 July 1997.

Of the 160 Articles in the Basic Law, 42 Articles refer directly to economic issues and another 28 are related to economic development. In particular, Article 5 states that, "The socialist system and policies shall not be practiced in the Hong Kong Special Administrative Region, and the previous capitalist system and way of life shall remain unchanged for 50 years." This article offers a clear pledge that the HKSAR will continue to enjoy free, open and competitive markets which are not controlled by state planning or state direction.

Furthermore, Articles 106, 110 and 115 define the HKSAR's future economic autonomy in the important spheres of public finance, monetary and financial affairs, and trade and investment; Articles 107 and 108 prescribe budgetary prudence and a low tax regime; while Articles 109, 112 and 114 offer a commitment to the HKSAR's continuing role as a center for international business. These, together with other Articles in the Basic Law, provide a commitment that the distinctive economic philosophy, policies and systems practiced in the HKSAR that have enabled it to flourish and prosper over the past years will continue well into the future.

Key Indicators: Hong Kong, China	1991	1992	1993	1994	1995	1996
Output						
Nominal GDP *(US$ bn)*	86.0	100.7	116.0	130.8	140.8	155.0
Real GDP *(% change)*	5.1	6.3	6.1	5.4	4.5	4.9
Private Consumption *(% change)*	8.6	8.5	7.5	6.7	2.5	4.8
Private Investment *(% change)*	11.1	9.7	-0.7	15.5	8.8	11.5
Government Consumption *(% change)*	7.7	7.2	2.2	3.9	4.4	4.4
Government Investment *(% change)*	-3.2	5.2	39.3	17.1	19.4	15.8
Exports *(% change)*	15.0	18.3	12.7	9.8	11.9	4.9
Imports *(% change)*	18.1	20.8	12.0	13.5	13.0	4.1
Prices and Labor Market						
GDP Deflator *(% change)*	9.2	9.7	8.5	6.9	2.6	5.4
CPI(A) *(% change)*	12.0	9.4	8.5	8.1	8.7	6.0
Unemployment Rate *(%)*	1.8	2.0	2.0	1.9	3.2	2.8
Financial Markets						
M2 *(% change)*	17.9	14.3	26.9	18.7	15.1	19.3
Short-term Interest Rate *(%)*	6.2	3.9	3.4	4.8	6.2	5.5
Exchange Rate *(annual average HK$/US$)*	7.771	7.741	7.736	7.728	7.736	7.734
Balance of Payments						
Trade Balance *(f.o.b. - % of GDP)*	-2.4	-4.3	-3.3	-8.4	-14.0	-11.8
Current Account Balance *(% of GDP)*	6.6	5.3	7.0	1.2	-3.6	-1.0
Budget Balance *(% of GDP)*	3.4	2.8	2.1	1.1	-0.3	1.3
Population *(millions)*	5.8	5.8	5.9	6.0	6.2	6.3

Source: Data are as submitted by member economies, unless otherwise specified.

Summary of Forecasts	1997						1998-2000					
	Official	IMF	PECC	ADB	DRI	WEFA	Official	IMF	PECC	ADB	DRI	WEFA
Real GDP	5.5	5.3	5.1	5.5	4.8	5.8	5.0	5.0	5.2	5.3	4.9	5.5
Real Exports	6.7	n/a	8.9	14.5	9.5	6.2	n/a	n/a	10.8	13.3	9.2	7.7
Real Imports	8.2	n/a	9.6	15.9	9.5	7.0	n/a	n/a	12.9	13.1	9.2	9.5
CPI	6.5	7.1	5.9	7.0	7.8	7.0	8.0	6.5	5.7	5.6	7.5	7.0

Notes: The IMF forecast is from the *World Economic Outlook* (IMF, September 1997); figures for the period 1998-2000 refer to 1998 only. The PECC forecast is from the *Pacific Economic Outlook 1997-1998* (PECC, 1997); 1998-2000 figures refer to 1998 only. The ADB forecast is from the ADB, *Asia Economic Outlook, 1997-1998*; figures for the period 1998-2000 refer to 1998 only. The DRI forecast is from *World Market Executive Overview* (3rd Quarter, 1997). The WEFA forecast is from *Asia Economic Outlook* (August, 1997). Note: DRI and WEFA figures for real export and real import growth include services.

The Republic of Indonesia

Background Information	
Capital	Jakarta
Population	200 million (end of December 1996)
Language	Indonesian
Major Industries	pulp and paper, cement, textiles, oil and gas, mining, wood products, fertilizer, chemical, manufacturing
Major Exports	textiles and textile products, electrical appliances, footwear, oil and gas, mining products, palm oil, paper, rubber.
Major Imports	chemicals and pharmaceuticals, cotton yarns, iron and steel, electrical equipment, cereals, machinery, motor vehicles, plastic products

GDP

Real GDP growth moderated to 7.8 percent in 1996 from 8.1 percent in 1995 but remained above the target of 7.1 percent under the five-year development plan, Repelita VI. The easing reflected efforts by the authorities to restrain demand particularly through monetary policy measures.

Private consumption accelerated marginally to 6.6 percent from 5.9 percent in 1995, receiving a strong boost from higher purchasing power, as reflected in the increase in per capita GDP to US$1,023 in 1996, up from $920 in 1995.

Private investment growth slowed to 11 percent in 1996 from 14.1 percent in 1995, responding to higher real interest rates (which rose to 9.8 percent in 1996 from 7.4 percent in 1995). Nevertheless, private investment remained buoyant, reflecting a more conducive business climate following the adoption of various deregulation measures.

The outlook for 1997 was one of reasonably strong economic growth above the Repelita VI target of 7.1 percent. However, given spillover effects of the currency instability in the region, as well as risks to the outlook from the haze (which has curtailed tourist arrivals) and possible weather-related reductions in agricultural output from the El Nino effect, the forecast for 1997 has now been reduced to 6.5 percent, followed by 6.0 percent in 1998.

INFLATION

CPI growth eased to 6.5 percent in 1996 from 8.6 percent in 1995. The rate of inflation decelerated sharply over the course of the year and into 1997 from a recent high of 10.6 percent in February 1996 to below the 5 percent mark in mid-1997 (July: 4.9 percent).

With the depreciation of the rupiah in the third quarter of the year, rising import prices have reversed these gains, and annual inflation in 1997 and 1998 is now expected to be 9.0 percent.

EMPLOYMENT

Working-age population (15 years and over) grew on average 2.4 percent per annum in the first half of the 1990s reaching 78.3 million in 1995, up from 69.5 million in 1990, a gain of almost 9 million. **Labor force** growth was further boosted by increases in women's labor force participation. **Employment** growth failed to keep pace with this influx of additional workers, and unemployment increased on trend during this period. In part, this reflected the fact that, in contrast to the pre-1990 period, the proportion of jobs in the agricultural sector began steadily decreasing. While rapid growth in the manufacturing sector provided 2 million additional jobs over this period (rising from 7.9 million workers in 1990 to 9.9 million in 1995), job growth fell short of supply. **Unemployment** rose accordingly to around 5.9 million or 7.0 percent of the labor force, as compared to 2.2 million or 3.0 percent in 1990. **Underemployment**, defined as working less than 35 hours per week, also increased slightly from 23 million (33.1 percent) in 1990 to 26.6 million (34.0 percent) in 1995.

The outlook for employment under Repelita VI is based on the assumption that the proportion of total employment in services, trade and manufacturing will increase; however, in general, the agricultural sector will still be the dominant employer, although its role will be decreased.

CURRENT ACCOUNT

The current account deficit widened from 3.4 percent of GDP in 1995/96 (or US$7.0 billion) to 4 percent of GDP in 1996/97 (US$8.8 billion) as import growth outpaced export growth. **Non-oil/gas export growth** slowed in nominal terms from 15.4 percent in 1995/96 to 11.7 percent in 1996/97. In the case of some major commodities, such as timber, this reflected difficulties over raw materials. In the case of key export-oriented products such as textiles, garments and footwear, it reflected the entry of new competitors into the international market. In the case of primary products, particularly agricultural commodities, it reflected weakening world prices. **Non-oil/gas import growth** also slowed in nominal terms in 1996/97 to 14.6 percent from 19.0 percent in 1995/96. A major factor in this was the steep rise in imports of capital and consumer goods, as well as higher imports through export zones (Batam, Bonded Zones and Entreport Area).

The current account deficit for 1997/98 is expected to decline to around 2.5 percent of GDP on the strength on increasing exports and decreasing imports.

EXCHANGE RATE

The rupiah remained within Bank Indonesia's intervention band throughout 1996 and the first half of 1997 although the band was widened from 2 percent to 8 percent in September 1996. As the turbulence in Southeast Asian foreign exchange markets developed, the intervention band was widened again to 12 percent to discourage flows of speculative funds and to reduce the volatility of foreign exchange reserves. However, the exchange market pressures continued and, on 14 August 1997, Bank Indonesia announced that it would float the rupiah (see box for details).

FISCAL POLICY

Total revenues in 1996/97 came in at Rp 84.8 trillion, marginally above the Planned Government Expenditure and Revenue Budget (RAPBN). **Tax revenues** at Rp 55.8 trillion were marginally (0.3 percent) under budget. **Non-tax revenues** at Rp 9.1 trillion were 25 percent over budget mainly due to the proceeds from the block sale of Rp 1.4 trillion worth of shares of PT Telkom, the national telephone company. Oil revenues at Rp 19.9 trillion were Rp 5.8 trillion or 41.1 percent above budget. **Development revenues,** however, at Rp11.0 trillion fell 11 percent under budget owing to the slowness in disbursement of the fund, especially from the current commitment fund.

Total expenditures in 1996/97 came in at Rp 95.0 trillion or about 5 percent over budget. **Total routine expenditures** of Rp 61.6 billion were 9.7 percent over budget, reflecting higher than expected outlays in a number of areas, including on current goods and services and debt service (especially prepayment of foreign debt financed by the proceeds from sale of the PT Telkom shares). **Development expenditure** at Rp 33.5 trillion was 3.0 percent under budget, reflecting gains in efficiency, economizing on development projects, and a decrease in project aid.

The 1997/98 fiscal plan called for a balanced budget, with expenditures rising 11.6 percent over the preceding year to Rp 101.1 trillion. Domestic revenue is expected to increase by 12.6 percent, based on assumptions of 7.1 percent GDP growth and 6.0 inflation, along with a modest increase in the tax ratio from 11.9 percent in 1996/97 to 12.1percent in 1997/98. Non-oil revenue was projected to increase by 14.2 percent, far more rapidly than the 5.3 percent gain expected in oil revenues. The changed short-term economic outlook will affect these figures.

MONETARY POLICY

In 1996 and through 1997, Bank Indonesia has sought to restrain demand, sterilizing short-term capital inflows through sale of Bank Indonesia Certificates (SBIs), applying moral suasion and increasing banks' reserve requirements from 2 percent to 3 percent in February 1996.

Through 1996, Bank Indonesia used open market operations to reduce money supply as outstanding SBPUs (money market securities issued by commercial banks which expand the money supply) declined to Rp 0.2 trillion compared to Rp 4.2 trillion in 1995; outstanding SBIs increased to Rp18.6 trillion compared to Rp11.7 billion in 1995. Nonetheless, monetary expansion was relatively high in 1996, with M2 and M1 growing by 30.5 percent and 26.2 percent, respectively, well above the targets of 17 and 15 percent. A key factor was growth in bank credits which, reflecting strong domestic demand, rose by 25.5 percent in contrast with the target of 17 percent.

In 1997, Bank Indonesia has continued its restrictive stance. A target of 17 percent was set for M2 growth and banks' reserve requirements were raised to 5 percent in April 1997 to keep credit expansion to business within the 18 percent target.

Interest rates were raised several times in the first part of 1996 to restrain money supply growth. When this led to large short-term speculative inflows, Bank Indonesia reduced rates, lowering the 7-day SBI rate gradually from 12.75 percent in September 1996 to about 7.25 percent in May 1997.

However, in response to the speculative flows following the turbulence in foreign exchange markets during the second quarter of 1997, Bank Indonesia raised the 7-day SBI rate to around 29 percent and the 30-day SBI rate to around 30 percent. Since early September 1997, Bank Indonesia has decreased the SBI rate gradually; for example, the 30-day SBI rate was cut to 21 percent at the end of September. Domestic interest rate policy continues to be oriented to maintaining downward pressure on inflation and the current account deficit, while at the same time reducing the gap between offshore and domestic interest rates to a level that does not attract speculative inflows.

FOREIGN DIRECT INVESTMENT

In recent years FDI approvals have increased rapidly following liberalization of the foreign investment regime. FDI inflows showed a steep rise from an average inflow of US$9 billion in 1990-93 to US$23.7 billion in 1994 and then a further 68 percent rise to US$40 billion in 1995.

The tertiary sector, particularly housing, hotels and restaurants, has attracted the largest portion of FDI into Indonesia.

Indonesia Adopts Free Floating Exchange Rate Regime

Following the turbulence in Southeast Asian foreign exchange markets during May and June 1997, pressures on emerging market currencies intensified in July 1997. In Asia, several currencies, including Indonesia's Rupiah, depreciated sharply against the U.S. dollar. In response to this situation, on 14 August 1997, Bank Indonesia, the central bank, abandoned the Rupiah's managed floating exchange rate regime by eliminating the intervention band for the Rupiah exchange rate. The Rupiah exchange rate will be determined by market forces, with the authorities influencing the market indirectly through fiscal and monetary policies. Bank Indonesia can, of course, still intervene in the market at its own discretion.

The move to float the Rupiah is a further step to improve the flexibility of the foreign exchange rate system, following the progressive widening of the intervention band (in all eight times since 1992). Moreover, it is consistent with recent developments in Southeast Asia, as most economies in the region have similarly adopted a free floating exchange rate regime. As Indonesia's financial market has become an integral part of the regional financial market, the management of the Rupiah exchange rate must be adjusted to that generally adopted in the region.

By floating the currency, the impact of speculative flows, which have been experienced by most economies in the region, can be lessened and control over domestic monetary policy enhanced. The experience of most emerging economies in Asia and other regions (including developed economies) has demonstrated that, with increased global capital flows, it has become more difficult to maintain the exchange rate fixed to another currency or to a basket of foreign currencies under turbulent conditions, even with the spending of large amounts of foreign reserves. Therefore, most economies in the world rely on a more flexible exchange rate system.

The experience of other economies has also shown that the transition to a more flexible exchange rate system has been characterized by temporary currency overshooting. However, with appropriate monetary and fiscal policies supported by prudent market behavior, the exchange rate will reach its new equilibrium in line with economic fundamentals. The role of the monetary authorities is to promote prudent behavior by market participants in using sources of funds, particularly short-term offshore loans.

Key Indicators: Indonesia	1991	1992	1993	1994	1995	1996
Output						
Nominal GDP *(US$ bn)*	128.2	139.1	158.0	175.7	197.7	222.5
Real GDP *(% change)*	8.9	7.2	7.3	7.5	8.1	7.8
Private Consumption *(% change)*	8.0	3.5	6.5	5.8	6.3	6.8
Private Investment *(% change)*	6.3	5.2	6.9	16.1	14.1	12.4
Government Consumption *(% change)*	7.0	5.8	0.1	2.3	3.4	5.4
Government Investment *(% change)*	9.0	5.4	2.9	4.7	7.4	4.5
Exports *(% change)*	19.9	14.7	6.6	9.0	4.3	6.5
Imports *(% change)*	16.8	6.6	4.4	13.3	16.8	12.9
Prices and Labor Market						
GDP Deflator *(% change)*	8.8	5.4	8.9	7.0	8.7	8.7
Headline CPI *(% change)*	9.5	4.9	9.8	9.2	8.6	6.5
Unemployment Rate *(%)*	2.5	2.7	3.1	4.4	7.0	4.9
Financial Markets						
M3 *(% change)*	17.0	20.2	22.0	20.2	27.6	26.3
Short-term Interest Rate *(%)*	21.9	16.7	11.8	14.3	17.2	17.0
Exchange Rate *(annual average Rp/US$)*	1,950	2,030	2,087	2,164	2,253	2,343
Balance of Payments						
Merchandise Trade Balance *(f.o.b. % of GDP)*	2.6	4.8	5.4	4.6	2.8	1.5
Current Account Balance *(% of GDP)*	-3.4	-2.2	-1.5	-1.7	-3.4	-4.0
Budget Balance *(% of GDP)*	n/a	n/a	n/a	n/a	n/a	n/a
Population *(millions)*	182.94	186.04	189.14	192.22	195.28	200.00

Source: Data are as submitted by member economies, unless otherwise specified.

Summary of Forecasts	1997						1998-2000				
	Official	IMF	PECC	ADB	DRI	WEFA	Official	PECC	ADB	DRI	WEFA
Real GDP	6.5	7.0	7.3	8.0	7.3	7.3	6.0	7.8	7.9	5.8	7.2
Real Exports	n/a	n/a	11.7	10.8	10.9	9.5	n/a	12.2	12.0	10.4	11.0
Real Imports	n/a	n/a	16.3	11.3	13.8	8.4	n/a	8.0	10.2	10.5	10.9
CPI	9.0	7.3	7.2	7.5	7.6	6.1	9.0	7.8	8.0	7.6	7.0

Notes: The IMF forecast is from the *World Economic Outlook* (IMF, September 1997); figures for the period 1998-2000 refer to 1998 only. The PECC forecast is from the *Pacific Economic Outlook 1997-1998* (PECC, 1997); 1998-2000 figures refer to 1998 only. The ADB forecast is from the ADB, *Asia Economic Outlook, 1997-1998*; figures for the period 1998-2000 refer to 1998 only. The DRI forecast is from *World Market Executive Overview* (3rd Quarter, 1997). The WEFA forecast is from *Asia Economic Outlook* (August, 1997). Note: DRI and WEFA figures for real export and real import growth include services.

Japan

Background Information	
Capital	Tokyo
Population	125.9 million (1996 estimate)
Language	Japanese
Major Industries	electrical machinery, transportation equipment, general machinery, chemical and allied products
Major Exports	transportation equipment, integrated circuits, office machinery.
Major Imports	crude oil, textiles, office machinery

GDP

Real GDP grew 2.9 percent in 1996 on a fiscal year basis (April 1996 to March 1997) and 3.5 per cent on a calendar year basis, continuing the recovery from the trough reached in October 1993. Private demand strengthened, contributing to sustained autonomous recovery. This year, growth has been strongly affected by the April 1997 increase in the consumption tax from 3 to 5 percent. This induced a shift forward in consumer expenditures, boosting first quarter growth to 5.7 percent (quarter-over-quarter at annual rates) but contributing to a sharp decline in activity in the second quarter.

Economic policy measures in 1996 included review of the Deregulation Action Program in March, and approval of the six financial Acts in June which contained the measures to enhance the stability of the financial system and to settle the *jusen* (housing loan companies) problem.

Private consumption, led by consumer durables and auto sales gradually picked up in FY1996, on the strength of rising wages and improving employment conditions, before falling in the April-June quarter due to the consumption tax effect and the repeal in June of a tax rebate.

Plant and equipment investment grew 6.4 percent in FY1996, reflecting the end of the capital stock adjustment process and an upturn in corporate profits. The non-manufacturing sector, in particular telecommunications and information technology, started to recover in FY1996, along with the manufacturing sector which took the lead in driving the recovery in FY1995.

Housing construction grew 14.2 percent in FY1996, reflecting the fall in land prices, low interest rates and accelerated purchases prior to the consumption tax increase.

INFLATION

The CPI rose slightly at 0.4 percent in FY1996. The consumption tax increase in April 1997 caused a spike in the CPI in that month and is expected to result in average annual inflation on a fiscal year basis of 1.6 percent this year.

Wholesale prices declined by 0.7 percent in FY1996 and are forecast to increase by 1.3 percent in FY1997.

EMPLOYMENT

Employment has been growing steadily, and signs of improved labor market conditions are emerging with the decline in the index of enterprises' sense of excess labor.

The unemployment rate has, however, remained at a comparatively high level by historical standards, averaging 3.3 percent in FY1996. It is expected to decline as growth in total employment of 0.7 percent (including 1.0 percent growth for employees) is projected to exceed growth in the labor force of 0.5 percent.

CURRENT ACCOUNT

The current account surplus declined to Yen 7.2 trillion (US$63.6 billion) in FY1996 from Yen 9.5 trillion (US$99.8 billion) in FY1995. The yen depreciation and growth abroad boosted exports in the first half of CY1997, leading to an increase in the current account surplus on a quarterly basis in each of the first two quarters.

EXCHANGE RATE

Following its appreciation in the first half of CY1995, the yen trended down in CY1996 and through the first calendar quarter of 1997, falling to its level of the beginning of 1993, before firming in the second and third quarters.

FISCAL POLICY

The central and local governments' combined deficit reached 7.3 percent of GDP in FY1996. However, structural fiscal reforms are expected to reduce this to about 5.4 percent in FY1997.

MONETARY POLICY

Short-term interest rates have remained in the neighborhood of 0.5 percent since the Bank of Japan lowered its official discount rate to that level in September 1995.

Long-term interest rates trended down through 1997, falling to historical lows below 2 percent in the third quarter.

Money supply (M2+CD) growth has fallen slightly in the first half of CY 1997 from the mid-3 percent range in 1996.

FOREIGN DIRECT INVESTMENT

FDI outflow from Japan has been growing again since FY1993, reflecting the appreciation of the yen. FDI amounted to Yen 5.4 trillion in FY1996, one-fourth of which went to Asia. **FDI inflows** to Japan are much lower but increased to Yen 0.8 trillion in FY1996.

OUTLOOK

The official short-term forecast (December 1996) estimated growth of 1.9 percent in FY1997 with private demand rebounding from the weakness in the first half of FY1997 to lead an autonomous recovery.

The extent of the decline in the April-June quarter creates some risk to the short-term outlook. By comparison, the IMF's September 1997 *World Economic Outlook* projects growth of 1.1 percent in 1997 and 2.1 percent in 1998.

The medium-term economic plan, under the structural reform assumptions, estimates annual real growth of 3 percent on average over the period to FY2000 with CPI inflation remaining below 1 percent per year on average.

Japan faces acknowledged medium- and long-term challenges of further globalization, increasingly sophisticated social and economic needs, longer life expectancy and fewer children and rapidly evolving information and telecommunication technologies.

To achieve the government's medium-term growth and inflation goals, it is generally agreed that the pace of structural reform and deregulation (see box) will have to speed up and that appropriate measures will have to be adopted to minimize and mitigate the inevitable frictions to facilitate the process. In particular, labor market issues will have to be addressed to keep the full-employment rate of unemployment as low as possible, with a goal of 2.75 percent in FY2000.

Structural reforms such as deregulation are required to rectify high-cost market structures, in turn needed to increase consumer demand as well as to stimulate the corporate innovation that will lead to the emergence of new industries in high-tech sectors. Once these structural reforms are implemented, private demand can be expected to strengthen. Such a trend, coupled with the increase in overseas production by Japanese companies and efforts to improve access to Japanese markets, should help attain appropriate external balances.

Deregulation Measures in Japan

As reflected in its Individual Action Plan in MAPA, Japan has committed to a number of mid- and long-term measures of deregulation. This reflects a growing awareness in Japan that steady implementation of deregulation measures is a prerequisite for sustaining mid- and long-term growth to meet the challenges posed by accelerated globalization and emergence of "Mega-Competitions."

Japan's longer-term potential growth is on a declining trend due to the downward pressure on the availability of labor and on savings rates created by rapid aging of the population. By 2020, it is estimated that one in four Japanese will be 65 years old or over. The aging of Japanese society might also lead to increased burdens on the social security system.

Under these circumstances, the government further revised its Deregulation Action Plan in March 1997. This plan contains comprehensive deregulation measures in the following major areas; (a) housing and land; (b) information and telecommunications; (c) distribution; (d) standards, certifications and import procedures; (e) financial services, securities and insurance; (f) energy; (g) employment and labor; (h) matters related to pollution, wastes, environmental protection, dangerous articles, disaster prevention and public safety; and (i) education.

The significance of implementing the structural reforms, including deregulation, is shown in the government's mid-term economic outlook. Under the structural reform assumptions, real GDP is projected to grow 3 percent per year over the period to FY2000. Absent these reforms, it is projected to be only 1.75 percent in this period.

These estimates are supported by analysis conducted by the Economic Planning Agency showing that deregulation measures in several areas implemented since FY1990 have generated an increase of 1.68 percent in nominal GDP through the creation of new demand and an additional 0.98 percent in nominal GDP through the impact on consumer demand of falling prices.

Key Indicators: Japan	1991	1992	1993	1994	1995	1996
Output						
Nominal GDP *(US$ bn)*	3,419.0	3,725.8	4,292.8	4,700.3	5,140.3	4,595.0
Real GDP *(% change)*	3.8	1.0	0.3	0.6	1.4	3.5
Private Consumption *(% change)*	2.5	2.1	1.2	1.9	2.0	2.8
Private Investment *(% change)*	2.9	-5.8	-7.6	-2.2	1.3	8.2
Government Consumption *(% change)*	2.0	2.0	2.4	2.4	3.5	2.3
Government Investment *(% change)*	4.9	14.5	15.7	2.8	0.7	9.9
Exports *(% change)*	5.2	5.0	1.3	4.6	5.4	2.3
Imports *(% change)*	-3.1	-0.7	-0.3	8.9	14.3	10.5
Prices and Labor Market						
GDP Deflator *(% change)*	2.7	1.7	0.6	0.2	-0.6	0.0
Headline CPI *(% change)*	3.3	1.6	1.3	0.7	-0.1	0.1
Unemployment Rate *(%)*	2.1	2.2	2.5	2.9	3.2	3.4
Financial Markets						
M3 *(% change)*	3.6	0.6	1.1	2.1	3.2	3.3
Short-term Interest Rate *(%)*	7.3	4.4	2.9	2.2	1.2	0.6
Exchange Rate *(annual average Yen/$US)*	134.5	126.7	111.2	102.2	94.1	108.8
Balance of Payments						
Merchandise Trade Balance*(f.o.b.% of GDP)*	2.8	3.3	3.3	3.1	2.6	1.8
Current Account Balance *(% of GDP)*	2.0	3.0	3.1	2.8	2.2	1.4
Budget Balance *(% of GDP)*	-0.3	-3.3	-4.5	-5.7	-6.8	n/a
Population *(millions)*	124.0	124.5	124.8	125.0	125.6	125.9

Source: Data are as submitted by member economies, unless otherwise specified. The short-term interest rate refers to 3-month certificates of deposit (CDs). The budget belance includes the social security accounts.

Summary of			1997					1998-2000		
Forecasts	Official(1)	IMF	PECC	DRI	WEFA	Official (2)	IMF	PECC	DRI	WEFA
Real GDP	1.9	1.1	1.7	1.9	2.1	3.0	2.1	2.6	2.7	2.6
Real Exports	2.9	n/a	6.8	7.8	3.7	n/a	n/a	5.5	4.3	6.6
Real Imports	3.6	n/a	2.5	2.9	1.8	n./a	n/a	6.0	2.6	4.6
CPI	1.6	1.6	1.3	1.6	1.6	0.8	0.7	0.6	1.5	1.4

Notes: The IMF forecast is from the *World Economic Outlook* (IMF, September 1997); figures for the period 1998-2000 refer to 1998 only. The PECC forecast is from the *Pacific Economic Outlook 1997-1998* (PECC, 1997); 1998-2000 figures refer to 1998 only. The DRI forecast is from *World Market Executive Overview* (3rd Quarter, 1997). The WEFA forecast is from *Asia Economic Outlook* (August, 1997). Note: DRI and WEFA figures for real export and real import growth include services.

(1) December 1996 official forecast; as these figures are on a fiscal year basis, they cannot be directly compared to the other forecasts, which are on a calendar year basis.

(2) Refers to figures achieved if Japan immediately and actively implements the structural reforms included in *Social and Economic Plan for Structural Reforms Towards a Vital Economy and Secure Life* (December 1995).

Republic of Korea

Background Information	
Capital	Seoul
Population	45.55 million (1996)
Language	Korean
Major Industries	electronics, automobile production, chemicals, shipbuilding, steel, textiles, clothing, footwear
Major Exports	electronic and electrical equipment, machinery, steel, automobiles, ships, textiles, clothing, footwear.
Major Imports	machinery, oil, steel, transport equipment, organic chemicals, grains

GDP

Real GDP growth slowed significantly in 1996 to 7.1 percent from the 8.7 percent average of the previous two years, primarily due to the end of the investment boom and the decline in export growth. Key underlying factors were a sharp decline in the unit export price of a key industry, semiconductors, and the appreciation of the won against the yen, which led to a plunge in business profits, dampening investment and domestic demand.

The slowing growth trend continued into the early part of 1997 as first quarter growth declined to 5.4 percent year-over-year. However, with the rebound in growth to 6.3 percent year-over-year in the second quarter, it would appear that the contractionary phase of the growth cycle has run its course and that the economy will continue to recover over the second half of this year. Nonetheless, for 1997 as a whole, real growth is expected to register a further slowdown to 6.4 percent, before strengthening to 6.7 percent in 1998.

Facility investment (i.e., machinery and equipment) may actually decline in 1997, for the first time in four years, reflecting a decline in corporate profits, excess production capacity and unclear prospects for export prices. Compounding factors are recent business failures and financial scandals, which are likely to squeeze credit, and the uncertainty associated with the presidential election.

Construction investment is expected to moderate as well in 1997 due to a large stock of unsold apartments and sluggish factory construction, despite a large increase in social capital formation.

Private consumption is expected to slow further to the 5 percent range in 1997 as a result of moderate wage growth and weak consumer confidence stemming from uncertainty about job security.

Export growth is expected to rebound to double digit rates in 1997, reflecting both a strong world economy and the depreciation of the Korean won in real effective terms. In contrast, **import** growth is expected to slow substantially as imports of capital goods decline with the contraction of investment.

INFLATION

Inflationary pressures increased in 1996 despite slower growth. This was due to a number of factors including higher-than-expected wage increases, the impact on import prices of the depreciation of the won, and an oil price increase in the first half of 1996. These factors began to contribute to an increase in the price of manufactured goods beginning in the second half of 1996.

Consumer prices, reflecting these pressures, rose by 4.9 percent in 1996, up marginally from 4.5 percent the previous year. However, price growth slowed at the beginning of 1997 as the CPI increase fell to 4.4 percent through the first half of 1997 (on a year-over-year basis).

For 1997 as a whole, the CPI is expected to slow somewhat from its 1996 pace as lower wage increases and fiscal tightening offset the impacts of the depreciation of the won that occurred through the first three quarters of the year.

EMPLOYMENT

Employment growth slowed to 1.9 percent in 1996 from an average of 2.65 percent the previous two years. Employment continued to fall in the manufacturing sector and continued to rise in the service sector. In 1997, the slower economic growth is expected to contain labor demand, resulting in lower employment growth.

Labor force growth, meanwhile, is expected to be comparatively strong, reflecting rising labor force participation of women and changes in the unemployment insurance program in 1996 that lengthened the stay in the market required to qualify for unemployment insurance benefits.

The unemployment rate, which remained unchanged in 1996 at 2.0 percent despite the slower employment growth, is expected to rise to 3 percent in 1997 as a consequence of these trends.

CURRENT ACCOUNT

The current account deficit widened to US$23.7 billion in 1996, or 4.9 percent of GDP, from US$8.95 billion in 1995.

The single most important factor was the 75 percent decline in the price of semiconductors, Korea's largest single export item comprising 18 percent of exports. The depreciation of the Japanese yen in 1996 also weakened the price competitiveness of Korean products, many of which compete internationally with Japanese products. Finally, increasing foreign travel and royalty payments pushed the invisible trade deficit to US$7.7 billion up from US$3.7 billion in 1995.

The **current account deficit** is expected to narrow to about US$20 billion in 1997 and further in 1998, as export growth recovers and import growth decelerates. However, the prospects for a significant recovery in export prices remain uncertain and, given the irreversibility of the liberalization of payments on current account transactions, the invisible trade balance is not likely to improve in the near future.

EXCHANGE RATE

Starting in mid-1995 and continuing through 1996, **the won depreciated** against the U.S. dollar. In all it fell 10.2 percent from the end of the second quarter of 1995 to year-end 1996. This reflected in part the global rise of the dollar during this period but also Korea's increasing current account deficit. Against the Japanese yen, however, the won appreciated over this period as the yen fell comparatively further (27.2 percent) against the U.S. dollar. As a result, Korea's real effective exchange rate appreciated by more than 8 percent from the third quarter of 1995 to the end of 1996.

During 1997, the won's depreciation against the dollar has continued with the won/US$ rate moving to the 915 range at the beginning of the fourth quarter, a further 7.5 percent depreciation from the rate of 844 at year-end 1996. In contrast to 1996, the won has also marginally depreciated against the yen over the first three quarters.

FISCAL POLICY

In 1996, the budget surplus shrank to 0.2 percent of GDP from 0.5 percent in 1995 as the economic slowdown weakened tax revenues.

In 1997, fiscal policy is to be tightened to reduce inflationary pressures and the external deficit. Expenditure growth is to be reduced from 15 percent in 1996 to 11 percent in 1997 and further to 9 percent in 1998. This is to be achieved by freezing government employment and restricting social infrastructure investment to projects that directly increase the competitiveness of Korean firms. The deceleration of government spending is expected to keep the government budget in surplus despite some weakness in revenue growth.

MONETARY POLICY

Money supply growth remained relatively high in 1996. M2 growth accelerated to 16.2 percent compared to 15.5 percent in 1995, but broader measures such as the MCT (M2 plus CDs and money trusts) and M3 showed lower growth rates from a year ago. The Bank of Korea (BOK) has set its 1997 targets for the yearly growth rates of the M2 and MCT at 16.5 percent and 17.5 percent, respectively, which is lower than that of the previous year. The BOK has also indicated that it will push for the full implementation of indirect monetary management policy in the years ahead, which is in line with the accession to the OECD.

FOREIGN DIRECT INVESTMENT

FDI inflows reached a record US$3.2 billion in a total of 966 cases during 1996. This is a 10.8 percent increase in the number of cases and a 64.9 percent increase in the dollar volume from the 872 cases and US$1.9 billion registered in 1995. Inflows into the domestic manufacturing sector, which amounted to US$1.9 billion for 369 cases in 1996, showed a particularly high growth rate.

This amount is still small relative to the size of the economy and its development stage reflecting the fact that Korea adopted an indigenous growth strategy that was less dependent on FDI than borrowing in the early stages of its development. More recently, recognizing the need for FDI to help promote industrial restructuring and to develop high technology, the government has sought to improve the foreign investment environment by simplifying investment procedures and introducing various supports.

FDI outflows also increased significantly in 1996. The increase was mainly due to the reduction of restrictions on and the simplification of procedures for overseas direct investment.

MEDIUM-TERM OUTLOOK

Assuming broadly favorable external conditions (annual growth in the world economy of 3.5 to 4 percent and inflation stabilizing at about 2 percent), steady moderation in money supply growth and balanced budgets, and a flexible exchange rate policy coupled with gradual capital account liberalization, the Korean economy is projected to grow at around 6.5 to 7.0 percent per annum over the period 1997 to 2000.

One risk to this scenario in that pressures to bring about an early improvement in economic performance may result in interest rates being lowered to reduce borrowing costs.

Current account deficits are expected to continue as investment rates exceed savings rates. The latter are expected to be in the 32-35 percent range up to the year 2000 and then gradually to decline due to the aging population. Preliminary simulation results indicate current account deficits of approximately 2-4 percent of GDP for the next four years. At this pace, the net foreign debt would rise from around 8 percent of GDP currently to around 15 percent by the end of 2000. Factors bearing on the precise path of deficits over this period include the pace of capital market liberalization (with faster liberalization being associated with higher short-term deficits) and short-term changes in the real effective exchange rate, as the won adjusts in nominal terms to fluctuations in the key yen/dollar rate.

Structural Reform in Korea

Despite the overall economic slowdown and worsening external balance in 1996, reforms aimed at restructuring and opening up the Korean economy continued. Korea's OECD membership as well as pressure to increase domestic competitiveness are expected to accelerate this restructuring effort.

To some extent, realization of the medium-term growth prospects for Korea also depends in part on the structural reforms being accelerated and focused on addressing fundamental issues such as insufficient competition, rather than on quick fixes aimed at symptoms of these problems. Partner economies in APEC and the OECD are to be consulted as regards a good strategy. Some visible results in terms of economic dynamism and lower costs of production are expected to begin to surface before the end of the century, although major results would only come afterwards.

Labor market reforms have included measures to reduce rigidities. Employers have been given the right to lay off workers, hire temporary workers and replace strikers. Although this action led to labor unrest, which prompted the government to reexamine and revise some aspects of these provisions, the process highlighted the need for reform in other areas.

Financial market reform and deregulation is to be accelerated on the assumption that increased competitiveness in the financial sector will lead to another surge in the Korean economy, boosting the competitive edge of other industries in Korea. A private presidential advisory panel comprised of businessmen and representatives from the financial industry has been established to develop reform measures in a bid to turn the supplier-directed, local financial industry into a consumer-oriented market. Short-term steps towards reform will address the further deregulation of this sector and the consolidation of business lines for specialized lending-only financial firms. The improved efficiency of local financial firms alone is expected to lower interest rates. The mid- and long-term measures will emphasize making local financial firms larger and having them specialize in self-selected business areas, thus resulting in a reorganization of the domestic financial industry as a whole.

Capital market liberalization, which is to be accelerated due to Korea's membership in the OECD, also has broader implications for the outlook, as it will result in intensified competition within the financial sector. Given the impact that business failures have had in 1997 on banks' balance sheets, and risks of further failures among conglomerates burdened with excess production capacity and high levels of debt, monitoring the health of financial institutions while increasing competition in the financial sector is a challenging task for the government

Key Indicators: Korea	1991	1992	1993	1994	1995	1996
Output						
Nominal GDP *(US$ bn)*	294.1	307.9	332.8	380.7	456.5	484.6
Real GDP *(% change)*	9.1	5.1	5.8	8.6	8.9	7.1
Private Consumption *(% change)*	9.5	6.6	5.7	7.6	8.3	6.9
Private Investment *(% change)*	11.4	-2.5	6.2	12.3	n/a	n/a
Government Consumption *(% change)*	8.5	7.6	3.0	4.2	2.8	7.1
Government Investment *(% change)*	22.2	11.0	-0.6	8.2	n/a	n/a
Exports *(% change)*	11.8	11.0	11.3	16.5	24.1	14.1
Imports *(% change)*	19.	5.1	6.7	21.7	22.1	14.8
Prices and Labor Market						
GDP Deflator *(% change)*	10.1	6.1	5.1	5.5	5.6	3.4
Headline CPI *(% change)*	9.3	6.2	4.8	6.2	4.5	4.9
Unemployment Rate *(%)*	2.3	2.4	2.8	2.4	2.0	2.0
Financial Markets						
M2 *(% change)*	18.6	18.4	18.6	15.6	15.5	16.2
Short-term Interest Rate *(%)*	18.32	16.41	12.96	13.29	14.05	12.63
Exchange Rate *(annual average won/$US)*	760.8	788.4	808.1	788.7	774.7	844.2
Balance of Payments						
Merchandise Trade Balance*(f.o.b.% of GDP)*	-2.4	-0.7	0.6	-0.8	-1.0	-3.2
Current Account Balance *(% of GDP)*	-3.0	-1.5	0.1	-1.2	-1.9	-4.9
Budget Balance *(% of GDP)*	-0.8	-0.3	0.1	0.6	0.5	0.02
Population *(millions)*	43.27	43.75	44.20	44.64	45.09	45.55

Source: Data are as submitted by member economies, unless otherwise specified.

Summary of	1997						1998-2000					
Forecasts	Official	IMF	PECC	ADB	DRI	WEFA	Official	IMF	PECC	ADB	DRI	WEFA
Real GDP	6.4	6.0	6.0	6.3	6.4	6.0	6.7	6.0	6.8	6.9	6.0	6.0
Real Exports	21.4	n/a	15.3	8.6	12.3	10.4	9.9	n/a	10.8	16.2	12.1	13.2
Real Imports	7.5	n/a	5.9	4.7	12.0	7.6	9.8	n/a	9.5	12.3	12.0	13.3
CPI	4.4	4.2	4.7	4.7	5.1	4.6	4.5	3.7	4.4	4.6	4.7	5.0

Notes: The IMF forecast is from the *World Economic Outlook* (IMF, September 1997); figures for the period 1998-2000 refer to 1998 only. The PECC forecast is from the *Pacific Economic Outlook 1997-1998* (PECC, 1997); 1998-2000 figures refer to 1998 only. The ADB forecast is from the ADB, *Asia Economic Outlook, 1997-1998*; figures for the period 1998-2000 refer to 1998 only. The DRI forecast is from *World Market Executive Overview* (3rd Quarter, 1997). The WEFA forecast is from *Asia Economic Outlook* (August, 1997). Note: DRI and WEFA figures for real export and real import growth include services.

Malaysia

Background Information	
Capital	Kuala Lumpur
Population	21.7 million (1997 estimate)
Language	Bahasa Melayu, English, Chinese, Tamil
Major Industries	electronics and electrical, textiles and clothing, footwear, chemicals, petroleum, wood products, metal products, rubber
Major Exports	electronics and electrical, machinery, petroleum and LNG, palm oil, sawn timber and wood products, rubber, cocoa and cocoa products, textiles, clothing and footwear
Major Imports	manufacturing inputs, machinery and transport equipment, metal products, consumer durables, food, beverages and tobacco

GDP

Real GDP growth slowed to the more sustainable level of 8.6 percent in 1996 from 9.5 percent in 1995. The moderation in economic activity in 1996 was due primarily to a slowdown in domestic demand growth to 6.3 percent, following several years of strong growth since 1993.

The manufacturing sector continued to be the main source of growth in the economy. It recorded a more moderate expansion in 1996 (12.2 percent versus 14.5 percent in 1995), as export-oriented industries slowed in the face of weaker external demand for electrical and electronics products. Overall, the share of manufacturing rose to 34.2 percent of GDP in 1996 from 33.1 percent in 1995.

Output in the construction sector grew at the more moderate pace of 14.2 percent in 1996 compared with 17.3 percent in 1995. This still-strong growth reflected both several major infrastructure and civil engineering projects, as well as residential and non-residential construction. Activity in the services sector remained strong with growth at 9.7 percent, reflecting the strong performance of the following subsectors: finance, insurance, real estate, business services, transport, storage, communications and utilities.

Private consumption growth moderated to 6.0 percent in 1996 in real terms as a result of lower earnings from commodities and the various monetary measures put in place to discourage consumption and encourage savings.

Private investment growth slowed to 13.4 percent in 1996 in real terms after averaging 24.1 percent growth in the preceding three years.

Public sector expenditure growth also moderated in 1996 due entirely to a sharp deceleration in public consumption and investment spending. Reflecting the continued stringent control on operating expenditures and fiscal prudence, growth in public investment slowed to 1.1 percent while public consumption increased only marginally by 1.4 percent in 1996.

In the first part of 1997, the pace of growth was maintained at about the 1996 level with real GDP expanding by 8.5 percent year-over-year in the first quarter and by a preliminary estimate of 8.4 percent in the second quarter.

The growth outlook for the year as a whole has, however, been scaled back somewhat, reflecting a combination of factors, primarily the spillover effect from the currency instability in the region. Real growth is expected to reach 8 percent in 1997.

INFLATION

The CPI rose by 3.5 percent in 1996, more or less unchanged from the 3.4 percent recorded in 1995. Higher food prices were offset by lower import prices that resulted from the appreciation of the ringgit during the year together with the removal of import duties from a wide range of items in the 1996 Budget.

Inflation eased to 2.6 percent through the first 9 months of 1997 and is expected to be contained at below 4 percent in 1997, despite the impact on import prices from the depreciation of the ringgit in the second half of the year.

EMPLOYMENT

Employment increased at an estimated rate of 3.3 percent in 1996, while the labor force grew by 3.2 percent. The services sector accounted for the largest share of total employment (47 percent), followed by the manufacturing sector (27 percent) and the agriculture sector (17 percent).

The unemployment rate fell as a consequence of these trends to 2.6 percent, further tightening labor market conditions. 1996 was the fifth consecutive year that effectively full employment was maintained and labor shortages, especially as regards skilled workers, had put pressures on wages.

These labor market conditions persisted into 1997. For the year as a whole, the unemployment rate is expected to be 2.5 percent.

CURRENT ACCOUNT

The current account deficit fell significantly in 1996 to RM12.3 billion from RM21.8 billion in 1995. As a percent of GDP, it fell to 4.9 percent of GDP in 1996 (1995: 10.0 percent of GDP). For 1997, the deficit was expected to widen marginally (to about RM13.1 billion). However, the deficit is envisaged to narrow to 4.8 percent of GDP.

EXCHANGE RATE

In 1996, the ringgit was broadly stable, trading for the most part in a narrow range of RM2.48- RM2.53 to the U.S. dollar and appreciating in the course of the year by 2.6 percent against a composite basket of major trading partners' currencies.

This pattern persisted through the first 6 months of 1997. However, the spillover effects of the currency instability resulted in the depreciation of the ringgit in tandem with other regional currencies against the U.S. dollar, falling about 21 percent from the end of the 2nd quarter to the end of the 3rd quarter.

FISCAL POLICY

The federal budget was in surplus in 1996 for the fourth successive year. The overall surplus of 0.7 percent of GDP was broadly unchanged from the 0.9 percent achieved in 1995. Federal revenues grew 14.4 percent in 1996 to reach 23.3 percent of GNP on the strength of sustained strong economic growth and more efficient tax administration. Several tax concessions were implemented during the year as part of the overall tax reform package to enhance productivity and competitiveness of the private sector, promote savings and reduce price pressures.

The federal government's financial position is expected to remain strong in 1997, reflecting continued commitment to fiscal consolidation as part of the macroeconomic strategy to contain demand and price pressures. Federal revenues are expected to increase by 8.6 percent in 1997, resulting in a budget surplus of about RM5.1 billion.

MONETARY POLICY

Money supply expanded significantly during 1996, reflecting rapid growth of economic activity and strong demand for credit by the private sector.

Growth in the broader aggregates **M3 and M2** decelerated over the course of the year from highs of 27 percent and 27.9 percent, respectively, at the end of April to 22.7 percent and 20.9 percent at year-end 1996 (compared to 22.3 percent and 24 percent, respectively, at year-end 1995).

However, reflecting the continued strong demand for transaction balances, the pace of **M1** accelerated to 18.3 percent at year-end 1996 compared with 11.7 percent at the end of 1995.

In the conduct of monetary policy during the first eight months of 1997, priority continued to be accorded to achieving price stability aimed at ensuring that prospects remain favorable for sustainable economic growth. An important element of the policy was also to ensure stability in the money and foreign exchange markets so as to create a predictable environment for the private sector to conduct business and investment.

FOREIGN DIRECT INVESTMENT

FDI inflows amounted to RM14.4 billion (US$570 million) and were targeted primarily in the manufacturing (87 percent) and oil and gas (10 percent) sectors.

Key Indicators: Malaysia	1991	1992	1993	1994	1995	1996
Output						
Nominal GDP *(US$ bn)*	47.4	56.2	59.9	72.5	86.1	98.7
Real GDP *(% change)*	8.6	7.8	8.3	9.2	9.5	8.6
Private Consumption *(% change)*	9.5	3.0	4.6	9.8	9.4	13.4
Private Investment *(% change)*	23.1	0.5	19.1	27.9	25.3	9.1
Government Consumption *(% change)*	12.4	4.0	10.7	9.9	7.3	1.4
Government Investment *(% change)*	18.6	28.0	8.4	-0.6	8.7	1.1
Exports *(% change)*	18.6	9.7	17.0	27.0	20.2	6.5
Imports *(% change)*	27.4	0.6	15.7	32.8	24.6	1.5
Prices and Labor Market						
GDP Deflator *(% change)*	2.9	5.2	2.7	5.4	5.0	5.4
Headline CPI *(% change)*	4.4	4.7	3.6	3.7	3.4	3.5
Unemployment Rate *(%)*	4.3	3.7	3.0	2.9	2.8	2.6
Financial Markets						
M2 *(% change)*	15.3	19.6	23.5	13.1	22.3	22.7
Short-term Interest Rate *(%)*	8.0	7.9	6.5	5.4	6.6	7.2
Exchange Rate *(annual average RM/$US)*	2.73	2.61	2.70	2.56	2.54	2.53
Balance of Payments						
Merchandise Trade Balance*(f.o.b.% of GDP)*	1.1	5.8	5.0	2.4	0.04	4.1
Current Account Balance *(% of GDP)*	-8.8	-3.8	-4.8	-6.3	-10.0	-4.9
Budget Balance *(% of GDP)*	-2.0	-0.8	0.2	2.3	0.9	0.7
Population *(millions)*	18.2	18.6	19.0	19.5	20.1	21.2

Source: Data are as submitted by member economies, unless otherwise specified.

Summary of Forecasts	1997						1998-2000				
	Official	IMF	PECC	ADB	DRI	WEFA	Official	PECC	ADB	DRI	WEFA
Real GDP	8.0	7.5	8.2	8.5	8.0	8.0	7.0	8.6	8.5	7.8	8.3
Real Exports	n/a	n/a	5.9	7.9	7.4	9.5	n/a	11.1	15.0	9.8	11.2
Real Imports	n/a	n/a	6.1	5.2	7.9	10.1	n/a	12.3	14.9	9.0	11.1
CPI	3.0	3.9	3.4	3.7	3.4	3.4	n/a	3.5	3.8	3.8	3.6

Notes: The IMF forecast is from the *World Economic Outlook* (IMF, September 1997); figures for the period 1998-2000 refer to 1998 only. The PECC forecast is from the *Pacific Economic Outlook 1997-1998* (PECC, 1997); 1998-2000 figures refer to 1998 only. The ADB forecast is from the ADB, *Asia Economic Outlook, 1997-1998*; figures for the period 1998-2000 refer to 1998 only. The DRI forecast is from *World Market Executive Overview* (3rd Quarter, 1997). The WEFA forecast is from *Asia Economic Outlook* (August, 1997). Note: DRI and WEFA figures for real export and real import growth include services.

Mexico (United Mexican States)

Background Information	
Capital	Mexico City
Population	92.8 million (1996)
Language	Spanish
Major Industries	automobile production, oil, in-bond industry, cement, brewing, textiles, clothing
Major Exports	oil, automobile production, in-bond assemblage, cement, brewing, fruits and vegetables
Major Imports	machinery, transport equipment, steel, electronics

GDP

Real GDP grew 5.1 percent in 1996, substantially higher than the original target of 3 percent under the economic program implemented by the Mexican government during 1996 to consolidate the recovery after the 1995 downturn and establish the basis for sustainable medium-term growth. The recovery continued into 1997 and, by the end of the second quarter of 1997, GDP had increased for five consecutive quarters for a total increase of 7.0 percent, the fastest pace of growth since 1981.

Although the **recovery was kick-started by exports** (up 18.7 percent in 1996), it quickly broadened as consumption grew by 2.3 percent and investment by 15.8 percent. Construction was the strongest sector, growing by 11.4 percent, followed by manufacturing (10.9 percent), transportation and telecommunications (8.7 percent) and mining (8.3 percent).

In 1997, real GDP is expected to grow 6.5 percent, broadly in line with medium-term potential growth of about 5 percent. Higher levels of savings and investment will result in a **balanced expansion** of domestic demand as the recovery is consolidated, with real investment projected to grow by 12.6 percent, including 14.4 percent private investment growth and 6.6 percent in the public sector.

INFLATION

In 1996, CPI grew by 34.4 percent on an annual average basis, little changed from the 35 percent recorded in 1995. However, this masked a sharp decline during the course of the year, as evidenced by the slowdown of CPI growth to 27.7 percent in December on a year-over-year basis from 52 percent in the corresponding year-earlier period. Contributing to the successful reduction of inflation were tight monetary policy, moderate wage demands, and relative exchange rate stability.

The disinflationary momentum was sustained into 1997 and, by the second quarter, year-over-year inflation was down to 20.3 percent. It is projected to continue to decline in the second half of the year to attain a level of 15.0 percent by year-end on a year-over-year basis.

The disinflationary policy strategy is based on maintaining firm monetary policy, sound public finances, and the Central Bank's commitment to provide all information necessary for economic agents to adjust expectations and evaluate the consistency of macroeconomic policies.

EMPLOYMENT

Employment growth rebounded strongly in 1996 with the number of workers affiliated with the social security system increasing by 819,950 or about 8.8 percent, mainly due to the creation of permanent jobs. This indicator has shown consistent monthly growth rates since May 1996, after 15 consecutive months of reporting declines. The key factors for this evolution in the labor market were a strong rebound in the demand for labor in the manufacturing sector, and a significant expansion of the in-bond industry, mainly in the northern border states.

The open unemployment rate decreased in line with the strong job growth from 5.5 percent in December 1995 to 4.1 percent in December 1996

Labor market conditions are expected to improve throughout 1997, given the likely continuation of economic growth, with the unemployment rate falling to 3.9 percent by year-end and real wages registering a slight increase.

CURRENT ACCOUNT

The current account deficit amounted to US$1.9 billion in 1996 or 0.6 percent of GDP, which was similar to 1995 and much lower than in 1994.

The total trade balance registered a surplus of US$6.5 billion, US$0.6 billion less than in 1995.

Exports showed great dynamism, growing by 20.7 percent in value relative to 1995, three times the growth rate of world trade in the same period. Oil exports grew 38.4 percent and non-oil exports, led by manufactured goods, grew 18.6 percent. Merchandise exports were more diverse in 1996 than in the recent past, with foreign sales of natural resources continuing their declining trend as a proportion of total foreign trade.

Imports meanwhile grew in value by 23.5 percent overall, with the recovery in investment activity inducing a strong increase in imports of capital and intermediate goods, which grew 25.6 percent and 23.1 percent, respectively.

In 1997, the current account is likely to register a deficit of around US$4.3 billion, or 1.2 percent of GDP, reflecting a projected decline in the trade surplus to US$1.4 billion. The deficit is expected to be fully financed by foreign direct investment.

EXCHANGE RATE

In 1996, the second year of the floating exchange rate regime, the peso was broadly stable against the U.S. dollar, finishing the year down a marginal 3 percent from its 1995 year-end level.

In 1997, the peso is expected to depreciate around 9 percent compared to the level at the end of 1996. Mexican authorities have determined a reference level of 8.53 pesos per dollar by the end of 1997, but no predetermined level of the exchange rate will be defended by the Central Bank.

FISCAL POLICY

The 1996 non-financial **public sector deficit** of US$304.8 million was smaller than envisaged in the economic program.

Tax revenues decreased in real terms due to constraints on liquidity within companies and the lagged effects of the economic downturn during 1995 and the first quarter of 1996. However, this was offset by higher-than-expected oil revenues, following the rise in international oil prices.

Expenditures increased in line with expectations, with larger rebates to mortgage debtors being offset by lower-than-programmed wage payments and transfers to the private sector.

For 1997, a deficit of 0.5 percent of GDP has been projected as Mexico continues to maintain a tight fiscal policy as part of the macroeconomic policy to promote a non-inflationary recovery. This deficit is explained by public funds earmarked to pay the cost of the social security reform, help relieve the over-indebtedness of firms and households, and assist with the program to recover investments in roads and highways.

MONETARY POLICY

The Bank of Mexico adopts a firm target for overall growth in the monetary base and adjusts the supply of primary money on a daily basis to meet demand. Since a primary policy goal is to provide economic agents with full information for the analysis of monetary policy, the Bank of Mexico announces in advance the course of monetary base stock for the year, on a daily basis.

The growth of the monetary base closely resembles that of bills and coins in circulation since banks do not tend to maintain positive balances in their current accounts under the Zero Average Reserve Requirement System. Regarding the sources of the monetary base, in 1996 40 percent was provided by net domestic credit, while the rest came from international reserves. This composition was markedly different from 1995 when international reserves did not figure as a source of the monetary base.

In 1996, The Bank maintained a neutral monetary policy stance. Base money grew 25.7 percent from year-end 1995 to year-end 1996. This was slightly below the projected growth of 28 percent, despite the fact that real GDP grew at a higher rate than anticipated, and that nominal interest rates declined significantly. Two of the factors that caused a smaller demand for primary money were the fall in real wages and the more intensive use of debit cards.

In 1997, the primary objective of monetary policy is to contribute to the abatement of inflation. Given that a reduction in annual inflation and declining interest rates are expected, the Central Bank envisages a greater increase in the demand for base money than what could be determined on the basis of inflation and the real GDP growth rate alone. An expected re-monetization of about 3.6 percent of the monetary base's 1996 year-end stock, together with official projections on GDP growth rate and inflation, should result in the estimated 24.5 percent growth of the monetary base.

FOREIGN DIRECT INVESTMENT

During 1996 the inflow of FDI was quite favorable and totaled US$7.6 billion, US$1.9 billion less than in 1995. Of the total FDI received in 1996, US$4.6 billion was accounted for by new investments, US$2.1 billion by reinvestment, and the remainder by inter-company accounts. By sector, 60 percent of the new investment in 1996 went to the industrial sector, 25 percent to the services sector, and the remaining 15 percent to commerce, transportation and communication, and other sectors.

MEDIUM-TERM OUTLOOK

The main objectives of Mexico's medium-term program are: to attain a real GDP growth rate of around 5 percent, consistent with the annual growth rate of the labor force; to create and strengthen domestic sources of financing on a sustained basis; to prevent future vulnerability to external capital flows in order to maintain a stable macroeconomic environment; and to improve social welfare.

In the past two decades, Mexico has faced recurrent crises that have frustrated its growth aspirations. These events were characterized by, among other things, inadequacy of domestic savings and an excessive dependency on external savings, which in turn created an environment of uncertainty. Accordingly, the strengthening of domestic savings has become a key policy objective.

Measures implemented in 1995 and 1996 have led to a significant rise in domestic savings, which increased from 15 percent of GDP in 1994 to 20.4 percent in 1996. This latter figure compared to an investment/GDP ratio of 20.9 percent in 1996.

To maintain average annual GDP growth above 5 percent between 1997 and 2000, it is estimated that the investment/GDP ratio must increase gradually to 25.4 percent in the year 2000. In order to prevent recurrent crises, it is the goal of the authorities that this capital formation requirement be funded mainly from internal sources, only being complemented by foreign direct investment. Consequently the medium-term program includes four financing strategies aimed at encouraging the increase of domestic savings rates.

The aim of the first strategy is to increase private saving from 16.1 percent of GDP in 1996 to 17.7 percent of GDP in 2000. The strategy involves reforms to the pension system, the promotion of popular savings, and a fiscal policy that will promote savings by creating a stable macroeconomic environment.

The second strategy is designed to consolidate public savings in order to cover the transitional costs inherent in the social security reform. A commitment to strong public finance, and a virtual balanced budget in the overall position of the public sector by the year 2000, are the bases of this strategy. These fiscal results would then enable Mexico to increase expenditures in areas such as productive infrastructure, health, and the alleviation of poverty, among others.

Given the strong need for financial resources, the third strategy of the medium-term program includes the promotion of external savings as a complement to domestic savings. However, only a moderate and sustainable current account deficit will be financed through stable and permanent external sources. Foreign direct investment is expected to reach US$10.8 billion by the year 2000.

Finally, the fourth strategy is geared to strengthening the financial system by implementing prudential and self-imposed regulations, promoting the deepening of financial markets, motivating efficient resource allocation and overhauling the banking system.

Structural Reform Policy in Mexico

In 1997, Mexico has continued to broaden its structural reform policies in key sectors of the economy. In *telecommunications*, long-distance service opens up to competition, satellites will be privatized, radio spectrum auctions will be introduced, and a new regulatory authority will be created. In the *natural gas* sector, reforms will include de-monopolization, new private sector concessions and the creation of a new regulatory authority. In the *railroad* system, five new companies will be created with a view to increasing competition, privatization will continue,[1] and a new regulatory framework will be established. In the p*orts and airports* reform, the privatization of ports, already well-advanced, will be completed, and the airport privatization program will be implemented.

The Social Security reform refers to both pension and health care components. The pension system reform, which became operational on 1 July 1997, includes the transition from a publicly-provided pay-as-you-go plan, to a privately-managed and publicly-regulated defined-contribution system. Under this new program, affiliates will have their own individual capitalization accounts in the private pension fund of their choice. This system establishes the following incentives: individual accounts with defined property rights, capitalized funds with access to market yields, transparency and accountability.

The main objectives of the comprehensive reforms in tax administration are to increase its effectiveness through the creation of a new career in tax administration and to implement new systems and procedures for collecting taxes. A new law creating the Tax Administration Service became operational on 1 July 1997. This new agency has the authority to collect all federal taxes and to carry out all tax-administrative functions, including auditing and taxpayer assistance. In addition, it incorporates customs administration, the federal tax police, and has the authority to negotiate tax treaties.

Other relevant aspects of the structural reform include the strengthening of social programs directed toward the most vulnerable groups of the population. Social public expenditure will be earmarked for establishing programs of social development and reinforcing existing programs to alleviate poverty, in order to improve the standard of living of the population. The 1997 budget allocates 55.8 percent of programmable expenditures to health care, social security and education, as well as to temporary employment programs for rural areas. Mexico sees these structural reforms, together with a tight fiscal and monetary stance that contributes to reducing inflation, as establishing the basis for medium-term growth.

[1] Bids have already been made for 80 percent of the assets of Ferrocarril del Noreste (Northeast Railway) for around US$1.4 billion.

Key Indicators: Mexico	1991	1992	1993	1994	1995	1996
Output						
Nominal GDP *(US$ bn)*	286.63	363.61	403.20	420.78	286.84	334.79
Real GDP *(% change)*	4.2	3.6	2.0	4.4	-6.2	5.1
Private Consumption *(% change)*	4.7	4.7	1.5	4.6	-9.5	2.3
Private Investment *(% change)*	14.5	15.0	-3.3	9.8	-31.2	15.8
Government Consumption *(% change)*	5.4	1.9	2.4	2.9	-1.3	3.7
Government Investment *(% change)*	0.6	-3.3	-0.4	2.9	-19.8	24.7
Exports *(% change)*	5.1	5.0	8.1	17.4	33.0	18.7
Imports *(% change)*	15.2	19.6	1.9	20.5	-12.8	27.8
Prices and Labor Market						
GDP Deflator *(% change)*	21.1	14.4	9.5	8.3	37.9	31.7
Headline CPI *(% change)*	22.7	15.5	9.8	7.0	35.0	34.4
Unemployment Rate *(%)*	2.7	2.8	3.4	3.6	6.3	5.5
Financial Markets						
M2 *(% change)*	47.2	20.3	13.4	21.3	38.7	28.2
Short-term Interest Rate *(%)*	16.65	16.84	11.78	20.07	48.65	27.27
Exchange Rate *(annual average Peso/$US)*	3.02	3.09	3.12	3.38	6.42	7.60
Balance of Payments						
Merchandise Trade Balance*(f.o.b.% of GDP)*	-2.3	-4.4	-3.3	-4.4	2.5	2.0
Current Account Balance *(% of GDP)*	-4.6	-6.7	-5.8	-7.0	-0.6	-0.6
Budget Balance *(% of GDP)*	-0.4	1.4	0.7	-0.3	-0.2	-0.2
Population *(millions)*	83.95	85.63	87.34	89.09	91.16	92.78

Source: Data are as submitted by member economies, unless otherwise specified. The short-term interest rate is the 28-day Cetes rate, year-end values.

Summary of Forecasts	1997					1998-2000			
	Official	IMF	PECC	DRI	WEFA	Official	PECC	DRI	WEFA
Real GDP	6.5	4.5	5.0	4.9	5.4	5.0	5.5	4.9	6.0
Real Exports	12.6	n/a	15.3	10.7	14.9	n/a	14.0	10.1	11.5
Real Imports	12.6	n/a	17.2	17.8	19.1	n/a	16.5	11.2	16.9
CPI	15.0	20.4	17.9	23.1	20.9	10.0	11.9	12.7	12.0

Notes: The IMF forecast is from the *World Economic Outlook* (IMF, September 1997); figures for the period 1998-2000 refer to 1998 only. The PECC forecast is from the *Pacific Economic Outlook 1997-1998* (PECC, 1997); 1998-2000 figures refer to 1998 only. The DRI forecast is from *World Market Executive Overview* (3rd Quarter, 1997). The WEFA forecast is from *Asia Economic Outlook* (August, 1997). Note: DRI and WEFA figures for real export and real import growth include services.

New Zealand

Background Information	
Capital	Wellington
Population	3.72 million (December 1996)
Language	English (Maori is also an official language)
Major Industries	meat and dairy products, machinery and equipment manufacturing, other food and beverage manufacturing, wood and paper products
Major Exports	dairy products, forest products, mutton, wool, beef, fruit, aluminum, machinery
Major Imports	machinery, vehicles, oil, plastics and articles of plastic, optical, photographic, technical and surgical equipment, pharmaceuticals.

GDP

Real GDP growth moderated to 2.7 percent in 1996 from the high levels of 6.0 percent and 3.5 percent in 1994 and 1995, respectively. This strong growth saw spare resources, such as labor, start to diminish and inflation pressures start to rise. The Reserve Bank accordingly tightened monetary conditions. Interest rates increased from mid-1994 through mid-1996, and the exchange rate appreciated, rising from US$0.56 at the end of 1993 to over US$0.70 at the end of 1996.

During 1996, the non-tradables sector expanded by 4.3 percent, while the tradables sector grew 1.5 percent. This sectoral divergence continued the pattern of the previous several years and reflected the effect of the strong currency on the ability of firms in the tradables sector to compete in both world and domestic markets.

Reflecting the monetary restraint, growth slowed to 1.4 percent year-over-year in the first quarter of 1997 (in fact, the economy contracted by 0.5 percent in the March 1997 quarter from the December 1996 quarter). However, growth resumed in the June quarter with a brisk 1.2 percent (seasonally adjusted) increase over the first quarter, bringing growth up to 2.4 percent on a year-over-year basis. It is anticipated that growth in the year to the end of March 1998 will be 2.4 percent, strengthening to 4.2 percent in 1998/99 in response to the decline in interest rates since mid-1996, an increase in government spending, income tax reductions from June 1998 and a favorable global economy.

INFLATION

Consumer price inflation has moderated from a peak of 4.6 percent in the year to June 1995, falling to 1.0 percent in the year to the September 1997 quarter.

Underlying inflation (which excludes credit charges) fell to 1.8 percent in the year to the September 1997 quarter. Inflation in the tradables sector was flat at 0.0 percent, while non-tradables inflation came in at 3.9 percent. The price of housing, previously a source of concern for the central bank, rose just 1.4 percent.

Inflationary pressures appear to be relatively subdued, and underlying inflation is expected to remain comfortably within the Reserve Bank's target band of 0-3 percent over the next few years. Firmer monetary conditions are anticipated from early 1998 to counteract inflationary pressures that might arise from the expected pick-up in economic growth in the 1998/99 year.

EMPLOYMENT

Employment growth decreased over 1996/97, from 3.9 percent in the year to March 1996 to 1.1 percent to March 1997. This slowdown reflects decreases in employment in the December 1996 and March 1997 quarters of 0.5 percent and 0.1 percent, respectively (on a seasonally adjusted basis). The declines were concentrated in the primary and manufacturing sectors, both down 6.1 percent in the year to March 1997.

Employment growth is expected to be subdued during 1997, reflecting the slower economic growth. However, it is anticipated that increasing momentum in the economy from late 1997 will see firms, over the course of 1998, once again taking on staff.

CURRENT ACCOUNT

The current account has been dominated by a substantial deficit on the invisibles balance. However, movements in the balance of trade have been important in determining changes in the overall account.

The current account as a percentage of nominal GDP has deteriorated from 1993, following a gradual improvement after 1990. This decline has been driven by a weakening merchandise balance. The invisibles balance has remained between -4 and -6 percent of GDP since 1993. The decline in the merchandise balance since the 1993 peak has been mostly due to weakening export values, although an increasing nominal import penetration ratio has also been a factor.

Two navy frigate imports, each worth around US$410 million are expected to arrive during the next two (March) years. Excluding these one-off items, the current account balance is forecast to remain at around -4.5 percent of GDP over the next few years. The investment income balance is supported by the government's debt repayment program.

EXCHANGE RATE

The New Zealand dollar (NZ$) strengthened against the currencies of New Zealand's main trading partners over the course of 1996. The trade weighted index increased to 67.5 in December 1996, up from 62.3 a year previously.

The strength of the exchange rate reflected high domestic real interest rates. The exchange rate has remained relatively high even after the decrease in interest rates in late 1996 and early 1997 -- probably because real interest rates were still relatively high compared to other economies.

FISCAL POLICY

The government achieved operating surpluses (on an accruals basis) in excess of 3 percent of GDP in both 1994/95 and 1995/96 fiscal (June) years. The surpluses resulted from strong economic growth pushing up tax revenues, and expenditure restraint.

The government signaled in its June 1997 budget that it will reduce income taxes and increase spending. The government has allowed for additional spending in the period 1997/98 to 1999/2000 totaling NZ$5 billion (or US$3.45 billion). This has been offset, in part, by deferral of the second stage of agreed tax cuts from 1 June 1997 to 1 June 1998.

The government's surplus in 1996/97 is estimated at NZ$2.8 billion (2.9 percent of GDP). Forecast surpluses are NZ$1.5 billion in 1997/98 (1.5 percent of GDP), NZ$1.9 billion in 1998/99 (1.8 percent of GDP) and NZ$2.6 billion in 1999/00 (2.3 percent of GDP).

MONETARY POLICY

The Reserve Bank of New Zealand is responsible for managing monetary policy with the intention of maintaining price stability. Price stability is defined by agreement between the Minister of Finance (or in future the Treasurer) and the Governor of the Reserve Bank.

Until December 1996, the price stability target was annual underlying consumer price inflation of between 0 and 2 percent. Underlying inflation excludes credit charges and significant (greater than 0.25 percent impact on CPI) government charges and external shocks.

In December 1996, the incoming coalition government broadened the price stability target from underlying inflation of 0-2 percent to underlying inflation of 0-3 percent.

FOREIGN DIRECT INVESTMENT

Net FDI inflows in the year to March 1996 were US$3.0 billion, up from US$2.5 billion in the year to March 1995. The major components of the FDI were equity capital of US$1.5 billion and reinvested earnings of US$1.3 billion. Direct investment abroad showed a net decrease of US$0.2 billion in the year to March 1996, as net declines in equity capital of US$0.7 billion and other long-term capital of US$0.6 billion were only partially offset by increased reinvested earnings and short-term capital.

Key Indicators: New Zealand	1991	1992	1993	1994	1995	1996
Output						
Nominal GDP *(US$ bn)*	41.9	39.8	43.8	51.7	59.9	64.6
Real GDP *(% change)*	-1.7	0.9	5.0	6.0	3.5	2.7
Private Consumption *(% change)*	-0.7	-1.2	1.6	4.6	5.2	4.0
Private Investment *(% change)*	-12.8	-3.5	13.5	19.9	13.6	6.1
Government Consumption *(% change)*	0.0	1.2	1.2	-1.4	0.6	1.2
Government Investment *(% change)*	-10.8	-25.2	-11.4	0.5	8.8	9.6
Exports *(% change)*	9.5	2.6	6.0	10.4	2.7	4.5
Imports *(% change)*	-5.2	8.1	6.0	12.9	8.7	7.2
Prices and Labor Market						
GDP Deflator *(% change)*	1.0	1.7	2.6	1.3	2.7	1.9
Headline CPI *(% change)*	0.9	1.3	1.4	2.8	2.9	2.6
Unemployment Rate *(%)*	10.6	10.2	9.2	7.3	6.2	5.9
Financial Markets						
M3 *(% change)*	9.3	10.5	7.0	5.1	9.2	14.1
Short-term Interest Rate *(%)*	10.0	6.7	6.3	6.7	9.0	9.4
Exchange Rate *(annual average NZ$/US$)*	1.74	1.86	1.84	1.68	1.52	1.45
Balance of Payments						
Merchandise Trade Balance *(% of GDP)*	5.0	4.1	4.1	2.7	1.5	0.8
Current Account Balance *(% of GDP)*	-2.2	-2.7	-1.2	-2.5	-3.7	-4.2
Budget Balance *(% of GDP)*	n/a	-7.0	-1.1	0.9	3.1	3.6
Population *(millions)*	3.45	3.49	3.52	3.58	3.64	3.72

Source: Data are as submitted by member economies, unless otherwise specified. All data are on a calendar year basis except as noted below. Real GDP figures are production-based GDP. Exports and imports growth are for goods and services in real terms. CPI figures are headline CPI on an annual average calendar year basis. Unemployment rate and M3 figures are for the December quarter in each year. The interest rate refers to the annual average 90-day bank bill rate. The budget figures are accrual operating balances on a June fiscal year basis.

Summary of			1997					1998-2000		
Forecasts	Official	IMF	PECC	DRI	WEFA	Official	IMF	PECC	DRI	WEFA
Real GDP	2.4	1.2	2.4	1.7	2.4	4.2	3.9	3.9	2.5	3.2
Real Exports	n/a	n/a	2.0	4.9	8.6	n/a	n/a	4.0	5.7	6.0
Real Imports	n/a	n/a	3.8	9.0	13.0	n/a	n/a	7.2	5.2	4.6
CPI	n/a	1.4	1.5	2.2	2.0	n/a	1.3	2.7	2.9	2.6

Notes: The official figure for 1997 refers to FY 1997/98, while the official figure for 1998-2000 refers to FY1998/99. The IMF forecast is from the *World Economic Outlook* (IMF, September 1997); figures for the period 1998-2000 refer to 1998 only. The PECC forecast is from the *Pacific Economic Outlook 1997-1998* (PECC, 1997); 1998-2000 figures refer to 1998 only. The DRI forecast is from *World Market Executive Overview* (3rd Quarter, 1997). The WEFA forecast is from *Asia Economic Outlook* (August, 1997). Note: DRI and WEFA figures for real export and real import growth include services.

Papua New Guinea

Background Information	
Capital	Port Moresby
Population	4.16 million (1996)
Language	English, Pidgin and Motu
Major Industries	mining and petroleum; agriculture, including coffee, cocoa, palm oil and copra cash crops; fisheries
Major Exports	copper, gold and petroleum; palm oil; coffee and cocoa; copra and copra oil; forestry products; fish
Major Imports	consumer goods, machinery and equipment, fuels; chemicals; and rice and other foodstuffs

GDP

Real GDP bounced back quite well in 1996 from a sharp decline in growth in 1994 and a recession in 1995 that had been brought on by a combination of factors, including: declines in the contribution of the mining and oil sectors, in part reflecting a fall in oil prices; capital outflows which led to the floating of the currency and a sharp devaluation of the kina; and budget cuts and monetary tightening required to stabilize the economy.

Real GDP grew by a preliminary estimate of 1.9 percent in 1996 following the 2.9 percent decline in 1995. The recovery was broadly based with only mining output experiencing a further decline. Construction rebounded from a 25 percent decline in 1995 to lead the recovery, growing by 30 percent, supported by new investment in the mining sector and transportation infrastructure.

Agricultural output growth meanwhile strengthened moderately to 3 percent with increased production of staple products such as cocoa, coffee and palm oil, as well as logs. Manufacturing output also recovered from a decline in 1995 to grow by 2 percent in 1996.

Prospects for 1997 are for growth to strengthen moderately from 1996 rates, with a further acceleration into 1998, supported by an active construction sector. The IMF projects growth of 3 percent in 1997 and through the 1998-2001 period.

INFLATION

Inflation, which had been held broadly in check during the early 1990s, jumped into double-digits following the devaluation of the kina. It has since been reduced from 17.3 percent in 1995 to 11.6 percent in 1996. The IMF projects inflation to be reduced to 7 percent by the end of 1997 and 4.8 percent by the end of 1998.

CURRENT ACCOUNT

The current account jumped into large surpluses in 1993-95 as resource-generated exports more than doubled while imports grew much more slowly. However, in 1996, lower average prices over the year for several key export commodities (especially copper) resulted in export receipts declining by approximately 16 percent. With the value of imports rising by 22 percent, the **current account surplus declined** from 14.3 percent of GDP in 1995 to an estimated 5.2 percent of GDP in 1996.

With export receipts expected to further decline in 1997, the current account may swing into deficit this year. However, recovering terms of trade are expected to restore the surplus in 1998 and beyond.

EXCHANGE RATE

The exchange rate has been following a moderate downward trend against the U.S. dollar since the devaluation in late 1994. The kina depreciated by 3 percent against the dollar in 1996, and a further 6 percent over the first three quarters of 1997.

Foreign exchange reserves were rebuilt to the US$550 million range (approximately 10 percent of GDP) in the first quarter of 1997, after bottoming out in the first quarter in 1995.

FISCAL SITUATION

Restoration of prudent fiscal policies has been a key aspect of the policy package to restore economic stability. Measures have included tax reforms (including tariff policies and a planned introduction of a broad-based consumption tax in 1998, alongside measures to improve tax collection) and a real reduction in spending through public service cuts and wage restraint. Reflecting these measures, the fiscal position shifted from a deficit of 0.6 percent of GDP in 1995 to a surplus estimated at 0.5 percent in 1996.

The government budget is expected to register small deficits in 1997 and 1998 on the order of 1 percent of GDP.

MONETARY POLICY

Following the **floating of the kina**, monetary policy was aimed at bringing down the rate of inflation. The treasury bill rate rose from an average of 6.9 percent in 1994 to 17.4 percent in 1995. Interest rates peaked in the first quarter of 1996 and started to ease in line with the rapid deceleration of inflation. The treasury bill rate averaged 14.4 percent in 1996 but was down to the 10 percent range in the second half of the year. It remained at about 10 percent through the first four months of 1997.

FOREIGN DIRECT INVESTMENT

The unstable macroeconomic situation in 1993-94 resulted in a net outflow of FDI in those two years. However, inflows surged in 1995 to over US$450 million and continued strong in 1996. The mining sector is expected to continue to attract strong inflows of private capital over the near term.

Structural Adjustments under the Economic Recovery Program

The government of Papua New Guinea undertook a number of structural reforms under the Economic Recovery Program adopted with the 1995 budget. These structural adjustments were initiated to re-establish fiscal and monetary stability and the basis for stable medium-term growth. The main elements of the structural reform program were:

- shifting to a market-determined floating exchange rate;
- shifting to market-determined interest rates;
- raising the minimum liquid assets ratio for banks;
- a commitment to limit the fiscal deficit to 1 percent of GDP;
- measures to enhance competitiveness and restore business confidence;
- creating the basis for sustainable development of renewable natural resources, in particular of forests, through measures such as surveillance and monitoring of logging and fisheries;
- replacing import restrictions with tariffs and lowering tariffs on industrial inputs and other imports;
- public sector reforms, including lowering the number of public servants;
- measures to improve public services, especially in education, health and agriculture, including by raising budget allocations to these sectors;
- initiatives to upgrade economic infrastructure; and
- channeling development resources to the rural sector.

Key Indicators: Papua New Guinea	1991	1992	1993	1994	1995	1996
Output						
Nominal GDP *(US$ bn)*	3.79	4.29	5.09	5.27	4.75	5.27
Real GDP *(% change)*	9.6	11.8	16.6	3.5	-2.9	1.9
Exports *(% change)*	21.9	22.7	29.4	n/a	n/a	n/a
Imports *(% change)*	24.9	8.5	-3.3	n/a	n/a	n/a
Prices and Labor Market						
GDP Deflator *(% change)*	7.0	2.7	3.1	2.8	17.8	12.4
Headline CPI *(% change)*	7.5	4.3	5.0	2.9	17.3	11.6
Unemployment Rate *(%)*	n/a	n/a	n/a	n/a	n/a	n/a
Financial Markets						
Short-term Interest Rate *(%)*	10.3	8.9	6.3	6.9	17.4	14.4
Exchange Rate *(annual average kina/US$)*	0.952	0.964	0.978	1.005	1.276	1.318
Balance of Payments						
Merchandise Trade Balance *(f.o.b % of GDP)*	2.1	14.8	29.9	25.1	29.8	19.2
Current Account Balance *(% of GDP)*	-4.1	2.2	12.8	10.8	14.3	5.2
Budget Balance *(% of GDP)*	-1.8	-5.0	-5.6	-4.3	-0.6	0.5
Population *(millions)*	3.77	3.85	3.92	4.00	4.07	4.16

Sources: Economic Committee, *1996 APEC Economic Outlook*; IMF, *International Financial Statistics (* September 1997); and the Asian Development Bank, *Asian Development Outlook*, *1997*; *Key Indicators of Developing Asian and Pacific Countries, 1997;* and Bank of PNG, *Quarterly Economic Bulletins.* Nominal and real GDP and GDP deflator figures for 1991-1993 are taken from the Economic Committee and IMF *op.cit*; estimates for 1994-1996 are by the Economic Committee, based on various sources. The data for CPI, short-term interest rate and exchange rate data drawn from the IMF *op.cit..* Trade balance and current account for 1991-1995 are drawn from the IMF *op.cit*; estimates for 1996 are from the Bank of PNG, *Quarterly Economic Bulletin*. Budget deficit figures for 1991-1994 are drawn from the IMF *op.cit*; for 1995-1996 from the Bank of PNG, *Quarterly Economic Bulletin*.

Republic of the Philippines

Background Information	
Capital	Manila
Population	71.9 Million
Language	Filipino and English
Major Industries	electronics, garments, chemicals, machinery, transport equipment, tourism, food processing
Major Exports	electronics, garments, finished electrical machinery, coconut products, bananas, shrimps and prawns, processed food, machinery and transport equipment
Major Imports	mineral fuels and lubricants, electrical machinery, non-electrical machinery, base metals, transport equipment, cereals and cereal products

GDP

Real GDP in 1996 expanded by 5.7 percent as against 4.8 percent in 1995. The momentum was maintained in the first half of 1997 as real GDP expanded by 5.4 percent on a year-over-year basis through the first two quarters.

Real GNP continued to grow roughly a percentage point faster than GDP, reflecting the strong flow of net factor income from abroad. In 1996, this inflow amounted to US$1.8 billion, 52 percent more than in 1995. The strong flow of remittances from overseas Filipino workers continues to account for a major share of this income, but investment income is gaining in importance.

Private consumption growth rose to 4.6 percent from 3.8 percent in 1995, spurred by rising per capita income and the availability of a wide variety of quality goods at reasonable prices in the market. Spending on all major commodity groups, led by fuel, light and water, as well as on food and beverages, household furnishings and transport and communication services, saw marked increases.

Investment growth accelerated to 15.6 percent in 1996 from only 3 percent in 1995, reflecting a combination of continuing political stability and sound macro fundamentals, the opening of major sectors to external competition, and the package of government programs to foster private investment.

Construction expanded by 15.9 percent, almost twice the growth recorded in 1995. The upward trend was led by private construction investment, which surged by 24.5 percent after growing only 8.4 percent in 1995. The private sector as a result accounted for about 63.9 percent of real capital formation in construction during the year.

Government expenditure growth slowed to 5.2 percent in 1996 from 5.4 percent a year ago, reflecting the efforts to streamline the bureaucracy.

INFLATION

CPI growth in 1996 was 8.4 percent on an annual average basis, up slightly from 8.1 percent in 1995. However, this masked a steady deceleration over the course of 1996 from double-digit rates during the first quarter (which reflected lingering effects of the rice supply shock of 1995) to the 4 percent range by the last quarter of 1996 and through the first 8 months of 1997. Slower monetary growth and the resolution of the rice supply problem were keys to this deceleration, which was managed in spite of significant oil price, power rate and transport fare adjustments.

Inflation will likely be lower in 1997 on an annual average basis on the strength of the 4.6 percent year-over-year average through the first 8 months, although the depreciation of the peso will lead to temporarily higher rates of inflation in the final quarter.

EMPLOYMENT

Employment grew to 27.2 million in 1996, up 5.9 percent over 1995, as the favorable economic environment led to the creation of about 1.5 million new jobs, more than double the target. Industry and services continued to expand their shares of total employment to 40.9 percent and 16.3 percent, respectively. **The unemployment rate** was reduced to 8.6 percent from 9.5 percent in 1995.

CURRENT ACCOUNT

The current account deficit widened from US$3.3 billion in 1995 to US$3.6 billion in 1996. However, as a share of GDP, it declined slightly from 4.4 percent in 1995 to 4.3 percent in 1996. Over the period 1992-95, the current account deficit as a proportion of GDP was kept at an average of 4 percent.

EXCHANGE RATE

The peso was broadly stable against the U.S. dollar in 1996, averaging P26.22/US$ for the year as a whole. This represented a modest depreciation of 2 percent from the 1995 rate of P25.71/US$.

A steady inflow of foreign exchange, including overseas remittances and returns on portfolio investments, led to a build-up of foreign currency reserves by the Philippine Central Bank and contributed to the stability of the peso vis-a-vis the dollar.

The peso depreciated by about 23 percent to an average of P32.39/US$ at the end of the third quarter of 1997 from a rate of P26.32/US$ at the beginning of the year.

FISCAL POLICY

The national government achieved a surplus of P6.3 billion in 1996, the third consecutive year in which the budget has been in surplus. **Revenues increased** 13.6 percent in 1996 to P410.5 billion as strong tax revenues more than offset a fall in non-tax revenues of 16.1 percent, which reflected in part low proceeds from the privatization program. **Expenditures grew** 15.4 percent to P404.2 billion in 1996. This was, however, short of the programmed level of P413.8 billion.

Fiscal policy is geared towards attaining a public sector surplus, including through major fiscal reforms such as the Comprehensive Tax Reform Program, government reengineering, a third wave of the privatization program and focused spending.

In 1997, the budget surplus is expected to grow to P13 billion as revenue flows improve due to a strengthened fiscal base, including the expanded value added tax, and higher fuel tax revenues.

The 1998 budget plan calls for the surplus to grow further to P16 billion as improved tax revenues from the expected passage of the Comprehensive Tax Reform program and from improved tax administration, more than offset an expected fall in privatization proceeds with most big-ticket holdings having been sold by the end of 1997.

MONETARY POLICY

Monetary policy in 1996 continued to support economic expansion, while being vigilant over inflation. The continuing surge in foreign exchange inflows, which were accommodated to smooth out movements in the exchange rate, was effectively sterilized with open market operations.

Reserve money growth went down to 14.3 percent in December 1996 from its comparable rate of 16.6 percent in 1995. Domestic liquidity growth was also contained at 15.8 percent as of December 1996 from 25.3 percent in December 1995.

Monetary policy was tightened to help stabilize the currency in mid-1997, including by raising short-term interest rates. Two and one-half months after the peso started to depreciate against the U.S. dollar in July, average short-term interest rates registered at 14.7 percent, 4.6 percent higher than the average for the first quarter of 1997.

FOREIGN DIRECT INVESTMENT

The Board of Investments approved P25.4 billion in FDI in 1996, a decline of 47.2 percent from the P48.1 billion posted in 1995. Of the inflows, 35 percent were targeted at the infrastructure/industrial services, 31 percent to manufacturing, 21 percent into public utilities and 7 percent into tourism-oriented services. Hong Kong, China topped the list of FDI sources with an equity infusion of P7.3 billion, followed by Britain (P3.7 billion), Japan (P1.5 billion) and Indonesia (P1.5 billion).

Republic Act 8179, which amended the Foreign Investments Act of 1991, further liberalized the investment regime to enhance the Philippines' attractiveness to foreign investors as an investment site.

MEDIUM-TERM OUTLOOK

In the face of the currency instability in the region, the Philippines has taken steps to reduce the current account deficit and maintain stability. To reduce the current account deficit, the government made expenditure cuts in the budget. The Central Bank raised interest rates to cool down private investment activity and permitted the peso to float. Meanwhile, tariff restructuring and import liberalization continue to stimulate further export-oriented industries.

The Challenge of Stabilization in a Small Open Economy

Since the late 1980s, the Philippines has followed a process of stabilization and structural reform, including policies to balance the government budget, liberalize trade, and liberalize financial and capital markets. The response of the economy to these policy reforms has been impressive:

- Real GDP growth strengthened steadily, from 2.1 percent in 1993 to 4.4 percent, 4.8 percent and 5.7 percent in 1994-1996, respectively. GDP per capita increased by 5.5 percent over this period.
- The annual inflation rate was reduced from the double-digit range in the early 1990s to the 4 percent range in the latter part of 1996 and through the first half of 1997.
- Trade flows soared, with merchandise exports growing at an annual average rate of 18.5 percent and merchandise imports at 21.5 percent over this period.
- FDI stocks increased from a level of US$1.4 billion in 1992 to US$9.4 billion in 1996, for an annual average growth of 70 percent.

However, these measures, which have opened up the economy and integrated it with the rest of the world, have also had implications for the conduct of macroeconomic policy and of the export-oriented growth policy. Particular attention has had to be paid to the current account balance. The current account deficit increased from 1.6 percent of GDP in 1992 to 4.3 percent in 1996. This reflected a widening of the merchandise trade deficit from 8.9 percent of GDP in 1992 to 13.4 percent in 1996, which could not be offset by the growth in the non-merchandise trade surplus, which grew from US$3 billion in 1992 to US$7 billion in 1996, an annual average growth of 41 percent.

As well, the exchange rate regime, which resulted in the peso remaining broadly stable against the U.S. dollar over the 1990s, also led to an appreciation in real terms, which was increased with the appreciation of the dollar against other major currencies starting in mid-1995. This had particular implications for policies aimed at promoting exports.

In the face of the current currency situation, the Bangko Sentral ng Pilipinas, the primary monetary policy body of the economy, is pursuing a balance of policies that will assist in establishing stability in the foreign exchange market and sustain growth.

Key Indicators: Philippines	1991	1992	1993	1994	1995	1996
Output						
Nominal GDP *(US$ bn)*	45.4	53.0	54.4	64.1	74.1	83.8
Real GDP *(% change)*	-0.6	0.3	2.1	4.4	4.8	5.7
Private Consumption *(% change)*	2.3	3.3	3.0	3.7	3.8	4.6
Private Investment *(% change)*	-5.3	16.7	20.5	20.8	2.6	28.8
Government Consumption *(% change)*	-2.1	-0.9	6.2	6.1	5.4	5.2
Government Investment *(% change)*	4.9	6.8	29.6	-2.5	9.4	13.0
Exports *(% change)*	6.3	4.3	6.2	19.8	12.0	20.3
Imports *(% change)*	-1.1	8.7	11.5	14.5	16.0	21.1
Prices and Labor Market						
GDP Deflator *(% change)*	16.5	7.9	6.8	10.0	7.5	9.2
Headline CPI *(% change)*	18.7	8.9	7.6	9.0	8.1	8.4
Unemployment Rate *(%)*	10.5	9.8	9.3	9.5	9.5	8.6
Financial Markets						
M3 *(% change)*	15.7	11.0	24.6	26.8	25.2	15.8
Short-term Interest Rate *(%)*	21.4	16.1	12.3	13.6	11.3	12.4
Exchange Rate *(annual average peso/US$)*	27.5	25.5	27.1	26.4	25.7	26.2
Balance of Payments						
Merchandise Trade Balance *(% of GDP)*	-7.1	-8.9	-11.4	-12.3	-12.1	-13.4
Current Account Balance *(% of GDP)*	-1.9	-1.6	-5.6	-4.6	-4.4	-4.3
Budget Balance *(% of GDP)*[(a)]	-2.1	-1.2	-1.5	0.9	0.6	0.3
Population *(millions)*	63.7	65.3	66.9	68.6	70.3	71.9

Source: Data are as submitted by member economies, unless otherwise specified.

Summary of Forecasts	1997						1998-2000				
	Official	IMF	PECC	ADB	DRI	WEFA	Official	PECC	ADB	DRI	WEFA
Real GDP	5-5.5	5.3	6.0	6.0	5.8	5.7	6-7	5.7	6.5	4.3	6.0
Real Exports	16.3-17.8	n/a	21.0	22.0	16.9	21.0	17.5	21.6	24.0	7.8	12.4
Real Imports	9.8	n/a	22.0	20.0	13.2	17.2	15.9	22.6	18.0	8.8	13.0
CPI	6-6.5	6.5	7.5	7.0	6.6	6.2	6.5-7	7.0	7.0	6.5	6.0

Notes: The IMF forecast is from the *World Economic Outlook* (IMF, September 1997); figures for the period 1998-2000 refer to 1998 only. The PECC forecast is from the *Pacific Economic Outlook 1997-1998* (PECC, 1997); 1998-2000 figures refer to 1998 only. The ADB forecast is from the ADB, *Asia Economic Outlook, 1997-1998*; figures for the period 1998-2000 refer to 1998 only. The DRI forecast is from *World Market Executive Overview* (3rd Quarter, 1997). The WEFA forecast is from *Asia Economic Outlook* (August, 1997). Note: DRI and WEFA figures for real export and real import growth include services.

Republic of Singapore

Background Information	
Capital	Singapore
Population	3.04 million (1996)
Language	English, Mandarin, Malay and Tamil
Major Industries	electronic products, machinery, transport equipment, fabricated metal products, petroleum products, paints, pharmaceutical and other chemical products, printing and publishing, industrial chemicals and gases, electrical machinery, plastic products
Major Exports	office and data machines, electrical machinery, telecommunications apparatus, petroleum and products, miscellaneous articles, general industrial machinery, organic chemicals
Major Imports	electrical machinery, office and data machines, petroleum and products, telecommunications apparatus, general industrial machinery, transport equipment, miscellaneous manufactured articles

GDP

Real GDP grew by 7 percent in 1996, down from 8.8 percent in 1995. Several sectors registered a moderation in growth. The manufacturing sector was affected by the downturn in global electronics demand. Slower regional growth affected hub-related services like entrepot trade and shipping services. However, the construction, financial and business services sectors remained bright spots. The construction sector turned in the strongest sectoral performance in 1996, benefiting from strong demand from both public and private sectors, particularly in the residential segment. Construction demand remained strong.

In 1997, the growth slowdown bottomed out in the first quarter as real GDP growth slowed to 4.1 percent year-over-year before rebounding to a 7.8 percent year-over-year pace in the second quarter as the electronic goods cycle started to swing back up.

Forward-looking indicators such as the Composite Leading Index and business expectations of the commerce and transport and storage sectors have also turned more favorable.

The manufacturing sector is expected to recover in the second half of the year. The commerce sector and hub services are also likely to benefit from the electronics recovery and stronger trade growth. Mobile communications and construction should continue to sustain strong growth in the second half.

Taking all these factors into consideration, the Ministry of Trade and Industry announced its 1997 GDP forecast to be in the range of 6-7 percent.

INFLATION

Inflationary pressures remained low in 1996, with the CPI growing by 1.4 percent compared with 1.7 percent in 1995. Slower economic growth, weaker sentiments in the property market and continued keen retail competition kept inflationary pressures low. The firm Singapore dollar helped to dampen imported inflation.

In 1997, CPI growth remained below 2 percent through the first half of the year, before moving up to 2.5 percent on a year-over-year basis in September.

EMPLOYMENT

Total net employment creation remained healthy at 101,000 jobs. Aside from manufacturing, all the other major sectors generated a net increase in the number of jobs. The unemployment rate has held steady at about 2 percent through the 1990s.

CURRENT ACCOUNT

Singapore continued to register a current account surplus in 1996. However, the surplus eased to S$19.9 billion in 1996, down from S$20.4 billion in 1995. This was due to lower net services exports, although the merchandise trade deficit narrowed significantly.

EXCHANGE RATES

In 1996, the Singapore dollar appreciated against most currencies, except the British pound and the Australian dollar. The appreciation against the U.S. dollar in 1996 of about 1 percent was markedly lower than 3.3 percent in 1995 and 10 percent in 1994. The more moderate pace of appreciation was largely due to the underlying strength of the U.S. dollar, which was underpinned by the buoyancy of the U.S. economy and good performance of its assets markets. The exchange rate moved in a narrow band of S$1.41-1.42 per US$ through the year.

In 1997, reflecting the global strength of the U.S. dollar, the Singapore dollar eased back to S$1.43 at mid-year from its year-end 1996 value of S$1.40, and then depreciated to the S$1.55-1.60 range at the beginning of the fourth quarter, in the wake of the currency instability in the region.

FISCAL POLICY

Singapore's fiscal policy in 1996 was aimed at providing a stable and conducive environment for the private sector, while enhancing the quality of life of Singaporeans. Operating revenue was more than adequate to finance all operating and development expenditures. Expansion in the size of the public sector was restrained, in line with the policy to free financial and manpower resources for the private sector as the growth engine.

Total expenditure in 1996 was S$19.2 billion, an increase of S$3.6 billion over 1995. Operating revenue totaled S$28 billion. The resulting surplus of S$8.9 billion was just slightly lower than the surplus in 1995. The surplus was further reduced to S$7.8 billion after taking into account capital contributions to educational and medical endowment funds, as well as various asset enhancement and wealth distribution programs.

MONETARY POLICY

Price stability remained the primary aim of exchange rate policy in 1996. External inflationary pressures remained subdued. On the domestic front, the moderation in GDP growth, following 3 years of above-potential growth, helped to alleviate labor market over-heating. Against this background, a moderate appreciation of the Singapore dollar was sufficient to achieve a further reduction in CPI inflation to 1.4 percent from 1.7 percent a year earlier.

FOREIGN DIRECT INVESTMENT

Despite keen competition, the manufacturing sector attracted investment commitments of S$8.1 billion in 1996. Foreign investors accounted for 71 percent of the total commitments. The electronics and industrial chemicals industries attracted the bulk of investments. The United States remained the leading investor with commitments of S$2.3 billion.

Investment commitments in the services sector promoted by the Economic Development Board amounted to S$1.5 billion in terms of total business spending and S$2.1 billion in terms of fixed assets. The commitments were largely in activities related to regional headquarters, communications and media and logistics services.

MEDIUM-TERM OUTLOOK

The medium-term outlook for the Singapore economy remains healthy. The favorable world trading environment is expected to continue to support growth in the manufacturing sector. Bright prospects for continued trade and investment liberalization and dynamism in the Asian region will provide support for growth in sectors like finance and business services, transport and communications, entrepot trade and regional headquarters activities. Over the medium term, the Singapore economy is expected to sustain an average annual growth rate of about 7 percent with low inflation.

Regionalization

In order to ride the economic boom in the region, the Singapore government called on Singapore companies to regionalize and create an "external economy" in 1992.

Five priority markets, namely China, India, Vietnam, Myanmar and ASEAN economies like Indonesia, were selected based on their high potential for economic growth, their pro-foreign investment policies and the complementarity between economies.

The Singapore government provides support in two broad forms to companies that regionalize. The first comprises broad-based initiatives to improve the regulatory environment and incentive structure for regionalization. These include bilateral agreements such as avoidance of double taxation, investment guarantee and agreements on economic cooperation.

The second consists of focused strategies to promote and facilitate investments by Singapore entities into the region. Eight flagship projects are Suzhou Industrial Park, Wuxi-Singapore Industrial Park, Bangalore Information Technology Park, Batamindo Industrial Park, Bintan Industrial Estate, Vietnam-Singapore Industrial Park, Bintan Beach International Resort and Karimun Marine and Petrochemical Complex.

The size of the external economy continued to grow in line with the drive to develop a second wing. Overseas operations' contribution to the value-added of the Singapore economy amounted to 11 percent in 1996. The latest available data on private investment overseas by companies (including financial institutions) indicated that the number of overseas affiliates has risen from 4,708 in 1994 to 5,159 in 1995. The stock of direct equity investments abroad by companies grew from S$29.8 billion to S$36.9 billion over the same period.

Key Indicators: Singapore	1991	1992	1993	1994	1995	1996
Output						
Nominal GDP *(US$ bn)*	43.5	49.6	58.1	70.9	85.3	94.0
Real GDP *(% change)*	7.3	6.2	10.4	10.5	8.8	7.0
Private Consumption *(% change)*	5.8	6.6	10.8	6.0	5.3	8.0
Private Investment *(% change)*	10.6	15.1	12.9	5.9	10.8	19.4
Government Consumption *(% change)*	7.7	3.2	11.2	0.1	9.6	18.9
Government Investment *(% change)*	24.8	3.6	7.5	18.7	2.4	2.8
Exports *(% change)*	7.0	1.4	15.6	23.3	13.7	5.2
Imports *(% change)*	4.0	2.9	17.1	13.7	12.7	5.0
Prices and Labor Market						
GDP Deflator *(% change)*	3.4	1.2	5.4	4.3	2.6	2.4
Headline CPI *(% change)*	3.4	2.3	2.3	3.1	1.7	1.4
Unemployment Rate *(%)*	1.8	2.0	1.9	2.0	2.0	2.0
Financial Markets						
M3 *(% change)*	12.4	8.9	8.5	14.4	8.5	9.8
Short-term Interest Rate *(%)*	3.84	2.46	2.26	3.62	3.41	3.41
Exchange Rate *(annual average S$/US$)*	1.73	1.63	1.62	1.53	1.42	1.41
Balance of Payments						
Merchandise Trade Balance *(f.o.b. % of GDP)*	-5.8	-7.9	-8.5	-1.5	-1.5	-0.6
Current Account Balance *(% of GDP)*	11.2	11.3	7.5	17.1	16.9	15.0
Budget Balance *(% of GDP)*	4.7	4.9	5.9	7.4	6.1	5.9
Population *(millions)*	2.76	2.82	2.87	2.93	2.99	3.04

Source: Data are as submitted by member economies, unless otherwise specified.

Summary of Forecasts	1997						1998-2000					
	Official	IMF	PECC	ADB	DRI	WEFA	Official	IMF	PECC	ADB	DRI	WEFA
Real GDP	6-7	6.0	7.5	7.5	7.2	6.7	n/a	5.5	7.7	8.0	7.2	7.2
Real Exports	n/a	n/a	9.6	5.0	9.1	7.2	n/a	n/a	9.9	10.0	9.4	6.6
Real Imports	n/a	n/a	9.2	7.8	8.0	7.7	n/a	n/a	9.5	10.0	8.5	8.2
CPI	n/a	2.2	1.8	2.7	1.8	1.9	n/a	2.0	2.0	3.4	1.8	2.0

Notes: The IMF forecast is from the *World Economic Outlook* (IMF, September 1997); figures for the period 1998-2000 refer to 1998 only. The PECC forecast is from the *Pacific Economic Outlook 1997-1998* (PECC, 1997); 1998-2000 figures refer to 1998 only. The ADB forecast is from the ADB, *Asia Economic Outlook, 1997-1998*; figures for the period 1998-2000 refer to 1998 only. The DRI forecast is from *World Market Executive Overview* (3rd Quarter, 1997). The WEFA forecast is from *Asia Economic Outlook* (August, 1997). Note: DRI and WEFA figures for real export and real import growth include services.

Chinese Taipei

Background Information	
Capital	Taipei
Population	21.5 million (1996)
Language	Chinese
Major Industries	electrical and electronic equipment, metals, chemicals, chemical products, textiles and apparel
Major Exports	electronic products, information and communication products, machinery, electrical machinery, transport equipment, metal products, textiles, chemicals and plastic products.
Major Imports	electronic products, machinery, chemical products, crude oil, metal products, transport equipment, optical and photographic instruments, textile products, and electrical machinery.

GDP

Real GDP slowed modestly in 1996 to 5.7 percent, down from 6 percent in 1995 and well below the projection of 6.8 percent made at the start of 1996. Macroeconomic indicators showed performance falling short of expectations almost across the board, with the external sector much less heated than in 1995, and the internal sector staying cool.

Two main factors behind the lower-than-expected performance were the slackened pace of private investment (mainly in real estate) and delayed public investment projects. However, investment in machinery and equipment kept up its double-digit real growth.

Although economic growth for the year was slightly lower than in 1995, the quarterly figures did give grounds for a renewal of optimism, showing an encouraging upward trend from 5.0 percent in the first quarter to 6.8 percent in the fourth.

The pick-up in growth momentum was sustained in the first half of 1997 as the economy expanded by 6.6 percent year-over-year in the first two quarters. This pace is expected to be maintained for the year as a whole. Private investment has picked up strongly as expected, supported by public investment. Transformation of the industrial structure is expected to continue, aided by the favorable environment fostering the development of industrial technology and high-tech industry.

The service sector is expected to continue to be the mainstay of growth in 1997 as information services, telecommunications, transportation and financial services rapidly expand. Within the industrial sector, the machinery, electronic, and information industries are expected to grow at a faster rate than manufacturing industry as a whole, while growth rates in the consumer products and chemical industries will be relatively slow. The construction industry has good prospects of regaining vitality, boosted by the drive to push public projects back on schedule as well as by the expected resurgence of private investment.

INFLATION

The CPI went up by 3.1 percent in 1996 as a whole, lower than the 3.7 percent increase recorded in 1995. Prices remained stable throughout the year, owing in part to a decline in the world prices of industrial raw materials, which resulted in both import prices and wholesale prices falling as compared with the previous year. In addition, the slower increases in the prices of services and residential rents as well as restrained wage trends also helped to hold down upward price movements.

Despite a hike in gasoline prices in January 1997, the CPI rose only 1.4 percent year-over-year for the first six months of 1997. One factor has been the impact of the foot-and-mouth disease epidemic among domestic hogs in March, which pushed down the price of pork. As the pace of domestic economic recovery is likely to remain moderate, the effective demand for commodities will reflect this and hold down the increase in general levels of prices. For the whole of 1997, the increase in the CPI is forecast at 1.7 percent.

EMPLOYMENT

Population stood at 21.4 million in 1996, with the 0-14 age bracket comprising 23 percent, the 15-64 bracket 69 percent and the 65 and older bracket 8 percent. The **labor force** registered 9.3 million, with an overall **participation rate** of 58.4 percent. Of the total **employment**, agriculture accounted for 10.1 percent, industry 37.5 percent, and services 52.4 percent. The service sector kept expanding as the economy's restructuring process continued

Employment growth in 1996 slowed to 0.3 percent in 1996 and the **unemployment rate** rose to 2.6 percent, the highest in ten years.

Measures have been introduced to improve labor market conditions and labor demand in 1997. However, the unemployment rate is expected to fall only slightly to 2.5 percent. Given the structural nature of recent unemployment, it is unlikely the rate will return to the very low levels that had been maintained for a decade.

CURRENT ACCOUNT

For 1996, owing to the slower expansion of world trade and especially the weakening of foreign demand for semiconductors, export growth was at its lowest level in six years. The downswing in domestic business activity combined with the falling prices for imports of raw materials brought about a negative growth of imports. With exports increasing and imports decreasing, the **current account** surplus totaled US$11.0 billion in 1996, or 4.0 percent of GDP. A current account surplus of US$10.0 billion is projected for 1997.

EXCHANGE RATE

In 1996, the NT$ depreciated by 3.5 percent against the U.S. dollar from NT$26.5/US$ in 1995 to NT$27.5 on average in 1996. However, over the same period, the NT$ appreciated by 11.6 percent against the Japanese yen and by 1.3 percent against the German mark.

In 1997, the NT$ has eased further against the dollar, falling to the NT$28.5 range at the beginning of the fourth quarter.

FISCAL POLICY

The recent surge of government expenditures has stemmed largely from the implementation of social welfare programs and major public projects, along with higher spending on land acquisition for public works.

Tax revenue growth has been depressed by the slowing of economic growth, and in particular of internal demand. In 1996, tax revenues fell for the first time in many years, down by 1.9 percent from the previous year.

To bridge the gap between receipts and expenditures, the government has financed the current year's budget with surpluses from previous years and the issue of government bonds. As a result, debt service has grown, rising to 13.1 percent of total expenditures in the 1997 budget.

Measures aimed at curbing public spending include, among others, encouraging private investment in public infrastructure by such techniques as Build-Operate-Transfer (BOT) and Build-Operate-Own (BOO), and setting limits on the ratio of spending to GNP at all levels of government.

MONETARY POLICY

For 1996, M2 grew at an annual rate of 9.2 percent, within the 9-14 percent target range, which has also been set for 1997. The average rate of interest on 31-90 day commercial paper in the secondary market was 5.8 percent in 1996, lower than the 6.7 percent in the previous year. In order to compensate for the drain on liquidity from capital outflows in the first part of 1996 and to keep market interest rates from rising too high, required reserve ratios were lowered on two occasions and the rediscount rate was also cut twice from March onwards. Owing to the strengthening demand for funds associated with the booming stock market and the open market operations by the monetary authority, market rates of interest went up during the first quarter of 1997.

FOREIGN DIRECT INVESTMENT

Inward FDI amounted to US$2.5 billion in 1996, the second-highest annual total ever recorded, owing to the vigorous policy efforts to improve the domestic investment environment.

FDI inflow was mainly from the Asia-Pacific region and mostly drawn to the financial, insurance, transportation and other service sectors, where the effects of liberalization have been particularly felt. Investment in electronics and electrical appliances saw a marked reduction due to oversupply in the semiconductor sector.

On an approval basis, FDI outflow expanded 38.6 percent to US$3.4 billion in 1996. China, Southeast

Asia and the United States were major recipients of investment from Chinese Taipei. The industries attracting the lion's share of these flows were banking and insurance, electronic and electrical appliances and transportation. Investment in these three sectors accounted for 50.3 percent of total outward investment.

Structural Reform in Chinese Taipei

Economic liberalization has been accelerated since the mid-1980s. Since the early 1990s, it has been carried out across the board at an even faster pace as part of Chinese Taipei's adjustments in developing the economy as an Asia-Pacific regional operations center (APROC). As of June 1997, 39 liberalization and facilitation bills had been passed and 87 regulations with the same purpose had been amended in connection with the APROC plan.

The real average tariff ratio (tariff revenue/CIF value of total imports) has been reduced from 7.7 percent in 1985 to 3.6 percent in 1996. Non-tariff barriers have also been lowered substantially. In financial services, the step-by-step liberalization of interest rates and the establishment of off-shore banking units and a foreign currency call-loan market have helped promote the efficiency and facilitation of the capital market. Among other service sectors, a new telecommunications law was enacted in 1996 to build an environment of fair competition and equal access to networks and services and to pave the way for the opening of the telecommunications market.

Before the mid-1980s, manufacturing was the fastest expanding sector and engine of the economy. Since then, services have outpaced manufacturing and gradually become the mainstay of economic growth. Within the manufacturing industry, the importance of non-durable consumer goods has been on the decline while that of capital goods and durable goods has increased. The intermediates industry has been growing steadily and its share of manufacturing output has fluctuated marginally. In general, capital- and technology-intensive industries have been expanding most rapidly. The infotech and electronics industry has seen the fastest growth among all industries since 1988. Over the next decade, manufacturing's share of GDP will be almost unchanged, while the share of the infotech and electronics industry in total manufacturing is expected to increase from 22.4 percent to one-third.

Within services, finance, insurance and business services have been the main source of the sector's fast expansion. Over the next decade, the service sector's share of GDP will be about the same, while specialized services' share in all services will expand from 50.7 percent to 60 percent

Key Indicators: Chinese Taipei	1991	1992	1993	1994	1995	1996
Output						
Nominal GDP *(US$ bn)*	179.4	212.2	222.6	241.0	260.2	272.3
Real GDP *(% change)*	7.6	6.8	6.3	6.5	6.0	5.7
Private Consumption *(% change)*	7.3	8.9	8.2	8.6	5.5	6.2
Private Investment *(% change)*	3.5	19.0	10.6	7.9	8.3	5.6
Government Consumption *(% change)*	7.4	4.5	0.6	-1.2	1.3	5.2
Government Investment *(% change)*	22.6	15.5	17.5	12.9	3.8	-0.5
Exports *(% change)*	12.8	5.3	7.2	5.5	12.8	7.1
Imports *(% change)*	15.1	12.2	8.3	3.5	9.8	5.1
Prices and Labor Market						
GDP Deflator *(% change)*	3.9	3.9	3.5	1.9	1.9	2.7
Headline CPI *(% change)*	3.6	4.5	2.9	4.1	3.7	3.1
Unemployment Rate *(%)*	1.5	1.5	1.5	1.6	1.8	2.6
Financial Markets						
M2 *(% change)*	16.3	19.9	16.4	16.3	11.6	9.2
Short-term Interest Rate *(%)*	7.6	7.2	6.8	6.8	6.7	5.8
Exchange Rate *(annual average NT$/US$)*	25.75	25.40	26.63	26.24	27.27	27.49
Balance of Payments						
Merchandise Trade Balance *(f.o.b. % of GDP)*	8.7	6.0	5.2	4.9	5.1	6.5
Current Account Balance *(% of GDP)*	6.9	4.0	3.2	2.7	2.1	3.8
Budget Balance *(% of GDP)*	-3.2	-4.6	-3.4	-2.0	-0.9	-1.2
Population *(millions)*	20.56	20.75	20.94	21.13	21.30	2.1.50

Source: Data are as submitted by member economies, unless otherwise specified.

Summary of Forecasts	1997						1998-2000					
	Official	IMF	PECC	ADB	DRI	WEFA	Official	IMF	PECC	ADB	DRI	WEFA
Real GDP	6.6	6.2	6.4	6.2	6.0	6.2	6.7	6.4	6.5	6.3	6.0	6.1
Real Exports	9.9	n/a	9.2	9.1	8.3	5.7	n/a	n/a	8.3	9.6	7.7	7.5
Real Imports	12.7	n/a	10.2	6.4	7.0	7.9	n/a	n/a	8.3	7.0	7.4	8.4
CPI	1.7	2.8	3.3	3.2	4.0	2.0	2.7	3.4	3.5	3.4	2.8	3.4

Notes: The IMF forecast is from the *World Economic Outlook* (IMF, September 1997); figures for the period 1998-2000 refer to 1998 only. The PECC forecast is from the *Pacific Economic Outlook 1997-1998* (PECC, 1997); 1998-2000 figures refer to 1998 only. The ADB forecast is from the ADB, *Asia Economic Outlook, 1997-1998*; figures for the period 1998-2000 refer to 1998 only. The DRI forecast is from *World Market Executive Overview* (3rd Quarter, 1997). The WEFA forecast is from *Asia Economic Outlook* (August, 1997). Note: DRI and WEFA figures for real export and real import growth include services.

Thailand

Background Information	
Capital	Bangkok
Population	60 million (1996)
Language	Thai
Major Industries	electronics, gems and jewelry, automobiles, textiles, clothing, footwear
Major Exports	textiles, computers and components, integrated circuits and parts, gems and jewelry, footwear
Major Imports	industrial machinery, electrical machinery and parts, chemicals, iron and steel, automobile chassis and body, integrated circuits and parts

GDP

Real GDP growth slowed in 1996 to 6.7 percent from 8.6 percent in 1995. A decline in exports, due to a combination of cyclical and structural factors (as described in Section 2.1), ushered in the growth slowdown.

Private consumption slowed to an even greater degree than GDP in 1996, falling to 5.7 percent from 7.9 percent the previous year.

Private investment, however, continued to grow faster than the overall economy in 1996 at 7.4 percent, but less than the 10 percent pace in 1995.

Government investment also continued to expand strongly in 1996, increasing by 15 percent, close to the 16 percent pace of 1995.

The slowdown intensified in mid-1997 as the currency came under pressure. Real GDP growth is now expected to be 2.5 percent in 1997 and 3.5 percent in 1998. As the government implements the economic reforms agreed with the IMF (see box), growth is expected to rise to a normal level, in the 6 to 7 percent range, in line with the potential growth of the Thai economy.

INFLATION

Inflation in 1996 remained at 5.9 percent, broadly unchanged from the 5.8 percent rate in 1995. Factors contributing to the relatively high level of inflation in 1996 included a rise in food prices due to the lingering effects of the 1995 floods and an increase in gasoline prices.

Nonetheless, the inflation trend during 1996 and into the first half of 1997 was downwards as the CPI fell from 7.4 percent (year-over-year) in early 1996 to the 4 percent range in mid-1997. However, with the currency depreciation, the CPI increased to 6.6 percent year-over-year in August.

Even with the recent change in the exchange rate system and the increase of the value added tax, inflation is expected to be maintained at 7 percent in 1997 and 8 percent in 1998, and to decline to the 4 to 5 percent range in the following years.

EMPLOYMENT

The labor market in 1996 remained tight despite the growth slowdown, and the unemployment rate fell to 2.0 percent from 2.6 percent in the previous year.

Between 1992 and 1996, the labor force increased at an average annual rate of 1.1 percent from 32.4 million to 33.9 million. Approximately 54 percent of the total labor force is employed in the agricultural sector

In 1997, labor demand is expected to remain tight particularly the demand for unskilled workers.

CURRENT ACCOUNT

In 1996, the **current account deficit** remained, for the second consecutive year, at the unsustainable level of 8 percent of GDP. In contrast, however, to 1995 when two-way trade soared, both exports and imports flattened out in 1996. The decline in exports, after many years of robust growth, reflected both moderation of world demand and domestic supply shortages.

The government has introduced a number of measures to reduce the current account deficit by increasing exports. These measures include export financing through the Export-Import Bank of Thailand, the creation of special institutes to support product improvement and development of better marketing strategies, and provision of funds for upgrading plant and equipment through financial institutions such as the Industrial Finance Corporation of Thailand.

Other measures include policies to reduce consumption, curtail government expenditure and increase savings through the promotion of provident funds and the establishment of a Government Pension Fund.

The government intends to reduce the current account deficit to 5 percent of GDP in 1997 and to 3 percent in 1998, as per the structural reform program (see box).

EXCHANGE RATE

In 1996 and through the first half of 1997, the baht was relatively stable against the U.S. dollar, depreciating by about 2.3 percent from year-end 1995 to the end of June 1997. During this period the government maintained the system under which the baht was pegged to a basket of currencies, a system that had been the anchor of economic policy for the past 13 years.

However, the strengthening of the baht broadly in line with the strengthening of the dollar since mid-1995, contributed to the decline of exports and the widening of the current account deficit. This, in conjunction with the structural factors described in Section 2.1, led to a change in the exchange rate system to a managed float whereby the value of the baht is determined by the market.

Between the end of the second quarter and the end of the third quarter, the baht depreciated by approximately 40 percent against the U.S. dollar.

FISCAL POLICY

The government registered a fiscal surplus in 1996 for the ninth consecutive year. The 1996 surplus amounted to 2.2 percent of GDP, down somewhat from the 2.7 percent registered in 1995.

To address a projected shortfall in tax revenue for fiscal year 1997 resulting from lower economic growth than contemplated in the budget, the government increased the value added tax rate from 7 to 10 percent effective on 16 August 1997, cut planned expenditures by 6 percent from 982 billion baht to 923 billion baht, and postponed investment projects of state enterprises.

These measures are expected to prevent a deficit from emerging this year and to restore the fiscal position to a surplus projected at 1 percent of GDP in 1998. These expenditure cuts and deferrals will also have a positive effect on the current account deficit.

The government has consistently affirmed its strong commitment to fiscal discipline and a commitment to a balanced budget is part of the economic reform program agreed with the IMF.

MONETARY POLICY

Monetary policy was tightened in 1997 through interest rate increases and administrative measures to curb borrowing in order to stabilize the financial market. Additional measures were taken to strengthen the financial system, including the establishment of a deposit insurance institution and changes to increase the efficiency of the auditing system of the Bank of Thailand.

FOREIGN DIRECT INVESTMENT

In 1996, foreign direct investment increased to US$2.4 billion as compared to US$2.1 billion in 1995, as it continued to play an important role in developing Thailand’s industrial base.

Highlights of the Economic Reform Program

The government of Thailand, in its agreement with the IMF, is committed to:

- Cut the current account deficit from 8 percent of GDP last year to 5 percent this year and to 3 percent next year.
- Hold economic growth this year and next year at 3-4 percent to bring the growth rate to a normal level in 1999.
- Keep annual inflation within 8-9 percent.
- Maintain financial and fiscal stability through a balanced budget.
- Bring in the IMF and international and local financial assistance to implement economic measures to restore investor confidence in the foreign currency market. Under the program, Thailand agrees that:

1. No more cash will be pumped into the ailing finance sector. A deposit insurance institution must be established quickly to safeguard depositors and creditors.
2. Contributions by finance houses and banks to the Financial Institutions Development Fund will be increased.
3. The deposit insurance institution will be part of the development fund, but their operations will be separate.
4. The Bank of Thailand will toughen its supervision of financial institutions.
5. The government must keep its treasury reserves equivalent to at least 1 percent of GDP. To achieve this, the government has raised the VAT rate from 7 percent to 10 percent and cut its budget by 59 billion baht.
6. State enterprises are no longer to be subsidized and must increase their charges to cover losses.
7. Pay raises for civil servants and state enterprise employees will be limited, and private employers will be asked to show similar restraint.
8. Privatization is likely in the areas of energy, transport, infrastructure and communications, while the government will give priority to upgrading education and basic health services.
9. Domestic interest rates are to be kept high enough to prevent capital outflow.

Key Indicators: Thailand	1991	1992	1993	1994	1995	1996
Output						
Nominal GDP *(US$ bn)*	98.0	111.1	124.7	142.8	166.3	184.3
Real GDP *(% change)*	8.5	8.1	8.3	8.8	8.6	6.7
Private Consumption *(% change)*	6.6	7.8	8.7	8.2	7.9	5.7
Private Investment *(% change)*	10.1	1.1	10.6	8.5	10.3	7.4
Government Consumption *(% change)*	6.2	6.4	5.1	7.6	8.2	6.8
Government Investment *(% change)*	26.8	26.5	4.5	22.9	16.0	15.0
Exports *(% change)*	23.5	13.2	13.0	21.3	23.6	-0.2
Imports *(% change)*	15.4	5.5	12.0	17.6	30.5	2.3
Prices and Labor Market						
GDP Deflator *(% change)*	5.7	4.2	3.4	4.7	6.3	4.8
Headline CPI *(% change)*	5.7	4.1	3.3	5.0	5.8	5.9
Unemployment Rate *(%)*	3.1	3.0	2.6	2.6	2.6	2.0
Financial Markets						
M3 *(% change)*	19.8	15.8	18.4	12.9	17.0	12.9
Short-term Interest Rate *(%)*	14.0	11.5	10.5	11.75	13.75	13.5
Exchange Rate *(annual average baht/US$)*	25.52	25.40	25.32	25.15	24.95	25.32
Balance of Payments						
Merchandise Trade Balance *(f.o.b. % of GDP)*	-6.0	-3.6	-3.4	-2.6	-4.9	-4.8
Current Account Balance *(% of GDP)*	-7.0	-5.7	-5.1	-5.6	-8.1	-8.0
Budget Balance *(% of GDP)*	4.9	3.1	2.2	1.8	2.7	2.2
Population *(millions)*	56.96	57.79	58.34	59.10	59.80	60.0

Source: Data are as submitted by member economies, unless otherwise specified.

Summary of Forecasts	1997						1998-2000				
	Official	IMF	PECC	ADB	DRI	WEFA	Official	PECC	ADB	DRI	WEFA
Real GDP	2.5	2.5	7.1	6.1	7.8	5.2	3.5	7.2	6.6	6.1	7.5
Real Exports	n/a	n/a	12.1	4.5	10.8	5.0	n/a	11.3	8.0	10.3	11.4
Real Imports	n/a	n/a	10.5	4.5	9.7	-4.0	n/a	9.3	7.2	8.9	9.2
CPI	7.0	7.0	5.0	5.0	5.9	6.2	8.0	4.8	4.8	4.9	5.2

Notes: The official forecast for 1998 -2000 refers to 1998 only. The IMF forecast is from the *World Economic Outlook* (IMF, September 1997); figures for the period 1998-2000 refer to 1998 only. The PECC forecast is from the *Pacific Economic Outlook 1997-1998* (PECC, 1997); 1998-2000 figures refer to 1998 only. The ADB forecast is from the ADB, *Asia Economic Outlook, 1997-1998*; figures for the period 1998-2000 refer to 1998 only. The DRI forecast is from *World Market Executive Overview* (3rd Quarter, 1997). The WEFA forecast is from *Asia Economic Outlook* (August, 1997). Note: DRI and WEFA figures for real export and real import growth include services.

United States of America

Background Information	
Capital	Washington, D.C.
Population	267.6 million (July 1997 estimate)
Language	English
Major Industries	motor vehicles and parts, petroleum refining, aircraft, chemicals, pharmaceuticals, retail trade, financial services
Major Exports	electrical machinery, road vehicles, office machinery, miscellaneous transport equipment, miscellaneous manufactured articles
Major Imports	road vehicles, electrical machinery, office machinery, apparel, miscellaneous manufactured articles

GDP

Real GDP growth accelerated to 2.8 percent in 1996, up from 2.0 percent in 1995. Growth strengthened further into 1997 as real GDP expanded by 4.9 percent in the first quarter of 1997 (quarter-over-quarter at annual rates) before moderating to 2.2 percent in the second quarter.

Consumer expenditure picked up in 1996, particularly on interest-sensitive items such as consumer durables and houses, and accelerated further to an annualized 6.4 percent in the first quarter of 1997, one of the largest quarterly gains ever. Consumer confidence rose to a 28-year high in mid-1997 on the strength of low inflation, good employment prospects, and rising household wealth from the strong stock market, auguring well for sustained growth.

Fixed capital investment also picked up in 1996, and the stronger growth carried over into 1997.

Government spending, after a sharp decline in 1995, stabilized in 1996 and thus supported growth by reducing fiscal drag.

Net exports of goods and services made a slightly negative contribution to GDP growth in 1996. Growth in trade flows was strong in the first quarter of 1997. Exports of goods and services grew an annualized 8.1 percent but imports were up 21.9 percent, resulting in net exports again subtracting from GDP growth.

INFLATION

Core inflation (CPI excluding the volatile food and energy components) decelerated to 2.5 percent in 1996 despite faster-than-expected output growth and low unemployment.

The CPI grew by 2.9 percent in 1996, before decelerating to 2.2 percent in mid-1997 on a year-over-year basis. A moderate tightening of monetary policy and a responsive labor market contributed to this good inflation performance. Falling import prices also contributed to lower inflation as the U.S. dollar strengthened globally.

FISCAL POLICY

Fiscal policy is oriented towards achieving a balanced federal budget, including social security, in 2002. In **FY1996** (to September 1996) the federal budget deficit narrowed to US$107 billion (or 1.4 percent of GDP) from US$164 billion (or 2.3 percent of GDP) in FY1995. The **FY1997** deficit dropped to US$22.6 billion, less than 0.3 percent of output, as strong economic growth boosted revenues.

MONETARY POLICY

The Federal Reserve eased in two quarter-point increments in December 1995 and January 1996 to bring its targeted federal funds rate down to 5.25 percent where it remained until March 1997, when it was raised a quarter point.

EXCHANGE RATE

The dollar appreciated against other major currencies from mid-1995 through 1996 and into 1997. As of May 1, the dollar had risen by 57 percent from its low against the yen. Since the end of 1995, it had appreciated on a trade-weighted basis by 13 percent against other G-10 industrialized economies and by 11 percent against a wider set of trading partners.

FOREIGN DIRECT INVESTMENT

Foreign direct investment inflows reached a new high of $80.5 billion in 1996, a 41 percent increase from 1995 and a four-fold increase from 1992. This reflected the combination of an open investment regime and a favorable investment climate brought about by the economy's strong performance.

European economies accounted for 62 percent of FDI inflows in 1996, while APEC partner economies accounted for most of the rest, including Canada (12.7 percent), Japan (7.1 percent) and other Asia-Pacific economies (15.7 percent).

Service industries (i.e., finance, insurance, communications and healthcare) were strongly targeted; in the manufacturing sector, FDI increased most in information and high technology industries.

The role of FDI in establishing economic linkages between economies is illustrated by the fact that, from 1977 to 1995, U.S. affiliates of foreign firms steadily increased their exports from $24.8 billion to $136.7 billion, of which a declining percentage were to the foreign parent. Meanwhile imports by these affiliates increased from $43.9 billion to $254.9 billion in the same period.

OUTLOOK

On the basis of the strong first-half performance, **real GDP growth in 1997** is likely to come in well above the official forecast of 2.0 percent. The IMF, in its September 1997 *World Economic Outlook*, projects 3.7 percent annual growth this year.

If the economy were to continue to grow at this pace, wage and price pressures could emerge. A mild reduction in GDP growth in 1998 and 1999 is likely to occur in order to bring economic activity back to a level that is compatible with stable inflation. Such a slowdown would return the unemployment rate to the NAIRU (non-accelerating inflation rate of unemployment), which is estimated to be in the 5 to 6 percent range.

With the economy currently at or near full employment, GDP growth over the medium term will be determined largely by labor force and productivity growth.

The labor force is projected to grow at 1.1 percent (of which one full percentage point is accounted for by growth in working-age population). This growth might be stronger if the recent increase in the labor force participation rate continues.

Trend productivity growth is projected to be 1.2 percent, although this too could be stronger as further deficit reduction raises business investment. On this basis, GDP growth is projected to be 2.3 percent over the medium term with some upside potential.

The net export position is projected to improve, as overall stronger growth expected over the medium term in the United States' main trading partners supports stronger export growth. Lower budget deficits, by increasing domestic savings, will also help in this regard, although this could be mitigated by continued strong domestic investment.

Current Structural Issues in the United States

A major goal of U.S. government policy is the long-term stability and growth of the economy. This goal informs numerous areas of policy, including education, health care, social welfare and poverty alleviation, deregulation and research and development.

Numerous federal government programs aim to augment human capital by making higher education more affordable. The income differential between high school (secondary education) and college (higher education) graduates has risen sharply since the early 1980s, reflecting rising returns to higher education. The government has recently implemented a direct student loan program (with repayment on an income-contingent basis) to help families unable to finance a college education. In addition, the Administration has proposed tax incentives for higher education and an expanded program of Pell scholarship grants.

A major health-care issue is the long-term financing of the government-funded health-care programs for the poor (Medicaid) and the elderly (Medicare). In the absence of reform, outlays for these programs are projected to grow from an estimated 4.7 percent of GDP in 1996 to 12.8 percent in 2050. One pressing issue involves the rapidly rising costs of home health care under Medicare. Improvements in the private health insurance market have also been implemented; a 1996 Act ensures that health insurance coverage continues after an individual leaves a job that had offered such insurance.

Over the past two decades, income inequality has increased and poverty has persisted. In part to combat this trend, the Earned Income Tax Credit has been expanded, and the minimum wage has been raised. Both of these measures increase the returns to employment for working families of modest means. Another important change is the Welfare Reform Act of 1996, which eliminated the Aid to Families with Dependent Children entitlement program and replaced it with a block grant to the states. The block grant will be fixed at US$16.4 billion per year for the fiscal years 1996-2001. The Act sets up time limits for welfare assistance: families on the rolls for five cumulative years become ineligible for cash aid. It also requires that 50 percent of the welfare caseload be working or in work-related activities by 2002.

Since the 1970s, the federal government has worked to improve the efficiency of the economy through deregulation of key sectors of the economy, including airlines, banking, trucking and natural gas. New technologies have expanded the scope for competition in sectors that were previously regulated monopolies. Recent efforts have focused on deregulation of the telecommunications and electric power industries. Active competition in long-distance telephone markets began in the 1980s. The Telecommunications Act of 1996 laid out rules to facilitate competition in local telephone service. Regulatory measures since 1992 have opened to competition wholesale markets in electric power generation. The federal government and state regulators are currently discussing initiatives to deregulate the generation and retail sale of electric power. Along with these efforts, revived efforts to enforce antitrust laws are also aimed at increasing economic efficiency.

Technological innovation has accounted for more than half of labor productivity growth in the United States in the last 50 years. A recent federal effort in research and development is the Advanced Technology Program, which involves cooperation between the government and private-sector R&D efforts. Funding of research through the National Science Foundation and the National Institutes of Health has also grown significantly in recent years.

Key Indicators: USA	1991	1992	1993	1994	1995	1996
Output						
Nominal GDP *(US$ bn)*	5916.7	6244.5	6558.1	6947.0	7265.4	7636.0
Real GDP *(% change)*	-0.9	2.7	2.3	3.5	2.0	2.8
Private Consumption *(% change)*	-0.6	2.8	2.9	3.2	2.4	2.6
Private Investment *(% change)*	-9.4	7.1	9.3	13.0	1.6	7.8
Government Consumption *(% change)*	0.6	0.5	-0.9	0.0	0.0	0.5
Government Investment *(% change)*	-1.2	3.4	-1.2	-1.3	1.8	2.7
Exports *(% change)*	6.3	6.6	2.9	8.2	11.1	8.3
Imports *(% change)*	-0.7	7.5	8.9	12.2	8.9	9.1
Prices and Labor Market						
GDP Deflator *(% change)*	4.0	2.8	2.6	2.4	2.5	2.3
Headline CPI *(% change)*	4.0	2.9	3.0	2.6	2.8	2.9
Unemployment Rate *(%)*	6.8	7.5	6.9	6.1	5.9	5.4
Financial Markets						
M3 *(% change)*	1.7	0.6	0.2	1.7	4.5	6.5
Short-term Interest Rate *(%)*	5.4	3.35	3.0	4.3	5.5	5.0
Real Effective Exchange Rate *(1990 = 100)*	97.8	96.4	98.9	97.8	92.2	98.3
Balance of Payments						
Merchandise Trade Balance *(f.o.b. % of GDP)*	-0.5	-0.6	-1.1	-1.5	-1.4	-1.5
Current Account Balance *(% of GDP)*	-0.1	-0.9	-1.4	-1.9	-1.8	-1.9
Budget Balance *(% of GDP)*	-4.6	-4.7	-3.9	-3.0	-2.3	-1.4
Population *(millions)*	252.14	255.04	257.80	260.35	262.76	265.19

Source: Data are as submitted by member economies, unless otherwise specified.

Summary of Forecasts	1997					1998-2000				
	Official	IMF	PECC	DRI	WEFA	Official	IMF	PECC	DRI	WEFA
Real GDP	2.0	3.7	3.2	3.6	2.8	2.3	2.6	2.3	2.1	2.3
Real Exports	6.5	7.3	7.2	9.9	4.6	n/a	n/a	7.3	6.7	6.8
Real Imports	4.0	8.2	8.3	12.7	4.8	n/a	n/a	9.6	6.3	5.5
CPI	2.6	2.4	2.3	2.4	2.5	n/a	2.8	2.1	2.9	2.9

Notes: The official forecast for 1998 -2000 refers to 1998 only. The IMF forecast is from the *World Economic Outlook* (IMF, September 1997); figures for the period 1998-2000 refer to 1998 only. The PECC forecast is from the *Pacific Economic Outlook 1997-1998* (PECC, 1997); 1998-2000 figures refer to 1998 only. The DRI forecast is from *World Market Executive Overview* (3rd Quarter, 1997). The WEFA forecast is from *Asia Economic Outlook* (August 1997). Note: DRI and WEFA figures for real export and real import growth include services.

Chapter 2

Benefits of Open Regionalism: the Impact of APEC Trade Liberalization under Alternative Scenarios

1. Introduction

Interdependence among the Asia-Pacific economies has increased over the past two or three decades. In particular, APEC member economies have witnessed a rapid expansion of trade with their partners in the region. As discussed in Appendix II, trade relationships among APEC member economies have evolved broadly in line with the constantly changing patterns of comparative advantage.

APEC economies differ widely with respect to per capita income, GDP, trade dependency, manufacturing shares, and commodity trade patterns. Nonetheless intra-regional trade and investment links have increased rapidly, helping make the Asia-Pacific one of the world's dynamic and rapidly-changing regions.[1] A number of reasons have been suggested to explain the basis for successful economic cooperation in the region.[2] First, APEC economies can be characterized as heterogeneous economically and culturally and hence the region "tend[s] to be economically complementary rather than competitive." Second, China's transformation into a market economy has led to its emergence as one of the largest dynamic economies in the world. Third, "less tendency towards protectionism in the Asia-Pacific region will further strengthen the economic power of this region in the world economy."

APEC's initial guiding principle, which has been reaffirmed at all subsequent Ministerial and Leaders' Meetings, was to facilitate and liberalize trade and investment on a non-discriminatory basis. In other words, APEC was to pursue what has become commonly known as "open regionalism." The Pacific Economic Cooperation Council (PECC, 1995) provides a precise definition of open regionalism, in which reductions in trade barriers are (1) stimulated and supported by a consensus between a group of economies located in the same region, (2) applied economy by economy in a non-discriminatory fashion and possibly unequally, by every participant in the group, and (3) undertaken in a number of sectors at the same time. According to this concept of collaboration to promote free and open trade and investment on a Most Favored Nation (MFN) basis, the benefits are expected to flow predominantly to APEC member economies. These economies would, in turn, form a critical mass in support of global liberalization initiatives.[3]

Through MFN liberalization achieved at Osaka in 1995 and Manila in 1996, and through APEC's influential role in concluding the Information Technology Agreement

[1] See Fukasaku (1992), p. 16.

[2] See Lo, Salih, and Nakamura (1988).

[3] For discussions on APEC's role in liberalizing global trade, see Bergsten (1994), Drysdale (1997), Elek (1992), Garnaut (1994), and Young (1993b).

at the inaugural WTO Ministerial meeting in Singapore in 1996, APEC established open regionalism as a key element of global trade liberalization.

The Economic Committee has assessed the impact on the region of implementation of the Manila Action Plan for APEC (MAPA).[4] This study shows that real GDP in APEC as a whole is expected to increase by 0.4 percent (US$68.5 billion) and in the world by 0.2 percent (US$70 billion). The overall effects of MAPA on global output are estimated to be about one-fourth of the impact of the Uruguay Round trade liberalization.

Several other studies have discussed trade liberalization within the Asia-Pacific region, using either a descriptive approach or economic modeling.[5] Most of this research investigates the economic effects of forming a preferential trading bloc in Asia.[6] However, no study has yet examined the economic effects of conditional trade liberalization in the APEC region or assessed the comparative benefits of APEC's open regionalism approach versus the preferential trade bloc approach that APEC has rejected. This chapter complements the Economic Committee's assessment of the impact of MAPA by addressing these latter questions, using a multi-economy computable general equilibrium (CGE) model and the GTAP database.[7]

This chapter is organized as follows: First, the design of the simulations is discussed. The simulation results are then presented, focusing on the impact on APEC and global trade flows, in total and by sector, under the alternative scenarios, as well as on the comparative welfare gains (in terms of income, wages and rental rates) under the alternative scenarios. Finally, the main conclusions emerging from this analysis are summarized. Appendix I contains background information on the data, parameters and bilateral protection rates used in the simulations, as well as the CGE model and its characteristics. Appendix II describes the patterns of trade and investment in the APEC region.

2. Design of the Simulations

[4] See Economic Committee, *Impact of APEC Trade Liberalization in APEC* (APEC, 1997).

[5] See Drysdale (1997), Garnaut (1994), Hufbauer (1995), Yamazawa (1996), and Young (1993a, 1993b, 1996) for a descriptive analysis of economic cooperation in the Asia-Pacific region. Discussions on the effects of cooperation in the region using economic models are given in Ballard and Cheong (1997); Cheong (1995, 1997); Brown, Deardorff, and Stern (1996); Martin, Petri, and Yanagishima (1994); Lewis, Robinson, and Wang (1995); and McKibbin (1996).

[6] Ballard and Cheong (1997) and Lewis, Robinson, and Wang (1995) study economic effects of preferential trading blocs in the East Asia and Asia-Pacific regions, while Cheong (1997), Martin, Petri, and Yanagishima (1994) and McKibbin (1996) examine the welfare effects of trade liberalization on an MFN vs. discriminatory basis in the Pacific regions. Ballard and Cheong (1997), Lewis, Robinson, and Wang (1995), and Martin, Petri, and Yanagishima (1994) show that broad Pacific trade liberalization is preferable to the formation of an East Asian trading bloc.

[7] Given the CGE model's complexity, only a general discussion is provided here. For in-depth information, see Hertel (1997). The model was solved using GEMPACK software, whose reference can be found in Harrison and Pearson (1996). For a detailed description of the model equations and structure, see Appendix 1.

In the following simulations, the potential economic effects of reaching the Bogor trade liberalization goal are assessed in terms of (1) impacts on trade flows for APEC and the world, both in total and in sectoral terms, and (2) welfare gains measured as gains in GDP, wages and returns to factors of production. For the evaluation of trade liberalization in APEC, it is assumed that APEC economies remove existing trade barriers[8] in order to achieve the long-term goal of open and free trade in the region declared at the Bogor APEC Economic Leaders' meeting in 1994. The timetable for APEC trade liberalization is set out in the Manila Action Plan for APEC (MAPA). Although MAPA itself is not sufficient for achieving APEC's goal of free and open trade, APEC members have agreed continually to improve their Individual Action Plans to this end.

Five scenarios for APEC trade liberalization are investigated, including preferential trade liberalization, unconditional liberalization, two alternative conditional MFN-based liberalization scenarios and global trade liberalization:

1. Preferential Trade Liberalization - This scenario is considered to provide a basis for comparison with the other four cases. Under this scenario, all tariffs are removed within APEC, but are maintained between APEC and non-APEC regions (EU and ROW).

2. Unconditional MFN-based Trade Liberalization - Under this scenario, in addition to removing tariffs internally, APEC offers lowered tariffs to non-APEC economies unconditionally on an MFN basis. That is, non-APEC economies are not required to reciprocate in order to take advantage of APEC's lowered trade barriers.

3. Conditional Trade Liberalization with the EU Reciprocating - Under this scenario, APEC offers lowered tariffs to the EU members as well as APEC members on the basis of reciprocal tariff elimination by the EU for APEC economies.

4. Conditional Liberalization with ROW Reciprocating - This scenario is the same as (3) but only ROW (but not the EU) reciprocates.

5. Global Trade Liberalization - In this scenario, all tariffs are removed by all regions.

For the purposes of the simulations, the global economy is divided into seven sectors and eight regions. Table 1 shows the classification of industry sectors and regions. The classification of industrial sectors is based on similar production requirements in intermediate goods and primary production factors. Production sectors include one agricultural sector (AGRC), 5 manufacturing sectors (PRAG, LMNF, RESC, HIND, TRME) and one service sector.

Of the eight regions, six are composed of APEC members and two (EU, ROW) are composed of non-APEC economies. Brunei and Papua New Guinea, both APEC members, could not be included in the APEC totals due to lack of data in the GTAP database. The NIEs are Chinese Taipei; Hong Kong, China; Korea and Singapore.

[8] Conditional liberalization scenarios assume that non-APEC regions reduce protection rates reciprocally. Therefore, these scenarios can be interpreted as the impact of preferential trade arrangements involving APEC economies and the reciprocating region.

Although Singapore is a member of ASEAN, it is included in the NIEs for analytical purposes. Australia and New Zealand are represented as ANZ, while Chile and NAFTA partners, Canada, Mexico and the United States are represented as AMR (hereafter America).[9] The EU data cover the 15 current members, including Austria, Finland and Sweden which joined the EU in 1995.

Table 1

Classification of Production Sectors and Regions

Production Sector		Region	
1. AGRC	Raw Agricultural Goods	1. AMR	Canada, Chile, Mexico, USA
2. PRAG	Processed Agricultural Products	2. ANZ	Australia, New Zealand
3. LMNF	Light Manufacturing Goods	3. ASN	Indonesia, Malaysia, the Philippines,Thailand
4. RESC	Resource-based Commodities	4. CHN	China
5. HIND	Heavy Industrial Products	5. JPN	Japan
6. TRME	Transportation, Machinery, & Equipment	6. NIE	Hong Kong, China; Korea; Singapore; Chinese Taipei
7. SVC	Services	7. EU	European Union
		8. ROW	Rest of World

3. Economic Effects of Trade Liberalization in APEC

Trade liberalization has an impact on trade and economic performance primarily through the reduction and/or elimination of tariffs and non-tariff impediments to imports.[10] Tariffs, by raising the price of imported commodities, penalize consumers by making them pay higher prices for goods, while at the same time providing protection for relatively inefficient domestic producers, thus distorting domestic resource allocation. Reducing trade barriers thus provides benefits in two ways: it directly improves consumer welfare by reducing prices and increasing real income, and promotes more efficient production in the liberalizing economy.[11]

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[9] Chile established a free trade area with Mexico in January 1992 and with Canada in December 1996.

[10] In addition to tariff reduction, measures such as voluntary export restraints (VERs) also affected exports.

[11] Production efficiencies can be realized both through the increased competition induced by reduced protection and also through scale economies that both domestic and foreign producers can realize through the enlargement of markets. The simulations reported here are based on the assumption of perfect competition and thus do not capture scale economy effects (i.e., reductions in the average cost per unit as production scale increases). In CGE models with increasing returns to scale, production costs are divided

Impacts on trade

Table 2 summarizes estimated changes for regional exports and imports evaluated at 1995 market prices. APEC and global trade volumes increase substantially in all five scenarios, for both exports and imports. The gains are greatest under global trade liberalization and smallest under the preferential trade liberalization scenario. The case of APEC unconditional MFN liberalization and the conditional liberalization scenarios fall in between.

Table 2

Impact on APEC and Global Trade under Alternative Scenarios

Scenarios		Exports APEC	Exports World	Imports APEC	Imports World
(1) Preferential	%	19.7	9.5	20.0	9.5
	US$ bn	517	492	527	496
(2) Unconditional MFN-based	%	21.7	11.6	20.6	11.5
	US$ bn	571	590	542	582
(3) Conditional (EU Reciprocating)	%	21.8	13.5	22.4	13.6
	US$ bn	574	673	590	678
(4) Conditional (ROW Reciprocating)	%	22.0	14.3	23.5	14.4
	US$ bn	580	709	619	720
(5) Global Trade Liberalization	%	23.3	21.6	24.3	21.6
	US$ bn	613	1,020	639	1,025

Only in the case of the preferential scenario is there a negative impact on the rest of the world (e.g., through trade diversion effects).[12] Even these are modest. However, if a CGE model with imperfect competition and scale economies is used for simulations, the impacts of APEC's trade liberalization will be much larger than those shown in Table 2. In the case of APEC unconditional MFN liberalization, non-APEC economies benefit, since the impacts on the world are bigger than those on APEC. These scenarios demonstrate that the greater the degree of participation by APEC's external partners in trade liberalization, the greater the gains for them and APEC. This illustrates that there are significant opportunity costs to both APEC and APEC's external partners if the latter do not participate in APEC trade liberalization.

Table 3 and Table 4 show changes in global exports and global imports by commodity and by trade liberalization scenario evaluated at 1995 market prices. Note that numbers for percentage changes in Tables 3 and 4 are the shares of global exports of commodities out of global production. All five scenarios show global exports of all

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into fixed costs and variable costs, while the former remain constant regardless of the amount of production, the latter can be reduced if trade liberalization permits greater scale economies to be realized.

[12] Table 2 does not explicitly report the negative impact on non-APEC economies. However, this can be drawn out by comparing estimates for APEC and the world. The difference between these two estimates provides a measure of the impact on non-APEC economies.

sectors increasing moderately, ranging from 0.2 percent to 5.2 percent. The impact on global exports for all sectors doubles under global trade liberalization compared to under preferential trade liberalization. For example, under preferential trade liberalization, export volumes for heavy industrial products increase by US$43 billion, compared to US$150 billion in the global scenario.

Transportation vehicles and machinery experience the highest gains in trade volume (the sum of exports and imports), ranging from US$246 billion to US$576 billion across the five liberalization scenarios. The gains in resource-based industry and services are more modest than in the transportation, machinery and equipment, but still sizable. As shown in Table 3, substantial gains are made in the export of services, while Table 4 elaborates the impact on the import of services, which is more modest.[13]

Table 3

Impact on Global Exports by Commodity

Scenarios		*AGRC*	*PRAG*	*LMNF*	*RESC*	*HIND*	*TRME*	*SVC*	**Total**
(1) Preferential	%	2.61	2.35	2.12	0.27	0.62	2.15	0.15	0.79
	US$ bn	71	79	86	4	43	119	48	450
(2) Unconditional MFN-based	%	2.88	2.61	2.55	0.16	0.83	2.90	0.17	0.96
	US$ bn	78	88	103	3	58	161	54	545
(3) Conditional (EU Reciprocating)	%	3.55	3.06	2.69	0.52	1.05	3.47	0.19	1.13
	US$ bn	97	103	109	8	72	193	62	644
(4) Conditional (ROW Reciprocating)	%	3.35	3.21	3.49	0.60	1.35	3.13	0.21	1.21
	US$ bn	91	109	141	8	93	174	68	684
(5) Global Trade Liberalization	%	5.18	4.61	4.80	0.93	2.18	5.06	0.28	1.81
	US$ bn	141	155	193	13	150	281	90	1,023

Table 4

Impact on Global Imports by Commodity

Scenarios		*AGRC*	*PRAG*	*LMNF*	*RESC*	*HIND*	*TRME*	*SVC*	**Total**
(1) Preferential	%	2.96	2.56	2.45	0.29	0.67	2.28	0.03	0.79
	US$ bn	80	86	99	4	46	127	8	450

[13] This reflects the fact that transportation services across national boundaries are accounted for in the service sector when exporting goods. For imports, the costs of transportation services are captured in the price of imports (C.I.F. prices).

(2) Unconditional MFN-based	%	3.27	2.85	2.91	0.17	0.90	3.05	0.02	0.96
	US$ bn	88	95	118	3	62	170	8	544
(3) Conditional Liberalization (EU Reciprocating)	%	4.03	3.33	3.07	0.56	1.13	3.64	0.03	1.13
	US$ bn	109	113	123	8	78	202	9	642
(4) Conditional Liberalization (ROW Reciprocating)	%	3.80	3.48	3.93	0.64	1.44	3.29	0.04	1.21
	US$ bn	103	117	158	9	99	184	13	683
(5) Global Trade Liberalization	%	5.89	5.01	5.37	0.99	2.33	5.30	0.03	1.81
	US$ bn	159	169	217	15	159	295	9	1,023

Welfare effects

Table 5 reports estimated percentage changes in global real income, real wage rates and rental rates under the five liberalization scenarios. It also reports the impacts on GDP in 1995 U.S. dollar terms. As in the case of trade flows, the gains in welfare as measured by gains in real GDP are the greatest in the global liberalization scenario and lowest in the APEC preferential scenario, with the APEC unconditional and two conditional scenarios in between. Following the pattern of trade flows, only in the case of preferential liberalization is there a decline in GDP outside the APEC region. In all other scenarios, APEC's external partners experience a net benefit that grows to the extent that they join APEC in liberalizing.

Trade liberalization is expected to affect wage rates and rental rates across all sectors and regions. Regional real wage rates are calculated by averaging changes in regional wage rates weighted with regional labor income shares. For APEC as a whole, real wage rates rise when APEC eliminates trade barriers under all liberalization scenarios. With the removal of trade protection, inefficient sectors that are protected from foreign competition shrink, releasing labor to be reallocated to more efficient production sectors, thus leading to the realization of higher wage rates. The pattern of change in rental rates is similar to that for wage rates.

Table 5

Impact on Real Income, Wage Rates and Rental Rates

Scenarios		*Real Income*		*Wage Rate*		*Rental Rate*	
		APEC	World	APEC	World	APEC	World
(1) Preferential	%	0.33	0.31	1.94	1.03	2.61	1.31

	US$ bn	52	90				
(2) Unconditional MFN-based	%	0.39	0.40	2.25	1.22	2.96	1.48
	US$ bn	62	116				
(3) Conditional Liberalization (EU Reciprocating)	%	0.40	0.42	2.14	1.38	2.81	1.68
	US$ bn	63	121				
(4) Conditional Liberalization (ROW Reciprocating)	%	0.35	0.39	2.16	1.46	2.83	1.89
	US$ bn	55	113				
(5) Global Trade Liberalization	%	0.42	0.58	2.35	2.08	3.04	2.54
	US$ bn	67	168				

4. Conclusion

At the Bogor Economic Leaders' Meeting in 1994, APEC member economies agreed on the goal of free and open trade and investment in the Asia-Pacific region to be achieved by 2010 in the case of industrialized economies and by 2020 in the case of developing economies. This move by APEC members was of particular significance because many new trade-liberalizing measures will be extended to non-APEC economies according to APEC's central principle of open regionalism. This chapter has analyzed the relative economic benefits of five liberalization scenarios ranging from preferential trade liberalization to global trade liberalization.

According to the model estimates, the most beneficial scenario for both APEC and the world involves the realization of global free trade. Under this scenario, the APEC region gains over US$67 billion in income while the world as a whole gains over US$168 billion. In and of itself, the superiority of global free trade is perhaps an unsurprising result. When all regions of the world agree to lower trade barriers, every economy enjoys new opportunities to expand both exports and imports.

What is striking, however, is the large opportunity cost to non-APEC economies should they choose to "free ride" on APEC trade liberalization measures rather than reciprocate them. The model estimates these costs to be approximately US$47 billion, suggesting that non-APEC economies could gain substantially by eliminating distortions in their import markets. Another interesting finding is that the estimated benefits to APEC of unilateral (or unconditional) trade liberalization--over US$62 billion--are very similar to, or in one case even greater than, the gains under the conditional liberalization scenarios. This suggests that while global free trade produces the most favorable results for APEC economies, unconditional liberalization by the APEC region captures the main part of the potential benefits for its member economies regardless of whether non-APEC regions reciprocate or not. By contrast, the benefits to APEC emanating from a preferential trade area, while sizable, are smaller--about $52 billion.

The quantitative estimates above support the view that APEC's concept of Open Regionalism, with its core principle of non-discrimination, forms a sound basis for economic cooperation within APEC. The findings also suggest that member economies should promote the adoption by non-members of APEC liberalization initiatives.

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APPENDIX I

Model and Protection Rates

Model, data and parameters

This study uses the neoclassical and standard computable general equilibrium (CGE) model described in Hertel (1997). Since a description of the GTAP model would require lengthy technical explanation, this section discusses general properties of CGE models.[14] The general equilibrium framework is most appropriate for analyzing the economic effects of major policy changes such as the implementation of WTO commitments and the formation of an FTA. Reduced trade barriers in the Asia-Pacific region would generate more competition between firms of member economies and induce producers to lower their prices, the effects of which would be picked up by the general equilibrium model. They capture wider interactions than the triangular calculations of a partial equilibrium analysis. In addition, the general equilibrium approach allows factor prices to vary. Thus, the relative changes in intermediate input and primary input prices would presumably affect the ratio of a firm's material components and the amount of value-added to the primary production factors in each equilibrium. Partial equilibrium analyses, on the other hand, assume constant production factor prices during the experiments, even though it is generally believed that prices will change according to the economic environment. Analyses with general equilibrium settings take into account the market interaction that is neglected by the partial equilibrium analysis.

The CGE models have been used extensively to capture the essential features of economic activity by converting the Walrasian general equilibrium structure from a complicated economy into an abstract representation of an economy with linkages to major economic agents. Each economy in the model includes activities by consumers, producers and the government. Unlike empirical macroeconomic models, CGE models can assess the effects of policy changes in many dimensions and identify gainers and losers, even in a single region model. The CGE model provides a framework through which different and diverse policies can be examined. Once the basic model has been specified and applied to actual data, various policies can be studied with minor modifications. The model used here is a static, Walrasian general equilibrium model that endogenously determines quantities and prices by using a descendant of the Johansen (1960) simulation approach.

A CGE model is a simplified computer representation of one or more economies. Thus, the model can estimate the essential features of economic activities when policies are changed. Two initial assumptions are: (1) there are no pure profits in any economic activity (producing, importing, exporting, transporting, etc.) and (2) all sectors in all economies are assumed to be in equilibrium. It is a multi-sector and multi-region model, allowing for the analysis of the effects of policy changes on regional welfare, production and demand per agent and per region, equilibrium prices, rates of return to

[14] Structural equations of the GTAP model are provided in Hertel (1997). Refer to APEC (1997) for discussion about the GTAP model.

factors of production, etc.[15]

A CGE model has three components: data, a set of parameters, and a system of equations for defining production, consumption, exports, etc. In this study, three sets of elasticity of substitution are required. As discussed above, the model in this paper is a linearized version of the non-linear model; thus, relatively small numbers for the parameters are necessary. The three sets of elasticities are given in Table AI-1. The first set of elasticities is a set of parameters for the Armington assumption between domestically-produced goods and imports (the first column in Table AI-1), the second set s for imports from different sources (the second column), and the final set is for primary production factors of labor and capital (the third column).

These are the elasticities taken from the GTAP[16] database and aggregated with weights of trade shares, using the aggregation facility of the GTAP. In this paper, the GTAP elasticities are used as a central case. These parameters should be carefully selected because the size of the parameters will affect the simulation results. It should be noted that these parameters are commonly applied to all regions in this study. If economy-specific information were available and reliable, economy-specific parameters could be assigned to reflect each economy's economic characteristics.

Table AI-1

Elasticities of Substitution

	Armington	Sources of Imports	Endowment Factors
AGRC	2.49	4.73	0.56
PRAG	2.38	4.77	1.12
LMNF	2.69	6.03	1.26
RESC	2.80	5.60	1.12
HIND	2.34	4.62	1.25
TRME	3.57	6.98	1.26
SVC	1.94	3.81	1.40

Armington elasticities are 2.37 to 2.54 for agriculture, light manufacturing, resource, chemicals, and metal products; 1.94 for the service industry; and 3.44 for the transportation industry, machinery and equipment. Overall, the elasticities for imports are about twice the elasticities for the Armington parameters. The elasticities for labor and capital are from 1.12 to 1.26 for manufacturing sector; 1.40 for the service sector; and 0.74 for the agricultural sector. The agricultural sector is less elastic than other sectors, implying that that sector's demand for primary production factors is less sensitive to the price changes in production factors.

15 The model assumes perfect mobility in factor markets within an economy and thus the simulation results should be interpreted as upper estimates.

16 See Hertel (1997) about sources of elasticities.

***Protection rat*es**[17]

Protection measures can be largely grouped into two categories: tariffs and non-tariff barriers (NTBs). Tariff rates are transparent trade impediments and are measured easily. However, it is difficult and time consuming for researchers to collect reliable NTB data by sector and region. The GTAP database is used as benchmark data for the simulations. The protection data in the GTAP database include major protective devices: (1) the individual economy's effective tariff rates,[18] which are based on the economy's submissions to GATT for the Uruguay Round; (2) tariff equivalents of NTBs in agriculture, taken from OECD and USDA/ERS estimates of Producer and Consumer Subsidy Equivalents; and (3) anti-dumping duties of Canada, the European Union, and the United States, which make up a substantial share of the world's anti-dumping cases. GTAP researchers estimated anti-dumping duties in the regions and aggregated these duties to the GTAP database using methodology suggested by Magee (1972). The GTAP database includes non-agricultural NTBs only for the United States and European Union, and statutory tariff rates only for other regions. Thus, this analysis may underestimate the economic effects under APEC trade liberalization. If more data become available, they can be reflected in the simulations.

Table AI-2 shows import protection rates for each commodity by supplying and demanding region. Viewing the data at the broadest level, all regions protect both raw and processed agricultural products more than on any other sector. Comparing regions, Australasia consistently imposes the lowest tariff rates in all sectors. Also, Japan, America (Canada, Chile, Mexico and the United States), the NIEs and the EU place relatively low tariffs on all manufactured goods.

The data also highlights contrasting protectionist policies in a certain sector for different regions. In the raw agricultural sector (AGRC), Australasia's low tariffs are equaled only by China, which goes so far as offering export subsidies (represented by negative figures). ROW and America both exhibit relatively low tariffs, ranging from 5-35 percent. ASEAN protects its raw agriculture the most, with exceptionally high tariff rates towards China (163 percent) and America (109 percent).

In the processed agricultural product sector (PRAG), Australasia again levies the lowest tariffs (3-8 percent), followed closely by America (4-16 percent), the NIEs (12-23 percent) and the EU (11-66 percent). ASEAN and ROW impose relatively high tariffs, exceeded only by Japan, which averages protection rates above 100 percent in this sector. Australasia, ironically, is on the receiving end of the highest protectionist barriers, including 80 percent from ASEAN and 215 percent from Japan.

As stated earlier, Japan, America, the NIEs, and the EU impose lower tariffs on manufactured goods. In the light manufactured goods sector (LMNF), these four regions' tariff rates range from 1-15 percent. China's tariff rates are considerably

[17] See *Survey of Impediments to Trade and Investment in the APEC Region* for discussion on trade barriers in the APEC region.

[18] These rates reflect three different tariff rates of MFN, GSP, and the tariff rates actually applied. These three tariff rates were effective at the time of file submission, and may be lower than the bound tariff rates. Refer to Gehlhar et al (1997) for a detailed discussion.

higher (20-80 percent), and Australasian rates range from 11-39 percent, the region's highest for any one sector.

All regions' tariffs for resource-based commodities (RESC) are lower than for any other sector. Notably, Australasia, America, and the EU erect tariff rates mostly under 1 percent. At the other extreme, China exhibits exceptionally high protection rates towards Japan (19 percent), the NIEs (31 percent), and the EU (31 percent). Similarly, ROW enforces its highest rates on China (27 percent) and Australasia (19 percent), while ASEAN applies a rate of 16 percent towards Japan and other members of ASEAN.

In the heavy industrial product sector (HIND), all regions have average tariff rates slightly lower than for light manufacturing goods, and slightly higher than for resource-based commodities. ROW's rates are noticeably higher than any other region's, averaging 21 percent.

Tariff rates in transportation, machinery, and equipment (TRME) are similar to those in the previous three non-agricultural sectors. As in those sectors, Japan, America, the NIEs and the EU are less protective than China, ASEAN, Australasia and ROW. Japan, in particular, imposes the sector's lowest tariff rate (average of 1 percent), while confronting some of the highest barriers in this sector, including 20 percent by Australasia, 27 percent by ASEAN, 38 percent from China, 23 percent by America, 17 percent by the EU and 22 percent by ROW.

Table AI-2

Bilateral Protection Rates by Sector and Region

	Tariffs and Non-tariff barriers							
	AGRC (agricultural sector)							
From\To	AMR	ANZ	ASN	CHN	JPN	NIE	EU	ROW
AMR	15.49	2.60	108.62	-9.55	91.31	80.73	44.58	6.76
ANZ	9.90	0.00	75.01	8.50	47.92	58.48	14.84	16.33
ASN	23.92	1.67	49.33	-0.25	12.47	18.04	43.00	18.96
CHN	9.40	2.48	162.96	0.00	67.55	85.68	28.58	15.18
JPN	8.80	1.40	47.06	9.75	0.00	22.83	25.74	15.40
NIE	35.27	1.60	47.22	-1.49	14.58	22.74	39.14	17.04
EU	22.82	2.50	80.95	-12.80	25.12	62.60	42.61	19.90
ROW	30.87	2.40	56.01	3.46	25.12	33.51	34.75	18.86
	PRAG (processed agricultural products)							
From\To	AMR	ANZ	ASN	CHN	JPN	NIE	EU	ROW
AMR	7.73	5.30	38.09	61.69	128.49	23.27	14.29	28.94
ANZ	16.28	0.00	80.37	19.45	215.28	41.03	66.02	32.38
ASN	4.44	2.81	19.09	21.56	96.87	19.62	14.66	30.27
CHN	4.59	5.17	49.50	0.00	54.71	11.55	17.32	19.05
JPN	3.82	3.23	39.40	48.53	0.00	17.24	10.71	41.91
NIE	6.10	2.93	31.89	58.45	117.84	23.23	13.69	36.34
EU	10.85	8.08	26.32	79.36	109.68	23.17	37.19	24.60
ROW	11.61	6.58	46.16	23.02	70.59	17.32	26.11	22.91
	LMNF (light manufacturing goods)							
From\To	AMR	ANZ	ASN	CHN	JPN	NIE	EU	ROW
AMR	0.27	11.04	22.11	26.96	2.25	7.22	3.44	21.80
ANZ	6.76	0.00	14.96	22.22	0.95	4.82	2.39	30.62
ASN	13.00	26.75	26.69	32.51	7.33	3.59	9.05	33.62
CHN	12.00	38.55	36.88	0.00	10.27	3.45	10.97	26.61
JPN	3.82	15.74	32.97	63.58	0.00	7.58	7.93	37.91
NIE	14.39	23.88	32.28	60.67	8.93	4.29	9.44	34.71
EU	7.58	15.50	27.93	48.13	7.74	8.69	0.24	17.95
ROW	13.65	25.98	25.28	32.48	6.47	8.60	8.64	24.75
	RESC (resource-based commodities)							
From\To	AMR	ANZ	ASN	CHN	JPN	NIE	EU	ROW
AMR	0.00	2.55	7.45	5.39	0.00	3.47	0.41	12.56
ANZ	0.39	0.00	9.22	4.54	1.31	1.30	0.37	18.74
ASN	0.54	0.45	16.76	3.54	1.52	3.90	1.36	9.21
CHN	0.60	0.00	11.54	0.00	2.86	1.71	0.44	26.65
JPN	0.07	0.12	16.42	19.21	0.00	5.12	0.58	2.08
NIE	0.47	0.00	5.07	31.09	3.29	0.40	0.00	11.39
EU	0.34	1.05	4.39	31.22	2.65	8.43	0.00	3.56
ROW	0.53	0.02	6.99	2.36	3.16	4.05	0.07	6.65
	HIND (heavy industrial products)							

From\To	AMR	ANZ	ASN	CHN	JPN	NIE	EU	ROW
AMR	0.85	7.75	16.38	16.52	2.44	6.24	13.38	17.20
ANZ	2.50	0.00	10.87	10.30	0.84	4.09	0.93	24.49
ASN	4.90	12.12	17.65	19.22	2.33	5.10	6.23	28.44
CHN	14.79	11.00	17.82	0.00	2.82	4.27	11.87	20.94
JPN	18.74	11.93	18.62	20.12	0.00	8.83	15.39	22.45
NIE	7.40	11.49	16.20	26.67	3.33	4.06	6.29	24.13
EU	8.32	9.26	15.62	19.32	3.31	8.23	1.02	13.68
ROW	5.37	6.84	12.25	9.58	2.53	6.86	4.14	16.42
	TRME (transportation, machinery)							
From\To	AMR	ANZ	ASN	CHN	JPN	NIE	EU	ROW
AMR	0.99	8.08	14.72	27.05	1.45	10.17	4.61	16.95
ANZ	2.79	0.00	19.14	20.15	1.46	6.15	4.79	19.73
ASN	2.33	20.69	21.98	33.48	1.50	1.30	9.39	19.83
CHN	4.15	11.27	23.19	0.00	1.04	1.71	6.94	16.46
JPN	23.23	19.68	26.78	38.42	0.00	8.11	17.38	22.36
NIE	7.07	11.60	20.53	28.48	1.01	4.70	8.02	21.92
EU	10.18	14.09	22.89	33.79	1.14	9.33	0.00	14.85
ROW	8.12	11.57	20.30	26.30	0.91	9.05	2.41	17.71

APPENDIX II

Patterns of Trade and Investment in the Asia-Pacific Region

Interdependence among the Asia-Pacific economies has increased over the past two or three decades. APEC member economies have witnessed a rapid expansion of trade with their partners in the region. More recently, foreign direct investment (FDI) has emerged as another important channel in reinforcing the process of market-driven integration in the region.[19] The trade relationships among the APEC member economies have evolved in line with the constantly changing patterns of comparative advantage. At the same time, these changing patterns reflect shifts in the world's division of labor, as these economies undertake industrial restructuring and experience structural changes in their external transaction patterns.

Patterns of trade in the APEC region

The dynamism of the APEC member economies is often explained by their high dependence on external trade. As shown in Table AII-1, merchandise exports of the APEC member economies as a whole increased from US$729 billion in 1985 to US$2,224 billion in 1995, an average annual growth rate of 11.8 percent. Imports grew by almost same amount from US$789 billion to US$2,321 billion in 1995.

Both exports and imports of APEC member economies grew faster than the world average of 10.5 percent. Accordingly, the share of the APEC region in world exports grew from 39.4 percent in 1985 to 44.4 percent in 1995. Correspondingly, the share of imports increased from 40.8 percent to 45.6 percent.

In particular, the Asian developing economies showed a considerable gain in their shares of world trade. For example, the Asian Newly Industrialized Economies (ANIEs) increased their share of world exports from 6.2 percent to 10.5 percent, and their share of world imports from 5.5 percent to 10.9 percent. APEC’s ASEAN members (Indonesia, Malaysia, the Philippines and Thailand) also witnessed rapid growth in their exports, increasing their share of world exports from 2.5 percent in 1985 to 3.9 percent in 1995. Also making a significant gain was China, which doubled its share of world exports from 1.5 percent to 3.0 percent.[20] Altogether, the East Asian developing economies increased their share of world exports from 10.2 percent to 17.4 percent.

In contrast to the performance of these developing economies, the APEC developed economies experienced a decrease in their share of world trade from 32.9 to 29.5 percent.

Table AII-1

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[19] See Economic Committee, "Foreign Direct Investment and Market Integration in APEC" (APEC 1995).

[20] In 1995, the ANIEs (Chinese Taipei; Hong Kong, China; Korea; and Singapore) and China each exported more than US$100 billion of goods, i. e. more than 2.0 percent of the world total value.

Trade in Goods and Services of APEC Member Economies

(US$ billions)

	Trade in Goods				Trade in Services			
	Exports		Imports		Credit		Debit	
	1985	1995	1985	1995	1985	1995	1985	1995
Australia	22.6	53.1	25.9	61.3	4.3	15.6	7.7	17.6
Brunei	2 .9	2.1	0.6	1.2	--	--	--	--
Canada	91.0	192.2	80.6	168.4	9.1	21.8	13.2	30.1
Chile	3.8	16.0	3.1	15.9	0.7	3.2	1.1	3.3
China	27.4	148.8	42.3	129.1	3.1	2.5	19.1	25.2
H.K., China	30.2	173.4	29.7	192.8	5.9	28.3	4.3	18.2
Indonesia	18.6	45.4	10.3	40.9	0.8	5.1	5.7	13.5
Japan	177.2	443.1	130.5	335.9	23.2	65.2	35.1	122.7
Korea	30.3	125.1	31.1	135.1	5.6	26.2	4.1	27.9
Malaysia	15.4	74.0	12.3	77.8	1.9	11.3	3.9	14.4
Mexico	22.1	47.3	14.0	46.9	4.8	10.3	5.5	9.5
New Zealand	74.9	195.5	73.3	176.1	13.8	47.8	14.9	45.7
PNG	0.9	2.7	1.0	1.5	0.0	0.3	0.3	0.6
Philippines	4.6	17.5	5.5	28.3	2.2	0.9	9.4	6.9
Singapore	22.8	118.3	26.2	124.5	4.7	29.4	3.6	16.6
Chinese Taipei	30.7	111.6	20.1	103.7	5.0	24.2	6.7	30.3
Thailand	7.1	56.4	9.2	73.7	2.0	14.8	1.8	18.8
United States	218.0	584.7	352.0	771.0	73.1	206.8	72.0	143.9
APEC	**729.0**	**2,223.7**	**788.8**	**2,320.6**	**147.9**	**495.8**	**169.7**	**504.2**
World total	**1,848.7**	**5,013.9**	**1,935.2**	**5,092.1**	**395.6**	**1,174.1**	**421.9**	**1,189.5**

Note: Services credit (debit) is comparable to exports (imports).
Sources: IMF, *International Financial Statistics*, various issues. IMF, *Direction of Trade,* various issues. ADB, *Key Indicators: Developing Asian and Pacific Countries*, various issues

The APEC region has also witnessed rapid growth in services trade in line with global trends. As shown in Table AII-1, world exports of services grew from US$396 billion in 1985 to US$1,174 billion in 1995. The annual growth rate of 11.5 percent for service exports was in fact higher than that of merchandise exports. For APEC member economies, the total value of service exports grew from US$148 billion to US$496 billion, while the value of imports increased from US$170 billion to US$504 billion. The corresponding growth rates were 12.9 percent and 11.5 percent. Thus, APEC services trade also exceeded the world average.

In the APEC region, only a few economies are net exporters of services. The United States is the largest net exporter of services followed by Singapore; Hong Kong, China; and New Zealand. Almost all the developing economies in the APEC region are chronic debtors in services trade.

Growing interdependence and intra-regional trade

Intra-regional trade for the APEC region as a whole has considerably deepened since the 1980s. This can be demonstrated by examining intra-regional trade shares and intra-regional trade intensities. The intra-regional trade share represents the total share of trade of a region accounted for by the member economies of the region. The trade intensity index meanwhile indicates the extent to which the region's exports are under- or over-represented in the region's imports, as compared to the region's weight in the overall world import market. Table AII-2 provides an overview of the regional trade shares and intensities of the APEC region and of the NAFTA and East Asian subregions.

As this table shows, intra-regional trade of APEC member economies accounted for 72.0 percent of the their total external trade in 1995, a significant increase from the 50 percent range of the pre-1980 period (and much higher compared with the EU).[21] Though there was a significant increase in intra-regional trade within NAFTA and East Asian subregions as well, stronger trade ties among those subregions dictated the regionalization of trade in the APEC region.

The trade intensity index provides a somewhat different perspective. In 1995, the trade intensity index for APEC as a whole was 160.4, indicating a higher degree of intensity of APEC members' intra-regional trade as compared with non-APEC partners. It is notable that the trade intensity indices for the East Asian and NAFTA regions are even higher than APEC's. In 1995, the index stood at 234.7 for NAFTA and at 202.1 for East Asia. The index for APEC does not show a definite trend, but rather has tended to fluctuate in the neighborhood of its current value (which in fact is quite similar to that of the EU in 1995). The discrepancy in the movements of the two indices may be attributable to the fact that APEC's share in world trade sometimes increased much more rapidly than that in intra-regional trade.

[21] As pointed out by Drysdale and Garnaut ("The Pacific: Application of a General Theory of Economic Integration," in C.Fred Bergsten and Marcus Noland eds., *Pacific Dynamism and the International Economic System, IIE, 1993*), the intra-regional trade share is an inadequate measure of regional trade bias. For example, if home region represents a large proportion of world trade, the intra-regional trade share will be high, even if resistances to intra-regional trade are not particularly low.

Table AII-2

Regional Trade Shares and Intensities

(percent)

Region	1970	1975	1980	1985	1990	1995
Intra-regional trade share						
APEC	56.2	58.4	55.7	63.7	64.2	72.0
East Asia*	30.1	31.9	35.1	34.8	39.9	42.4
NAFTA	36.5	41.5	31.8	36.6	37.5	50.1
EU	53.9	47.1	52.6	53.8	59.6	56.9
Trade intensity index**						
APEC	164.8	201.1	168.7	152.1	166.6	160.4
East Asia	269.6	251.7	239.5	185.8	206.1	202.1
NAFTA	178.5	296.6	191.0	175.3	216.0	234.7
EU	139.3	124.5	139.0	149.1	149.8	166.2

Source: Same as Table AII-1

Notes:

* Japan; NIEs (Hong Kong, China; Korea; Singapore; and Chinese Taipei); ASEAN-5 (Brunei, Indonesia, Malaysia, Philippines, Thailand); and China.

** Trade intensity index is defined as (Xij / Xi) / (Mj / Mw) multiplied by 100, where Xi(Xij) and Mj(Mw) denote region i's exports(to region j) and imports of region j(world total imports) respectively.

Patterns of FDI in the APEC region

Along with trade, a significant factor driving structural adjustments in the region has been the increase in regional investment flows.[22] Table AII-3 summarizes the trend of FDI flows in the region and globally for the period 1984 to 1995. After growing strongly in the late 1980's, global FDI flows witnessed a cyclical slow-down in the early 1990s before recovery in 1994-1995. World FDI flows reached a record high of US$315 billion in 1995. The value of annual FDI flows during the 1990-95 period almost doubled from 1984-89.

As shown in the table, developed economies as a whole are both the largest investors, and the largest recipients of FDI. In 1995, developed economies invested US$270 billion and received US$203 billion, which accounted for 85 percent and 65 percent of the world totals, respectively.[23] Not surprisingly, the three largest global economic

[22] See *1995 APEC Economic Outlook* (APEC, 1995)

[23] According to a recent report by United Nations Conference on Trade and Development, the world's largest 100 transnational corporations are all based in developed countries (UNCTAD, *World Investment Report* 1996). They account for one-third of the global FDI stock in 1994.

actors -- the United States, Japan and the European Union -- dominate the statistics. North America is still the largest recipient of FDI inflows in the region. However, the significance of developing economies as recipients and more recently as investors is rising. In particular, FDI flow into ASEAN and China has considerably increased. The net outflow of FDI for the ANIEs is a new phenomenon to note.

Table AII-3
Global FDI Flows (1984-1995)

(US$ billions)

Region	84-89*	90	91	92	93	94	95	90-95*
World Inflows	**115.4**	**203.8**	**157.8**	**168.1**	**207.9**	**225.7**	**314.9**	**213.0**
Developed	**93.1**	**169.8**	**114.0**	**114.0**	**129.3**	**132.8**	**203.2**	**143.8**
USA	43.9	47.9	22.0	17.6	41.1	49.8	60.2	39.8
Japan	0.1	1.7	1.7	3.5	0.2	0.9	0.03	1.4
EU	37.7	97.4	77.7	79.8	74.5	64.0	111.9	84.2
Developing	**22.2**	**33.7**	**41.3**	**50.4**	**73.1**	**87.0**	**99.7**	**64.2**
Asia**	9.9	19.8	20.8	27.2	46.5	53.6	65.0	38.8
NIEs	4.9	9.4	7.9	6.0	8.2	9.8	10.4	8.6
ASEAN	2.2	6.4	8.0	9.2	9.8	8.6	14.1	9.4
China	2.3	3.5	4.4	11.2	27.5	33.8	37.5	19.6
Latin America	7.7	8.9	15.4	17.7	19.5	25.3	26.6	18.9
Mexico	2.4	2.5	4.7	4.4	4.4	8.0	7.0	5.2
World Outflows	**121.6**	**240.3**	**210.8**	**203.1**	**225.5**	**230.0**	**317.8**	**237.9**
Developed	**114.0**	**224.4**	**201.9**	**181.4**	**192.4**	**190.9**	**270.5**	**209.9**
USA	16.8	27.2	33.5	39.0	69.0	45.6	95.5	51.6
Japan	20.9	48.0	42.6	21.9	15.5	18.5	21.3	28.0
EU	62.6	133.0	106.8	108.7	91.5	101.1	132.3	112.2
Developing	**7.6**	**17.8**	**8.9**	**21.6**	**33.0**	**38.6**	**47.0**	**27.8**
Asia	5.1	12.3	8.7	17.4	29.3	33.0	41.5	23.7
NIEs	4.3	10.8	7.2	12.6	23.3	28.6	34.6	19.5
ASEAN	0.3	0.7	0.5	0.7	1.5	2.4	3.5	1.5
Chna	0.6	0.8	0.9	4.0	4.4	2.0	3.5	2.6
Latin America	0.6	4.5	-0.4	2.6	2.2	3.9	3.8	2.8
Mexico	0.1	0.2	0.2	0.7	0.02	1.0	0.6	0.5

Source: UNCTAD, *World Investment Report* 1996

Notes:
* annual average
** South, East and Southeast Asia

The growth of FDI flows into APEC developing economies reflected initially their attractiveness as a low-cost production base but more recently their emergence as significant markets in their own right. The more recent development of outward direct investment flows from these economies (in particular the ANIEs) reflects the restructuring of trade and industrial production patterns, and thus the pursuit of globalization by the emerging multinational corporations (MNCs) based in these economies. Inward FDI flows into APEC developing economies have been mainly concentrated in the East Asian APEC members.

FDI has grown more rapidly than international trade or domestic production since the mid-1980s. For major developed economies, sales by foreign affiliates now exceed the total volume of their domestic exports (UNCTAD, *World Investment Report* 1995). The upsurge in FDI has been fostered by numerous factors, including the development of information technologies, liberalization of national investment regimes and competitive pressures on firms.

Related to the major roles played by developed economies in global FDI flows, the increasing use of cross-border mergers and acquisitions (M&A) is noteworthy.[24] Cross border M&A includes acquisition of the management rights of a foreign firm and mergers of two firms with different nationalities. Since the mid-1980s, the M&A type of FDI came to be widely used in developed countries with the acceleration of financial innovation and opening of new investment opportunities in Europe. Although there is no substantial increase in the M&A type of FDI in the APEC region outside North America, the APEC region will eventually take an important role in this global investment activity. In 1995, the value of worldwide M&A reached US$678 billion, including cross-border M&A transactions of $229 billion. In the case of the United States, more than 85 percent of inward FDI flows took the form of M&A in 1995. The significance of the M&A form of FDI into the United States may reflect its effectiveness in allowing investors to penetrate a mature market.

In terms of FDI stocks, APEC is the world's largest investor and recipient region. As shown in Table AII-4, APEC member economies accounted for 47.2 percent of the world total inward FDI stock in 1995. Of particular note is the recent increase in the share of the global FDI stocks accounted for by East Asian developing economies (China, ANIEs and ASEAN). China along with Hong Kong, China; Indonesia; Malaysia; Chinese Taipei; and Mexico were among the ten largest FDI-host developing economies in 1995.[25] China alone accounted for 4.9 percent of worldwide FDI stock in 1995, rising from negligible shares pre-1990.

The share of the APEC region in world outward FDI stocks in 1995 amounted to 49.0 percent, with the United States and Japan accounting for the largest part. While the APEC share of outward global FDI stock has remained broadly stable over the past decade and half, the share accounted for by the NAFTA economies has fallen while the share of Japan has risen. This structural change occurred in the 1980's.

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[24] According to the OECD Code of Liberalization of Capital Movements, cross-border M&A is recognized as a legitimate means of FDI. However, there exist many restraints on this form of FDI. One reason may be concern over possible loss of economic sovereignty. Economic effects of M&A type FDI need to be examined more systematically, but it is believed that it improves overall firm-specific advantage through corporate restructuring (Edward M. Graham and Paul R. Krugman, "The Surge in Foreign Direct Investment in the 1980s," in K.A.Froot ed., *Foreign Direct Investment*, The University of Chicago Press, 1993).

[25] The others were Argentina, Brazil, Cayman Islands and Saudi Arabia.

Table AII-4

Share of the Global Stock of FDI by Region

(percent)

	Inward FDI				Outward FDI			
Region	1980	1985	1990	1995	1980	1985	1990	1995
EU	38.4	30.8	41.5	38.7	41.5	41.8	46.1	44.3
NAFTA	29.0	36.5	31.5	27.9	47.3	42.7	30.6	30.0
USA	17.2	25.1	23.0	21.2	42.9	36.6	25.8	25.8
East Asia	6.9	9.0	8.8	13.8	4.0	7.3	14.4	17.2
Japan	0.7	0.6	0.6	0.7	3.7	6.7	12.2	11.2
NIEs	2.4	2.9	3.7	4.0	0.2	0.6	2.0	4.9
ASEAN	3.9	5.0	3.7	4.2	0.1	0.1	0.2	0.4
China	0.0	0.5	0.8	4.9	0.0	0.0	0.2	0.6
APEC	39.5	49.6	45.6	47.2	52.0	51.2	47.0	49.0
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
US$ Billions	482	735	1,717	2,658	514	686	1,657	2,730

Source: Same as Table AII-3