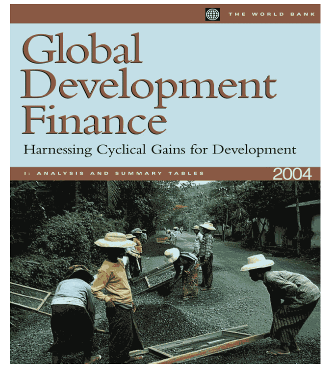
East Asia & Pacific

GDF 2004 Summary



Global Themes

- The global economic environment affecting capital flows to developing countries improved in 2003. Global growth gained momentum in the second half of the year as the locus of economic activity shifted towards business investment spending. Renewed confidence in international financial markets led to a considerable decline in risk spreads in bond markets and fueled a strong rally in equity prices. Worldwide, GDP growth increased from 1.8 percent in 2002 to 2.6 percent during 2003; it is projected to rise to 3.7 percent in 2004. But the global economy is emerging from the pervasive slowdown of recent years facing major macroeconomic challenges – including large fiscal deficits in many advanced economies and a large current-account deficit in the United States - which could have a critical bearing on the outlook for developing countries and the availability of external capital to finance their development.

- Developing countries as a group are markedly outperforming the high-income countries. Developing countries' GDP grew 4.8 percent in 2003, compared to a 2.1 percent advance in the high-income countries. The low-and middle-income countries are on track this year to match, or even surpass, the record 5.2 percent growth achieved in 2000, before the global slowdown. Since 2000, the developing world has been a net exporter of capital to the advanced economies. For developing countries as a whole, foreign-exchange reserves rose about $276 billion in 2003, bringing total reserves to $1,227 billion—equivalent to nearly four times their short-term external debt. This buildup reflects a precautionary reaction to the costly crises of the 1990s, as well as broader factors related to trade and exchange rates. It underlines the strong financial interdependence between developed and developing countries.

- Official development assistance is still an important source of external finance for many countries. But, as private capital flows have grown, official aid flows have risen only slightly, and remain below the levels needed to achieve the Millennium Development Goals (MDGs). Political developments and changes in attitudes are dramatically altering the landscape for official flows. Net official development assistance did increase to $58 billion in 2002, but half of the $6 billion rise reflects debt relief donor agencies, rather than increased resources provided directly to developing countries. Moreover, the increase represents little progress toward meeting the commitments for higher aid made at the 2002 Monterrey conference.

- From 1992 to 2003, total international investment in developing countries' infrastructure is estimated to have been $622 billion—an average of $52 billion a year or 3.8 percent of total gross domestic investment in the developing world. Infrastructure needs in developing countries remain largely unmet—1.1 billion people lack access to safe drinking water, 2.4 billion are affected by inadequate sanitation, 1.4 billion have no power, and telecommunication links are five times less dense than in the developed world. Worldwide, future demand for infrastructure is likely to come mainly from the developing world. The bottlenecks in assuring a healthy flow of capital from international markets to developing-country infrastructure are related to policies, institutions, and regulation. Multilaterals can play a crucial role in providing risk-mitigation instruments (including guarantees and political risk insurance) and promoting the development of local capital markets. Efforts also need to be taken to develop a strong institutional framework for the protection of creditors' rights, effective covenants, and reliable avenues of legal enforcement and remedy. No single solution will fit all sectors and all countries.

- Developing countries' international trade is equivalent to about one-half of their gross national income. Trade finance supplies the liquidity needed to conduct trade, and governments can support it by ensuring a sound and efficient financial system. Finance linked to trade transactions may hold up better during crises than other forms of foreign borrowing for several reasons - lenders can rely on security arrangements linked to traded goods; supplier's information on their borrowers may limit contagion; suppliers have an incentive to support their customers during cyclical downturns; and, in some cases, governments have provided preferential treatment to trade finance in the context of rescheduling agreements. Trade credit from suppliers and customers appears to have held up better during crises than bank lending.

- The development community should view remittances as a welcome source of external finance and strive to improve the financial infrastructure supporting them. Workers' remittances have become a major source of finance for many developing countries. On an aggregate basis, they increased by more than 20 percent during 2001–03, reaching an estimated $93 billion in 2003, with more remittances being diverted to formal channels from alternatives—a result of efforts to curb money laundering. The increased focus on remittances resulted in better reporting of data in many developing countries.

Regional themes

- Robust capital spending underpinned regional GDP growth in 2003, which accelerated to 7.7 percent, up from 6.7 percent in 2002 and 5.6 percent the year before. Capital spending was spurred by China, where investment increased by 26 percent in 2003. Health investment spending was also supported by sanguine financial-market sentiment, which translated into lower interest-rate spreads and a partial revival of portfolio flows-although FDI flows have been slow to rebound, except in China.

- The engine of regional growth continued to be China, both through its direct impact on aggregate GDP (amounting to two-third of the region) and increasingly, as an important export market for other regional economies. This latter development is offsetting some concerns among East Asian countries about competitive pressures from Chinese exports in third markets. China's output grew by 9 percent in 2003, with capital spending up 26 percent and trade flows rising 35-40 percent.

- Net private debt flows to East Asia and the Pacific strengthened markedly in 2003, growing to $9.4 billion, up from $-3.1billion in 2002. This largely accounts for an increase in short-term lending (including from commercial banks), which was 57 percent higher in 2003 than 2002. The recovery also mirrored a significant slowdown in debt repayments to private creditors in 2003, following substantial net repayments in 2002. Gross debt financing to the region picked up only slightly to $35 billion from $33 billion in 2002. Note that net official debt flows to the region have been negative for the past two years as East Asian countries continued to make significant net repayments to official creditors.

- FDI inflows to East Asia and the Pacific remained strong at around $57 billion in 2003, up slightly from $55 billion in 2002. The region's share of FDI to the developing world rose from 38 percent in 2002 to 42 percent in 2003. Once again, the rise was mostly due to the continuing surge in FDI to China in spite of the SARS epidemic in early 2003. China's share in regional FDI rose further to about 94 percent in 2003 from 90 percent a year earlier. By contrast, FDI inflows to other countries in the region have been slow to rebound.

- Robust capital inflows are contributing to a continued huge accumulation of foreign reserves, and in turn to a strong expansion of domestic credit, with implications for potential overheating in already fast-growing economies.

Other key regional points to note

- There have been important structural changes in the pattern of borrowing since the East Asian crisis. International claims on East Asia and the Pacific declined from $233 billion in 1997 to $152 billion in 2003 as Asian borrowers sought to "deleverage" and reduce their exposure to international lending. However, more recently there have been signs of an incipient revival in bank lending to East Asia.

- The region's local bond markets have grown considerably since the financial crisis of 1997-98, as the East Asian countries adjusted their financing requirements to rely less on foreign-currency debt; they have purposely avoided issuing international bonds to the same extent as they did before crisis. Domestic capital markets have became an important source of corporate finance in East Asia in recent years.

- The rise in portfolio equity flows in 2003 was largely driven by a sharp increase in activity to China- notably the China Life transaction, valued at more than $3 billion.

- East Asia accounted for about 44 percent of total developing-country infrastructure finance in 1990-96, led by China, Malaysia, and, to a less extent, Indonesia, the Philippines, and Thailand. But the region's share was cut in half during 1997-2001 in the wake of the East Asia crisis. Despite a modest recovery in 2002-2003, memories of failed projects still block a rapid resumptions of infrastructure investment.

- Average credit quality in East Asia continued to nudge up in 2003, building on improvements since 2001. One factor contributing to the improvement was the continuing fall in net external debt of East Asia since the late 1990s. The total external debt of East Asia declined to 26 percent of the region's GDP in 2003 from 38 percent in 1999.

East Asia and Pacific outlook in summary, 1981-2004

	1981-90	1991-00	1998	1999	2000	2001	2002	2003e	2004f
Real economy									
(percent change, unless stated)									
Real GDP growth	7.3	7.7	0.6	5.6	7.2	5.6	6.7	7.7	7.4
Private consumption per capita	5.6	5.4	-0.6	4.4	6.0	4.2	4.6	5.4	5.4
GDP per capita	5.7	6.3	-0.5	4.6	6.2	4.7	5.8	6.8	6.6
Population	1.6	1.3	1.1	1.0	0.9	0.9	0.9	0.8	0.8
Gross Domestic Investment / GDP /a.	23.2	28.7	31.7	30.4	31.4	32.7	34.7	38.2	39.5
Inflation /b.	5.5	5.6	9.2	0.0	4.9	2.1	3.6	2.8	3.8
Central Gvt budget balance / GDP	-1.3	-1.2	-1.5	-2.3	-3.3	-3.3	-3.4	-2.9	-3.1
Export Market Growth /c	6.7	8.3	-1.6	7.7	14.7	-2.3	4.1	7.0	10.4
Export Volume /d.	8.2	11.5	3.2	4.1	22.6	2.4	15.6	21.1	18.3
Terms of Trade / GDP /e.	0.1	0.3	0.2	-0.3	-0.3	-0.5	0.1	0.1	-0.3
Current Account / GDP	-1.4	0.4	4.5	4.2	3.5	2.4	3.4	2.6	1.7
Workers Remittances ($ billion)	--	9.1	9.8	12.1	12.2	13.7	17.0	17.6	--
Memorandum item:									
GDP growth: East Asia excluding China	5.6	4.6	-9.5	3.1	5.8	2.4	4.4	5.0	5.9

External Financing and Debt	1995	1996	1997	1998	1999	2000	2001	2002	2003e
(billions of dollar unless stated)									
Net inward FDI	50.8	58.6	62.1	57.7	50.0	44.2	48.2	54.8	56.8
Net inward portfolio equity flows	6.3	9.7	-3.9	-3.4	2.3	4.8	1.0	3.5	4.8
Net inward debt flows	54.1	52.2	44.9	-32.5	-12.2	-17.7	-8.1	-10.9	0.5
From public sources	9.1	3.6	17.3	14.7	12.6	7.0	3.2	-7.8	-8.9
From private sources	45.0	48.6	27.6	-47.1	-24.7	-24.7	-11.3	-3.1	9.4
Gross Market Based Capital Inflows	60.0	71.5	76.2	27.3	28.2	48.3	20.1	40.9	48.5
Total External Debt	455.6	490.4	526.3	533.2	538.6	497.3	501.3	497.4	514.7
Medium and Long Term	346.8	365.3	394.3	447.2	464.8	434.1	410.5	397.9	402.7
Short Term	108.8	128.7	132.1	85.9	73.8	63.2	90.8	99.5	112.1
Owed by Public Sector Borrowers	256.7	256.8	272.0	288.6	307.5	284.7	277.7	277.8	287.4
Owed by Private Sector Borrowers	198.9	237.2	254.4	244.6	231.1	212.6	223.6	219.6	227.3
Owed to Public Sector Creditors	160.9	153.7	152.5	179.1	200.3	188.2	180.5	183.3	190.9
Owed to Private Sector Creditors	294.7	340.3	373.8	354.1	338.3	309.1	320.8	314.1	323.8
Gross Foreign Exchange Reserves	154.5	199.7	212.5	233.2	262.5	272.6	320.3	408.3	544.5

-- Not Available

Note: e = estimate, *f* = forecast.

a. Fixed investment, measured in real terms.

b. Local currency GDP deflator, median.

c. Weighted average growth of import demand in export markets.

d. Goods and non-factor services.

e. Change in terms of trade, measured as a percentage of GDP.

External financing: East Asia and the Pacific, 1997-2003
(billionsof dollars)

	1997	1998	1999	2000	2001	2002	2003e
Current account balance	17.0	59.4	60.0	53.3	39.4	61.0	51.3
as % GDP	1.2	4.5	4.2	3.5	2.4	3.4	2.6
Financed by:							
Net equity flows	58.2	54.2	52.3	49.0	49.2	58.3	61.6
Net FDI inflows	62.1	57.7	50.0	44.2	48.2	54.8	56.8
Net portfolio equity inflows	-3.9	-3.4	2.3	4.8	1.0	3.5	4.8
Net debt flows	44.9	-32.5	-12.2	-17.7	-8.1	-10.9	0.5
Official creditors	17.3	14.7	12.6	7.0	3.2	-7.8	-8.9
World Bank	2.0	2.8	2.4	1.8	0.9	-1.7	-1.5
IMF	5.9	7.0	1.9	1.2	-2.5	-2.7	-0.5
Others	9.3	4.8	8.2	3.9	4.8	-3.4	-6.9
Private creditors	27.6	-47.1	-24.7	-24.7	-11.3	-3.1	9.4
Net M-L term debt flows	22.9	-3.8	-10.9	-14.6	-12.0	-10.8	-2.7
Bonds	13.3	0.7	0.9	-1.6	0.7	0.8	5.8
Banks	4.0	-4.8	-11.4	-11.6	-10.9	-9.4	-4.9
Others	5.7	0.3	-0.4	-1.3	-1.8	-2.2	-3.5
Net short-term debt flows	4.7	-43.3	-13.9	-10.1	0.7	7.7	12.1
Balancing item *	-107.3	-60.5	-70.8	-74.5	-32.9	-20.4	22.8
Change in reserves (- = increase)	-12.8	-20.7	-29.3	-10.1	-47.7	-88.0	-136.2
Memo items:							
Bilateral aid grants (excluding technical co-operation grants)	2.4	2.5	2.5	2.5	2.2	2.2	2.2
Net private flows (debt+equity)	85.8	7.1	27.6	24.3	38.0	55.2	71.0
Net official flows (aid+debt)	19.6	17.1	15.1	9.5	5.4	-5.6	-6.7
Workers' remittances	15.9	9.8	12.1	12.2	13.7	17.0	17.6

Note : e = estimate

a. Combination of errors and omissions and net acquisition of foreign assets (including FDI) by developing countries