

Appendix

Regional Economic Prospects

East Asia and the Pacific regional prospects

Recent developments

The economies of East Asia and the Pacific continued to expand rapidly in 2006, with regional gross domestic product (GDP) estimated to have increased 9.2 percent in 2006, the highest regional growth rate since 2001.¹ Once again China led the region with 10.4 percent growth.

Growth in Vietnam was also very robust at 8 percent. Growth in the region excluding China is expected to reach a more modest 5.4 percent, the same as in 2005 (table A.1).

Rapid investment growth, and a surge in exports as new capacity came on stream, saw the Chinese economy expand by 10.7 percent (year-over-year) in the first nine months of 2006. Robust expansion in credit and money supply, in part fueled by strong balance of

Table A.1 East Asia and the Pacific forecast summary

Annual percent change (unless otherwise indicated)

	1991–2000 ^a	2003	2004	2005	Estimate	Forecast	
					2006	2007	2008
GDP at market prices (2000 US\$) ^b	8.3	8.8	9.0	9.0	9.2	8.7	8.1
GDP per capita (units in US\$)	6.9	7.8	8.1	8.1	8.3	7.8	7.2
PPP GDP ^c		8.9	9.2	9.2	9.3	8.8	8.2
Private consumption	7.3	6.1	7.3	7.7	6.0	6.5	7.3
Public consumption	7.3	5.3	6.3	5.9	4.0	6.3	6.4
Fixed investment	9.7	17.0	11.8	9.6	8.9	11.7	9.0
Exports, GNFS ^d	12.4	17.8	22.4	17.7	16.1	12.7	11.9
Imports, GNFS ^d	12.0	17.0	19.4	12.5	13.1	14.0	12.8
Net exports, contribution to growth	1.2	5.3	7.0	9.6	11.4	11.3	11.2
Current account balance/GDP (%)	0.4	3.5	3.4	5.8	7.0	6.4	5.9
GDP deflator (median, LCU)	6.6	3.4	4.2	3.0	2.7	4.7	3.4
Fiscal balance/GDP (%)	-0.8	-2.5	-1.8	-1.3	-1.1	-1.1	-1.0
<i>Memo items: GDP</i>							
East Asia, excluding China	5.9	5.5	6.1	5.4	5.4	5.7	5.9
China	9.5	10.0	10.1	10.2	10.4	9.6	8.7
Indonesia	3.3	4.9	5.1	5.6	5.5	6.2	6.5
Thailand	3.6	7.0	6.2	4.5	4.5	4.6	5.0

Source: World Bank.

a. Growth rates over intervals are compound averages; growth contributions, ratios, and the GDP deflator are averages.

b. GDP is measured in constant 2000 U.S. dollars.

c. GDP is measured at PPP exchange rates.

d. Exports and imports of goods and nonfactor services.

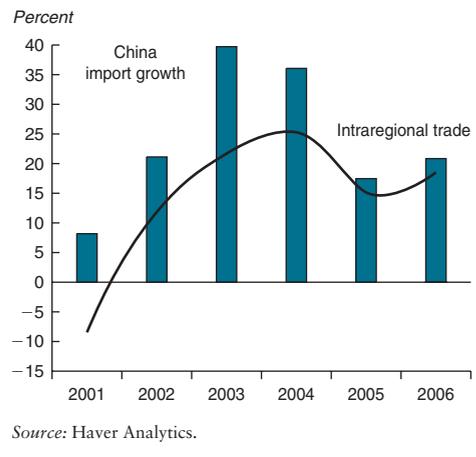
payments inflows, helped support an acceleration in domestic demand, whose contribution to growth increased to an estimated 7.3 percentage points in 2006, up from 5.6 percentage points the year before. Investment demand was particularly strong in the first half of the year, but efforts to contain it via tighter monetary policy and sector-specific administrative measures² resulted in a modest slowing of GDP in the third quarter to a 10.4 percent pace.

Notwithstanding an estimated 20.3 percent increase in the volume of exports during the course of the year, the contribution of the external sector to growth may turn out marginally lower than in 2005 because imports accelerated compared with 2005, increasing by an estimated 16.7 percent. Nevertheless, China's trade surplus increased further, reaching \$110 billion during the first nine months of the year, already higher than the total for all of 2005, and its international reserves now exceed \$1 trillion. Moreover, owing to years of annual export growth of more than 20 percent, China overtook the United States as the world's second-largest exporting nation during the course of this year.

Growth in the rest of the region has also been robust—if less spectacular—with smaller countries averaging a broadly stable 5.4 percent growth rate. A rebound in global high-tech demand and stronger import demand from China prompted an acceleration of exports (figure A.1), which offset weaker domestic demand growth owing to higher oil prices and a widespread tightening of monetary policies around the region, together with fiscal tightening in some economies.

Outturns across countries were varied, ranging from an estimated high of 8 percent in Vietnam to close to zero growth in the Solomon Islands. In Indonesia, growth slowed at the end of 2005 and in early 2006 as domestic demand eased following a \$10 billion reduction of fuel subsidies in the latter part of 2005, a series of natural disasters, and monetary and fiscal policy tightening.³ Activity appears to be picking up now, with monthly indicators suggesting a strong rebound in

Figure A.1 China's import demand is a big support for regional exporters

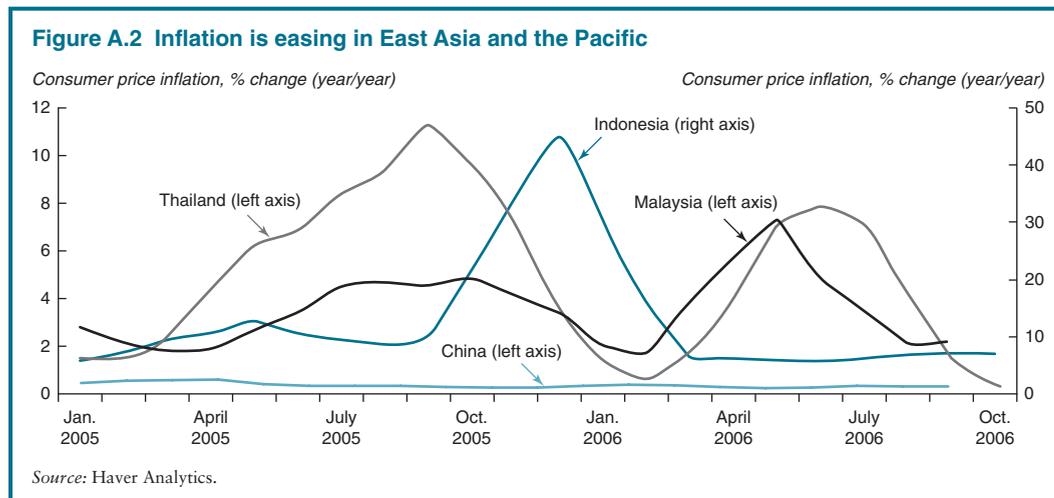


domestic consumption and investment. GDP is expected to increase by 5.5 percent for the year as a whole. Vietnam's 8 percent growth has been backed by across-the-board strength in exports, domestic consumption, and investment. Both Malaysia and the Philippines are estimated to have grown by about 5.5 percent. This robust result in the Philippines occurred despite a substantial tightening of fiscal policy, whose effects on GDP were countered by a recovery in agriculture and strong growth of electronic exports, outsourced back office services, and remittance inflows. In Thailand growth was flat at 4.5 percent in 2006, as depressed domestic demand (reflecting high oil prices, political uncertainty, and turmoil) offset a rebound in export activity. Cambodia is estimated to have grown an unprecedented 13.4 percent in 2005, driven by solid garment exports, strong tourism receipts, significant growth in foreign direct investment (FDI), a continuing construction boom, and record agricultural crops. Growth in Fiji in 2006 was more modest at 3.1 percent, reflecting robust expansions in the agriculture, forestry, fishing, and services sectors. GDP is estimated to have increased by more than 7 percent in both the Lao People's Democratic Republic and

Mongolia. The outturn in the Lao PDR reflects improved monetary and fiscal policy discipline, trade reforms, private sector development, and public financial management, while in Mongolia industrial production, mining, and foreign direct investment have been the main drivers of growth. Although the petroleum sector continued to grow rapidly in Timor-Leste, political turmoil caused non-oil GDP to stagnate and per capita incomes likely declined.

Overall, the region's current account surplus increased to about 7 percent of regional GDP. Excluding China, the change was more modest—from 2.3 to 3 percent of GDP—and reflects a number of factors, notably the acceleration in Chinese import demand and the strengthening of the high-tech cycle. In several countries, weaker domestic demand due to a tightening of macroeconomic policy (Indonesia, Thailand) and/or political turmoil (Solomon Islands, Thailand, Timor-Leste) also contributed, while in several countries high oil and mineral prices played a role (Indonesia, Lao PDR, Mongolia, Papua New Guinea, Solomon Islands, and Vietnam). In others, intensified competition in the garment sector and rising fuel prices placed current accounts under serious pressure and prompted a worrisome decline in foreign reserves. In Fiji, for example, the value of reserves has fallen to less than that of three months of imports.

Inflationary pressures in the region had picked up because of higher oil prices and sustained rapid growth. However, they appear to have peaked in 2006, owing to rapid productivity growth, a generalized tightening of monetary policy in the region, and currency appreciation in a number of economies. Following a build-up in inflationary pressure beginning in 2004 several central banks in the region increased policy interest rates. During 2006, both headline and core inflation were stable or easing in most of the larger economies in the region (figure A.2). In China, despite the strong expansion, inflation remains low at 1.6 percent in September, although prices in the service and housing sectors are rising more quickly (2 and 4.7 percent, respectively). In Indonesia and Thailand, inflation has declined after picking up following the removal of fuel subsidies in 2005, and it is projected to reach central bank targets in the course of 2006. Inflation has also declined in the Philippines, from 7.9 percent in 2005 to 5.7 percent in September, despite an increase in value-added taxes. In Timor-Leste inflation spiked to nearly 7 percent in the year to June 2006, driven by higher transportation costs. These developments have allowed central banks to keep policy rates stable, and in the case of Indonesia, to begin easing.



Regional equity markets were subject to the general correction affecting many emerging markets in May–June 2006. However, spreads on bonds remain low, and equity markets began recovering in August, suggesting that markets continue to judge the region’s fundamentals favorably. The cut in Indonesian fuel subsidies and improved fiscal balances contributed to the appreciation of the currency, a 40 percent up-tick in stock market valuations, and ratings upgrades.

Medium-term outlook

Looking forward, growth is expected to moderate somewhat, with GDP for the region as a whole increasing by 8.1 percent in 2008.

The outlook for China’s economy remains favorable. GDP is projected to slow from 10.4 percent in 2006 to about 8.7 percent in 2008. While export growth rates are projected to decelerate toward 14 percent, continued robust investment demand and a pickup in private consumption should maintain GDP growth at high rates.

For the moment, signs of overheating are limited to specific sectors and regions. Production capacity continues to expand in line with demand, inflation remains low, and the current account is in surplus—all of which augurs well for a soft landing. However, high investment rates and excess capacity in several sectors dominated by state-owned enterprises leave open the possibility of a sharp decline in investment. Moreover, while much of recent investment has been financed by retained earnings and has occurred in relatively open and commercial sectors, the risk that some of these investments will prove uneconomic and prompt an important increase in bad loans remains real.

Excluding China, growth is actually projected to strengthen somewhat from 5.4 to 5.9 percent by 2008. Having adjusted to the oil price shock of the last three years, oil-importing economies in the region should now derive modest benefits from the fall in world oil prices in the second half of 2006 and from the stabilization and further gradual declines in oil prices that are forecast. Continued strong import

demand from China, growth in exports to other fast-growing developing markets, and further competitive gains in market share are expected to partially offset weaker demand from Europe and the United States, so that export demand grows by about 8 percent annually. Given earlier tightening and stable inflation, central banks are expected to continue easing monetary policy in 2007, which should help bolster domestic demand in case of a significant export-led slowdown. In addition, high capacity utilization rates and continued efforts to strengthen the investment climate should stimulate investment and domestic demand more generally, permitting a modest acceleration in growth rates in a number of countries (Indonesia, Philippines, and Thailand). Elsewhere, growth is projected to remain stable (Malaysia, Papua New Guinea, Samoa, and Vietnam) or decline somewhat (Cambodia, Fiji).

Risks and policy challenges

Given the region’s large current account surplus, economic pressures for the revaluation of developing Asian currencies are likely to intensify. The 2.5 percent appreciation of the renminbi against the dollar since the beginning of the year is a modest step toward alleviating these pressures. An appreciation of Asian currencies would make imports more competitive, reduce capital inflows, and promote a switch in investment spending toward the nontradables sector, helping alleviate global imbalances and fostering a more balanced development path at home. At the domestic level it would help reduce inflationary pressures, improve capabilities for domestic macroeconomic management, steady asset markets, and improve living standards for local populations. Should regional surpluses not stabilize, there is a risk that protectionist pressures in some of the region’s markets will build possibly to the detriment of growth and medium-term prospects. While the recent decision by Chinese authorities to partially liberalize capital outflows should help reduce the upward pressure on the renminbi and the need to accumulate reserves, likely more needs to be done to reorient the economy

Table A.2 East Asia and the Pacific country forecasts

Annual percent change (unless otherwise indicated)

	1991–2000 ^a	2003	2004	2005	Estimate 2006	Forecast 2007	2008
Cambodia							
GDP at market prices (2000 US\$) ^b		7.0	10.0	13.4	8.9	6.5	7.0
Current account balance/GDP (%)		-3.6	-3.9	-6.4	-13.7	-10.7	-7.7
China							
GDP at market prices (2000 US\$) ^b	9.5	10.0	10.1	10.2	10.4	9.6	8.7
Current account balance/GDP (%)	1.5	2.8	3.6	7.1	8.5	7.5	7.0
Fiji							
GDP at market prices (2000 US\$) ^b	2.1	3.0	5.3	0.7	3.1	2.2	2.5
Current account balance/GDP (%)	-3.1	-8.3	-17.0	-17.1	-10.3	-6.1	-1.9
Indonesia							
GDP at market prices (2000 US\$) ^b	3.3	4.9	5.1	5.6	5.5	6.2	6.5
Current account balance/GDP (%)	-0.4	3.5	0.6	0.3	0.8	0.2	-0.5
Lao PDR							
GDP at market prices (2000 US\$) ^b		6.1	6.4	7.0	7.3	6.6	6.9
Current account balance/GDP (%)		-8.2	-14.3	-19.9	-14.6	-24.9	-23.6
Malaysia							
GDP at market prices (2000 US\$) ^b		5.4	7.2	5.2	5.5	5.5	5.5
Current account balance/GDP (%)		12.9	12.9	15.6	14.8	14.8	15.2
Papua New Guinea							
GDP at market prices (2000 US\$) ^b	3.9	2.7	2.9	3.0	3.8	4.0	4.0
Current account balance/GDP (%)	2.3	11.2	2.2	13.5	8.0	7.0	4.9
Philippines							
GDP at market prices (2000 US\$) ^b	3.1	3.6	6.2	5.0	5.5	5.7	6.0
Current account balance/GDP (%)	-0.2	4.4	1.9	2.5	2.6	1.8	1.5
Samoa							
GDP at market prices (2000 US\$) ^b	2.7	-1.0	3.1	3.0	3.0	3.5	3.5
Current account balance/GDP (%)	-8.4	5.0	-4.5	-7.3	0.1	0.2	0.0
Thailand							
GDP at market prices (2000 US\$) ^b	3.6	7.0	6.2	4.5	4.5	4.6	5.0
Current account balance/GDP (%)	-1.2	5.5	2.9	-1.5	0.2	2.2	2.5
Vietnam							
GDP at market prices (2000 US\$) ^b	7.0	7.3	7.8	8.4	8.0	7.5	7.5
Current account balance/GDP (%)		-4.9	-2.0	-0.4	2.4	0.1	-1.7

Source: World Bank.

Note: Growth and current account figures presented here are World Bank projections and may differ from targets contained in other Bank documents. Kiribati, Dem. Rep. of Korea, N. Mariana Islands, Marshall Islands, the Federated States of Micronesia, Mongolia, Myanmar, Palau, American Samoa, Solomon Islands, Timor-Leste, and Tonga are not forecast owing to data limitations. a. Growth rates over intervals are compound averages; growth contributions, ratios, and the GDP deflator are averages. b. GDP is measured in constant 2000 U.S. dollars.

toward domestic demand, perhaps by placing more emphasis on developing sectors that service the domestic as opposed to the external sectors of the economy.

Other important risks to the region include a sharper-than-projected slowdown in the United States. This would likely imply both a

significant direct reduction in demand for the region's exports and an indirect impact as global growth slows. Slower extraregional trade growth would also weaken intraregional trade growth. Reduced global demand would weaken commodity prices more quickly than projected, with additional negative impacts for

resource-rich countries in the region (for example, Indonesia, Mongolia, Papua New Guinea, and Vietnam).

Overall, the region's export performance has relied much more heavily on increasing its share in global markets than on rapidly rising import demand. As a result, while growth in the region will be sensitive to a slowing in the growth of high-income countries, even in the face of a serious U.S. recession, output in the region is unlikely to slow by much more than 1 or 2 percentage points. Indeed, such a slowing may be necessary in order to eliminate some of the capacity constraints and macroeconomic tensions that have become apparent in the region.

As indicated, most of the larger economies in the region are running current account surpluses and are holding exceptionally large foreign exchange reserves and are therefore less vulnerable to a sharp deterioration in international financial conditions. Some low-income countries with large current account deficits such as Cambodia are also recipients of significant development aid inflows. One area of note is the need for prudent management of high commodity price-driven windfall gains in small low-income minerals and other commodity-exporting economies such as Mongolia and Papua New Guinea. In Mongolia, for example, where the stock of external debt exceeds 70 percent of GDP, the debt burden could become unsustainable if international commodity prices were to fall substantially. In this context, efforts by the government to work out a revised debt management strategy and articulate medium-term priorities for domestic and external borrowing will be important.

Europe and Central Asia regional prospects

Recent developments

GDP growth in Europe and Central Asia is estimated to have accelerated to 6.4 percent in 2006, up from 6 percent in 2005 (table A.3). Growth in the region continued to be heavily influenced by high oil prices, with the very

rapid growth of oil exporters (estimated at 7.3 percent in 2006) generating substantial export demand for regional oil importers. The latter's economies are expected to have expanded by 5.9 percent. Growth is broad-based in the region. Only 2 of the 23 European and Central Asian countries covered in these projections (Moldova, growing at 3 percent, and Hungary at 3.8 percent) are expected to experience growth below 4 percent in 2006.

While the growth picture is very similar for oil importers and oil exporters (including natural gas exporters), the situation on current accounts is strikingly different. Oil exporters are enjoying an estimated average surplus of nearly 10 percent of GDP in 2006, while importers are facing an estimated average deficit of 5.9 percent of GDP. Similar, albeit less extreme, is the fiscal situation, with a projected 7.9 percent of GDP surplus in oil-exporting countries and a projected 2.6 percent deficit in oil-importing countries. As a consequence of these different positions, the challenges facing these countries are very different. While oil exporters have to focus on management of surpluses in a sustainable way, oil importers, having become vulnerable to swings in conditions in international financial markets, need to focus on consolidating their fiscal positions and hastening adjustment to high oil prices.

Domestic demand continues to drive the expansion among oil exporters, as oil revenues are channeled into the domestic economy via government transfers, the wage bill of civil servants, and various investment programs. Domestic demand rose an estimated 11.3 percent among regional oil exporters in 2006, with private consumption up 12.4 percent. Notwithstanding growing constraints on foreign partnerships in the energy sector, investment in the Russian Federation expanded by an estimated 13.4 percent. Overall, exports rose for oil exporters by 7.8 percent, reflecting expanded output and production capacity, including the opening of the Baku-Tbilisi-Ceyhan (BTC) pipeline. Nevertheless, volume growth of imports outstripped that of exports by a wide margin, expanding by an estimated