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## ACRONYMS AND NOTES

ADB	Asian Development Bank
ADO	<i>Asian Development Outlook</i>
ASEAN	Association of Southeast Asian Nations
CARs	Central Asian republics
CPI	consumer price index
DMC	developing member country
ECB	European Central Bank
EU	European Union
FDI	foreign direct investment
f.o.b.	free on board
FY	fiscal year
GDP	gross domestic product
IBRA	Indonesian Bank Restructuring Agency
IMF	International Monetary Fund
ICT	information and communications technology
NIEs	newly industrialized economies
NPL	nonperforming loan
OECD	Organisation for Economic Co-operation and Development
PRC	People's Republic of China
R&D	research and development
SBI	Sertifikat Bank Indonesia (Bank Indonesia Certificate)
SME	small and medium enterprise
SOE	state-owned enterprise
US	United States
VAT	value-added tax
WPI	wholesale price index
WTO	World Trade Organization

Billion is 1,000 million.

Trillion is 1,000 billion.

Unless otherwise specified, the symbol \$ means United States dollars; dollars are current US dollars.

— means that data are not available.

Quarterly growth figures are relative to the previous quarter on a seasonally adjusted annualized rate (unless otherwise specified). When rates relate to the same period in the previous year, they are denoted as year on year.

This *Asian Development Outlook 2001 Update* is based on the latest data made available at publication.

This *Update* does not cover all the developing member economies on the same chapter-by-chapter basis as was used in the *Asian Development Outlook 2001*. Hence, some of the smaller economies are dealt with in subregional overviews.

## FOREWORD

The economic outlook for developing Asia and the Pacific has changed significantly since the *Asian Development Outlook 2001* was published in April 2001. The 11 September terror attacks on the United States and the subsequent military response have exacerbated a global economic slowdown that was already more severe than was expected in April. Accordingly, this *Asian Development Outlook 2001 Update* reviews macroeconomic trends in the developing member countries of the Asian Development Bank (ADB) and revises April's economic forecasts for 2001 and 2002. An attempt has been made, in close cooperation with ADB staff in operations, to incorporate preliminary assessments of the economic impact of the attacks and the subsequent military response on the economies of developing Asia and the Pacific. However, events are still unfolding. There is a high level of uncertainty in the global environment and the economic outlook is changing by the day. The *Update* nevertheless is cautiously optimistic that, on the whole, developing Asia and the Pacific will continue to register healthy economic growth in 2001 and 2002 when compared with other regions in the world.

The *Update* was prepared by ADB's Economic Analysis and Research Division (EDAN), in collaboration with the Programs Departments and Office of Pacific Operations. The *Update* was put together by a team led by Brahm Prakash, Assistant Chief Economist (EDAN), comprising Cindy Houser, Sailesh Jha, Christine Kuo, Purnima Rajapakse and assisted by Charissa Castillo and James Villafuerte. Under the guidance of Charles Adams, the chapter "Outlook for Developing Asia and the Pacific" was prepared by Cindy Houser. Purnima Rajapakse processed and finalized the chapters on the subregions and individual economies. The contributors included Padmini Desikachar (Viet Nam), Yu-shu Feng (Thailand), David Green (Indonesia), Cindy Houser (Republic of Korea; Taipei, China; and the Newly Industrialized Economies), Sailesh Jha (Malaysia and Southeast Asia), Abid Hussain (Pakistan), Rezaul Khan (Bangladesh), Christine Kuo (Hong Kong, China; and Singapore), Xuelin Liu (Philippines), Elisabetta Marmolo (India), Long Yun Peng (People's Republic of China), Purnima Rajapakse (South Asia), Diwesh Sharan (Papua New Guinea and Pacific island developing member countries), and Tao Zhang and Masaaki Nagata (Central Asian republics, Azerbaijan, and Mongolia).

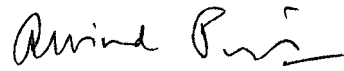
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I take this opportunity to thank all contributors, and earnestly hope that readers will find the *Update* useful. ADB welcomes feedback on the *Update* via telephone (++632 632 4444), fax (++632 636 2444), or email (ado2001update@adb.org).



Arvind Panagariya

*Director and Chief Economist*

*Economics and Development Resource Center*

Manila

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## OUTLOOK FOR DEVELOPING ASIA AND THE PACIFIC

**T**he global slowdown in economic activity is turning out to be deeper, more synchronized across major economies, and more persistent than expected in April 2001 when the Asian Development Outlook 2001 (ADO 2001) was released. In addition, and beyond the immediate loss of life and property, the 11 September terror attacks on the United States and subsequent military actions have disrupted economic activity and adversely affected sentiment toward the economic outlook. Thus, this ADO 2001 Update (the Update) anticipates that the global recovery previously expected to begin in late 2001 will be delayed and only become firmly established by the middle of 2002. As a consequence, near-term projections for growth in developing Asia and the Pacific (the developing member countries of the Asian Development Bank) have been revised downward.

Against a background of considerable uncertainty, a number of significant downside risks to the economic outlook remain and may have intensified. These include those associated with the synchronized nature of the global slowdown, the current account imbalance in the United States, the fragile condition of the Japanese economy, and the possibility of further disruptions to economic activity in the aftermath of the 11 September attacks. The attacks added to an already uncertain outlook for global trade and have increased risk aversion, raising the cost of capital market access for some vulnerable countries. There are reasons, nevertheless, for cautious optimism related to the underlying strength and resilience of the global economy, the considerable macroeconomic stimulus already initiated, and the intention of policymakers to take additional measures as needed to mitigate the severity of the slowdown.

Based on this assessment, real economic growth in developing Asia and the Pacific is now expected to fall from 7.0 percent in 2000 to 3.4 percent in 2001, with a modest rebound in 2002 and stronger performance in 2003. Underlying the economic slowdown across the region in 2001 is a large diversity in economic performance, with the newly industrialized economies undergoing the sharpest slowdown, while the People's Republic of China and India sustain relatively robust growth.

The first part of this chapter appraises recent developments in, and the outlook for, the three major world economies. The second part reviews recent economic developments in the region, summarizes the current 2001-2002 forecasts—as revised from the ADO 2001 forecasts—and assesses the risks to those forecasts.

## External Economic Developments and Outlook

### Introduction

The 11 September terror attacks on the United States (US) impacted a world economy in which the pace of activity was slowing to a surprising degree. The slowdown in global economic performance in the first half of 2001 was sharper and more synchronized across major economies than expected at the time of *ADO 2001*. The deterioration of the information, communications, and technology (ICT) sector that began in mid-2000 in the US broadened to other sectors by mid-2001 and deepened into a general demand-driven global cyclical slowdown. Aggressive monetary easing (especially in the US) as well as “new economy” relationships were initially expected to bring about rapid adjustments that would result in a relatively swift rebound in 2001 and a return to reasonably robust expansion in 2002. However, the magnitude of the reduction in US demand and its spillover effects to Europe and Japan were underestimated. Moreover, the extent to which world trade would be reduced was not anticipated. Then, amid signs of yet further weakening in the global economy, the September attacks abruptly disrupted US economic activity and significantly increased uncertainty over future global economic conditions. Box 1.1 reviews the global macroeconomic effects of the attacks.

Prior to the attacks, policymakers in the three major economies of the US, Japan, and the euro area (European Union members except Denmark, Sweden, and United Kingdom) had become increasingly confronted, as 2001 wore on, with negative economic news, such as deteriorating corporate profits, falling stock prices, rising unemployment, and faltering investor (and eventually consumer) confidence. Short-term interest rates began to fall in many economies as the focus shifted from inflationary pressures (which were ebbing) to the possibility of recession.

Optimism that US economic activity would rebound in the third quarter of 2001 had faded by midyear as did subsequent hopes for a modest US rebound in late 2001. Moreover, in the second quarter of 2001, economic conditions in Japan deteriorated significantly, and the pace of economic activity in the euro area slowed substantially. It is uncommon for these three major world economies—which together account for about 45 percent of world output and absorb nearly 50 percent of total exports from developing Asia and the Pacific—to be in simultaneous, mutually reinforcing slowdowns. Further, downward revisions to US productivity data (made before the attacks) reignited the debate about long-term trend growth prospects and further weakened the earnings outlook. With investor and consumer confidence then further shaken and financial markets falling sharply after the 11 September attacks, policymakers began to consider additional macroeconomic measures to preempt further weakening of the world economy. Together, these negative factors suggest that the slowdown in the global economy is likely to be sharper and more persistent than projected in *ADO 2001*, with recovery only beginning to take hold by the middle of 2002.

## Recent Developments in the Three Major World Economies

**Output and Employment.** The US economy was the first to slow, followed by Japan, and then the euro area. US real gross domestic product (GDP) growth, which fell to 1-2 percent, quarter on quarter, in the three previous quarters, further slowed to 0.3 percent in the second quarter of 2001. With US investment in a fourth (and exports in a third) consecutive quarterly contraction, consumption—which to that time had held up well—slowed to 2.5 percent growth in the second quarter of 2001, its smallest expansion in four years. As a consequence of these developments, manufacturing production shrank by about 4.0 percent in July 2001 relative to a year earlier, and shed over 860,000 jobs over the 12 months. This contributed to an increase in the unemployment rate from 4.0 percent in December 2000 to 4.5 percent in July 2001. In October 2001, with industrial production contracting for nearly a year, the unemployment rate jumped to 5.4 percent. According to data released by the Commerce Department on 31 October, because of the severe disruption to economic activity in September, the US economy contracted by 0.4 percent in the third quarter, year on year.

In Japan, the modest 2000 acceleration in growth had been expected to become a sustained, if mild, expansion that would bolster near-term economic prospects for developing Asia and the Pacific. Instead, economic activity weakened sharply in the first quarter of 2001, contracted by an annualized 3.2 percent, quarter on quarter, in the second quarter, and is expected to have contracted again in the third. The unexpected severity of the global ICT slowdown strongly affected the economy, which experienced double-digit contractions in export and private investment demand in the first and second quarters of 2001 after strong performance in the last quarter of 2000. Consumption sustained quarter-on-quarter growth of 2.0 percent in the second quarter but this is expected to have slowed to less than 1.0 percent growth in the third quarter as consumer confidence deteriorated along with the global outlook. With weak demand, industrial production has been on a downward trend for most of 2001, contracting by 11.7 percent in August 2001 from a year earlier. The unemployment rate reached a postwar high of 5.0 percent in the same month.

The euro area was expected to be relatively unaffected by the ICT

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