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*A GLOBAL ECONOMIC GROUP* ECONOMIC REPORT ON D-8 REGION (2000-2001)

DEVELOPING 8 COUNTRIES

**D-8**

*A GLOBAL ECONOMIC GROUP*

# ECONOMIC REPORT ON D-8 REGION
## (2000-2001)

**Istanbul, April 2003**

# ECONOMIC REPORT ON D-8 REGION
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# PART. I

# OVERALL ASSESSMENT

## Overall Assessment

As would be recalled, severe financial crisis, first started in the Far-Eastern countries in late 1990s then spread to other parts of the world including Russia and Latin America, not only hurt emerging markets but also affected global economic outlook. In order to repair serious damages to their economies, these countries undertook drastic measures and initiated as well structural reforms in major economic sectors including the banking, with financial support from international financing institutions and from the developed world. The signs of recovery in several countries including D-8 members emerged in 1999, especially in the year 2000.

However, as from 2001, the world economy was again faced with serious challenges, this time stemming primarily from the industrialised countries. Indeed, during the recent years, global economy slowed down substantially, stock markets experienced considerable volatility and world's major currencies underwent significant fluctuations. In the European Union, economic output declined and several members failed to meet Maastrich criteria concerning budget deficit and inflation rate. Japan is seriously concerned with its prolonged recession. On top of all these, the US economy came almost to a standstill.

This pessimistic economic outlook in the industrial world inevitably created serious repercussions on the economies of developing countries, certainly of D-8 members too as will be seen in the brief analysis presented herebelow.

The slowdown in major economies not only affected key production and services sectors in the emerging markets but also resulted in a setback in their exports owing to the contraction of demand, as well as in a loss of investor's confidence. Moreover, increasing rate of unemployment in several sectors is likely to have adverse consequences on their poverty alleviation programs. The negative trend of 2001 is also expected to undermine the prospects for 2002.

* * *

In 2000, **the GDP growth rates** in D-8 member countries ranged between 4 to 8 %, the lowest being in Nigeria and Pakistan (3,9 %), the highest in Malaysia (8,3 %) and in-between in the other five members (5-6 %). However, in the following year, due to the global slow down, growth rates in all the member countries declined without exception, to 0,4 % in Malaysia, 2,5-3 % in Nigeria and Pakistan, 3,5 % in Indonesia and about 5 % in Bangladesh, Egypt and the I.R. of Iran. In the special case of Turkey, the growth rate sharply went down to minus 7,4 %. In this instance, domestic economic problems played a key role, greater than the world economic conditions. Turkey experienced two severe shocks first in November 2000 and then in February 2001. As a matter of fact, during 1990s, Turkish economy had already suffered from high inflation and heavy public sector debt which reached 92 % of the GDP in 2001. Consequently, the capital and interest payments absorbed a larger part of the government budget. Under a new standby agreement with IMF, the Turkish Government, while radically curbing public spending, undertook radical structural reforms, including measures designed to strengthen banking sector and replacing pegged foreign exchange regime with a floating exchange rate, which resulted in a steep depreciation of the Turkish lira. Under these circumstances, the Turkish economy contracted.

In view of the continued world economic conditions, the prospect for 2002 in the member countries with the exception of Malaysia and Turkey remained more or less the same as the previous year's, perhaps with some slight improvements(*). In return, Malaysia, which recorded a growth rate of only 0,4 % in 2001, pursued expansionist policies to revive its economy while at the same time checking inflationary pressures of the higher spending. Indeed, the growth rate of Malaysia in 2002 is expected to reach about 4-5 %. In the case of Turkey, a big rebound was achieved from minus 7,4 % to plus 5,2 % last year.

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(*) Concerning major oil producing member countries such as the I.R. of Iran and Nigeria, one should also keep in mind that the rise and fall in oil prices have to be taken into account as an important factor in the evaluation of their economies. Indeed, increasing oil prices during recent years must have made significant contribution to the government revenues and foreign exchange receipts of these countries.

**As for the macro-economic stability and fiscal sustainability** of the member countries: Malaysia has the lowest inflation rate amongst the members, keeping it around 1,5 % although the government pursued in 2002 expansionist policies to revive the economy.

The highest inflation was recorded in Turkey. As a matter of fact, during the last two decades, Turkish economy had experienced high inflation rates, peeking 150 % in 1995. Following the deep crisis of 2001, the government took austerity measures and pursued deflationary monetary and fiscal policies to curb public spending and private consumption as well as investments. As a result, inflation was brought down from 68,5 % in 2001 to 29 % in 2002 in terms of consumer price index (CPI). The government is aiming at to bring it further down to a single digit rate in 2005.

In between these two lowest and highest rates, the inflation in Bangladesh, Egypt and Pakistan during the same period ranged from 2,4 % to 4 % which were indeed reasonable. In return, in Indonesia, the inflation rose from 2 % in 1999 to 12,6 % in 2001 and in Nigeria from 0,2 % to 18 % while in the I.R. of Iran declined from 20 % to 11,4% during the same period. The increase in the case of Indonesia can be explained with an increased public spending for fuel subsidies, social safety net programs and support to small and medium sized enterprises. In the case of Nigeria, higher incomes stemming from the rise of oil prices stimulated public spending and thus contributed to the sharp increase in inflation.

Amongst the member countries, it is again Turkey with the largest public debt, corresponding to 92 % of its GDP in 2001 and 81 % in 2002, of which a greater portion consists of domestic debt. Consequently, interest payments absorbing a significant part of the government budget not only presented a big burden for the whole economy but also created a serious problem of debt sustainability since larger portion of the domestic debt is short-term and the interest rates are quite high, much higher than inflation rates. Thus, a fiscal deficit of about 16 percent of GDP was recorded in 2001 which entirely stemmed from interest payments, despite the government's efforts to radically curb public spending.

Malaysia had an external debt of about USD 45 billion in 2001, corresponding to slightly over 50 % of its GDP, of which only 10 % is short-term. In view of the strength of its economy and foreign trade, the public debt of Malaysia is at manageable and sustainable level. Despite the fact that the government pursued expansionist economic policies to achieve a recovery in 2002, the fiscal deficit remained around 5 % of the GDP, which is much lower than Turkey's.

On the other hand, Bangladesh and Pakistan had more or less the same rates of fiscal deficits, that is about 6 % of their GDP during the period 2000-2002. Indonesia, while increasing public spending to support the programs mentioned above, took at the same time measures to improve fiscal sustainability in order to keep the deficit at about 3 % of the GDP.

Egypt eased its debt problems with the structural adjustment program supported by IMF Standby Agreement, structural adjustment loan from the World Bank and bilateral debt service relief with Paris Club. Hence, the debt service obligations of Egypt with a debt stock of 27 % of its GDP continued to steadily fall.

**The unemployment** is a general and long-standing phenomenon almost in all the member countries. During the period under review, hundreds of thousand of people lost their jobs in D-8 countries like in the rest of the world due to the global slowdown. Indeed, in Turkey unemployment rate jumped from 6,5 % in 2000 to 8,5 % in 2001 and nearly 10 % in 2002, as a great number of workers became jobless due to the severe contraction in the economy. Indonesia was also faced with a problem of almost the same rate, where unemployment rose from 6 % to 8 %. Amongst the remaining members, Malaysia had the lowest rate although it increased from 3,1 % in 2000 to 3,6 % in 2001. This rather small rise in unemployment as against the significant slowdown of the economy in 2001 as mentioned above was the result of alternative measures adopted by employers in the flexible labour market of Malaysia . With 16 %, the highest unemployment was recorded in the I.R. of Iran, while the ratio remained the same around 8 % in Egypt and Pakistan, perhaps with slight fluctuations. The two member countries, namely Bangladesh and Nigeria, each with a population over hundred million, must have also experienced an increased rate of unemployment in 2001 due to the same reasons although their statistics are not available.

**Export and import figures** of the member countries for 2000-2001 are indicated in the Table. I attached herewith. As will be observed, the global economic slowdown also adversely affected in varying degrees the exports of the member countries in 2001. Malaysia, Indonesia, Egypt, the I.R. of Iran and Nigeria had a marked decline in their exports while the performances of Bangladesh and Pakistan remained more or less at the same level in 2001. In the case of the four oil and gas producing countries, namely Egypt, Indonesia, I.R. of Iran and Nigeria, the decline in non-oil exports must have been even larger than revealed by the overall export figures, in which the share of export receipts from oil increased due to the rise in oil prices. This is especially valid for the I.R. of Iran and Nigeria. As for Turkey, its exports increased in spite of the global slowdown. This can partly be explained by that fact that the exporters must have turned their attention to foreign markets as the domestic demand shrunk as a result of sharp increase in inflation, making prices more expensive for the domestic consumers. On the other hand, the depreciation in the Turkish Lira made Turkey's export goods more competitive in world markets.

On the import side, as also indicated in the Table. I, the imports of Egypt, Indonesia, Malaysia and Turkey declined in 2001. With the exception of Turkey, in the other three countries, this may be linked with the decrease in their exports. Whereas the sharp drop in Turkey's imports could be explained by the drastic decline in private consumption, public spending and investments.

While the figures for Bangladesh and Pakistan remained more or less the same as in 2001, the imports of Iran and Nigeria increased by about 20 %.

In their foreign trade, four member countries, that is Indonesia, the I.R. of Iran, Malaysia and Nigeria recorded surpluses in 2001 like 2000. However, the margins diminished in all of them. Amongst the remaining four members, trade deficits of Egypt and Turkey sharply diminished while those of Bangladesh and Pakistan remained almost the same as before.

**As for the D-8 intra-trade**, as will be seen in Table. II, it increased from USD 14,562 billion in 1999 to USD 19,094 billion in 2000, a significant upsurge of over 30 %, which is a welcome development. It reflects the satisfactory economic performance of the member countries in 2000. All the member countries without exception succeeded to expand their trade with the other members. This is also in line with the increase of about 25 % in their overall trade with the whole world. Indeed, their overall trade increased from USD 397,127 billion in 1999 to USD 499,073 billion in 2000. Thus, the share of D-8 intra-trade in the total trade of the members with the world improved from 3,66 % to 3,82 %.

In 2001, as a result of the general decline in the economic performance of the member countries, their overall trade with the whole world decreased from USD 499,073 billion in 2000 to USD 449,548 billion in 2001, which represents a decline of about 10 %. Yet, the D-8 intra-trade remained almost at the same level of 2000, even with a slight rise, which resulted in an increase of the share of D-8 intra-trade in the total trade of the members with the world from 3,82 % in 2000 to 4,29 % in 2001. Hence, the D-8 intra-trade in 2001 has not been affected at all by the decline in their economic growth and their total trade with the world.(*)

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(*) The breakdown of the D-8 intra-trade is given in Table. III

Table. I

## RATIO OF INTRA D-8 TRADE TO THE D-8 TRADE WITH WORLD

### Bangladesh

*millions of US dollars*

| | Exports | | | Imports | | |
|---|---|---|---|---|---|---|
| | 1999 | 2000 | 2001 | 1999 | 2000 | 2001 |
| Trade with D-8 | 97 | 118 | 103 | 391 | 467 | 442 |
| Trade with World | 4520 | 5590 | 5736 | 8352 | 9001 | 9011 |
| D-8 Trade/ World Tr | 2.14% | 2.11% | 1.79% | 4.68% | 5.18% | 4.90% |

### Egypt

*millions of US dollars*

| | Exports | | | Imports | | |
|---|---|---|---|---|---|---|
| | 1999 | 2000 | 2001 | 1999 | 2000 | 2001 |
| Trade with D-8 | 125 | 191 | 130 | 779 | 956 | 540 |
| Trade with World | 3535 | 6287 | 4140 | 15962 | 21965 | 12720 |
| D-8 Trade/ World Tr | 3.53% | 3.03% | 3.14% | 4.88% | 4.35% | 4.24% |

### Indonesia

*millions of US dollars*

| | Exports | | | Imports | | |
|---|---|---|---|---|---|---|
| | 1999 | 2000 | 2001 | 1999 | 2000 | 2001 |
| Trade with D-8 | 2330 | 3145 | 3071 | 1011 | 1853 | 2393 |
| Trade with World | *48665 | * 62124 | * 56321 | * 24003 | * 33515 | * 30962 |
| D-8 Trade/ World Tr | 4.78% | 5.06% | 5.45% | 4.21% | 5.52% | 7.72% |

### I.R. of Iran

*millions of US dollars*

| | Exports | | | Imports | | |
|---|---|---|---|---|---|---|
| | 1999 | 2000 | 2001 | 1999 | 2000 | 2001 |
| Trade with D-8 | 841 | 1332 | 1275 | 370 | 599 | 792 |
| Trade with World | *21030 | *28461 | *23904 | *13433 | *15086 | *18129 |
| D-8 Trade/ World Tr | 3.99% | 4.68% | 5.33% | 2.75% | 3.97% | 4.36% |

## Malaysia

*millions of US dollars*

| | Exports | | | Imports | | |
|---|---|---|---|---|---|---|
| | 1999 | 2000 | 2001 | 1999 | 2000 | 2001 |
| Trade with D-8 | 2622 | 2859 | 2937 | 1928 | 2509 | 2506 |
| Trade with World | 84550 | 98153 | 88199 | 65491 | 82195 | 73857 |
| D-8 Trade/ World Tr | 3.10% | 2.91% | 3.32% | 2.94% | 3.05% | 3.39% |

## Nigeria

*millions of US dollars*

| | Exports | | | Imports | | |
|---|---|---|---|---|---|---|
| | 1999 | 2000 | 2001 | 1999 | 2000 | 2001 |
| Trade with D-8 | 204 | 531 | 606 | 366 | 419 | 434 |
| Trade with World | 12000 | 21685 | 20604 | 7609 | 8942 | 11484 |
| D-8 Trade/ World Tr | 1.7% | 2.44% | 2.94% | 4.81% | 4.68% | 3.78% |

## Pakistan

*millions of US dollars*

| | Exports | | | Imports | | |
|---|---|---|---|---|---|---|
| | 1999 | 2000 | 2001 | 1999 | 2000 | 2001 |
| Trade with D-8 | 383 | 512 | 468 | 1029 | 1100 | 935 |
| Trade with World | *8569 | *9202 | *9135 | *10309 | *10729 | *10340 |
| D-8 Trade/ World Tr | 4.46% | 5.56% | 5.12% | 9.98% | 10.25% | 9.04% |

## Turkey

*millions of US dollars*

| | Exports | | | Imports | | |
|---|---|---|---|---|---|---|
| | 1999 | 2000 | 2001 | 1999 | 2000 | 2001 |
| Trade with D-8 | 883 | 806 | 964 | 1203 | 1697 | 1724 |
| Trade with World | *29326 | *31664 | *35258 | *39773 | *54074 | *39748 |
| D-8 Trade/ World Tr | 3.01% | 2.54% | 2.73% | 3.02% | 3.13% | 4.33% |

For the reasons of uniformity and comparison, the figures of the Direction of Trade Statistics Yearbook 2002 are taken as basis to the extent they are compatible with those provided by the member countries. In few cases indicated above with (*), national figures are utilized as they differ from the Direction of Trade Statistics.

Table. II

## VOLUME OF D-8 TRADE

| | *millions of dollars* | | | *millions of dollars* | | | *percentage* | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Volume of Intra D-8 Trade (export-import)** | | | **Volume of Trade with World (export-import)** | | | **Ratio of D-8 IntraTrade/ D-8 World Tr.** | | |
| | **1999** | **2000** | **2001** | **1999** | **2000** | **2001** | **1999** | **2000** | **2001** |
| **Bangladesh** | 488 | 585 | 545 | 12872 | 14591 | 14747 | 3.79% | 4,00% | 3.69% |
| **Egypt** | 904 | 1147 | 670 | 19497 | 28252 | 16860 | 4.63% | 4.05% | 3.97% |
| **Indonesia** | 3341 | 4998 | 5464 | 72668 | 95639 | 87283 | 4.59% | 5.22% | 6.26% |
| **I.R. of Iran** | 1211 | 1931 | 2067 | 34463 | 43547 | 42033 | 3.51% | 4.43% | 4.91% |
| **Malaysia** | 4550 | 5368 | 5443 | 150041 | 180348 | 162056 | 3.03% | 2.97% | 3.35% |
| **Nigeria** | 570 | 950 | 1040 | 19609 | 30627 | 32088 | 2.90% | 3.10% | 3.24% |
| **Pakistan** | 1412 | 1612 | 1403 | 18878 | 19931 | 19475 | 7.47% | 8.08% | 7.20% |
| **Turkey** | 2086 | 2503 | 2688 | 69099 | 85738 | 75006 | 3.01% | 2.91% | 3.58% |
| **Total** | **14562** | **19094** | **19320** | **397127** | **498673** | **449548** | **3.66%** | **3.82%** | **4.29%** |

Source: Direction of Trade Statistics Yearbook 2002

Table. III

## D-8 INTRA-TRADE

### Bangladesh

*millions of US dollars*

| | Exports | | | Imports | | |
|---|---|---|---|---|---|---|
| Country | 1999 | 2000 | 2001 | 1999 | 2000 | 2001 |
| Egypt | 5 | 7 | 7 | 4 | 7 | 2 |
| Indonesia | 6 | 6 | 5 | 159 | 193 | 180 |
| I.R. of Iran | 33 | 36 | 37 | 28 | 20 | 10 |
| Malaysia | 6 | 8 | 5 | 90 | 128 | 146 |
| Nigeria | 1 | 2 | 1 | 3 | 2 | 6 |
| Pakistan | 25 | 35 | 26 | 85 | 93 | 86 |
| Turkey | 21 | 24 | 22 | 22 | 24 | 12 |
| **Total** | **97** | **118** | **103** | **391** | **467** | **442** |

### Egypt

*millions of US dollars*

| | Exports | | | Imports | | |
|---|---|---|---|---|---|---|
| Country | 1999 | 2000 | 2001 | 1999 | 2000 | 2001 |
| Bangladesh | 1 | 6 | *2 | 4 | 8 | 4 |
| Indonesia | 5 | 11 | 9 | 196 | 220 | 158 |
| I.R. of Iran | | | 4 | 13 | 16 | 11 |
| Malaysia | 13 | 14 | 10 | 196 | 247 | 112 |
| Nigeria | 3 | 4 | 7 | 2 | 2 | 1 |
| Pakistan | 7 | 28 | 21 | 11 | 50 | 10 |
| Turkey | 96 | 128 | 77 | 357 | 413 | 244 |
| **Total** | **125** | **191** | **130** | **779** | **956** | **540** |

### Indonesia

*millions of US dollars*

| | Exports | | | Imports | | |
|---|---|---|---|---|---|---|
| Country | 1999 | 2000 | 2001 | 1999 | 2000 | 2001 |
| Bangladesh | 182 | 242 | 163 | 6 | 8 | 5 |
| Egypt | 222 | 200 | 144 | 16 | 12 | 10 |
| I.R. of Iran | 101 | 147 | 143 | 37 | 93 | 90 |
| Malaysia | 1336 | 1972 | 2038 | 606 | 1131 | 1719 |
| Nigeria | 205 | 236 | 229 | 188 | 442 | 428 |
| Pakistan | 164 | 149 | 170 | 122 | 131 | 105 |
| Turkey | 120 | 199 | 184 | 36 | 36 | 36 |
| **Total** | **2330** | **3145** | **3071** | **1011** | **1853** | **2393** |

## I.R. of Iran

*millions of US dollars*

| | Exports | | | Imports | | |
|---|---|---|---|---|---|---|
| Country | 1999 | 2000 | 2001 | 1999 | 2000 | 2001 |
| Bangladesh | | 18 | 9 | | 40 | 41 |
| Egypt | *13 | *16 | 10 | | | 5 |
| Indonesia | *37 | 85 | 82 | *101 | 162 | 157 |
| Malaysia | 43 | 95 | 136 | 100 | 143 | 196 |
| Nigeria | | | | | | |
| Pakistan | 112 | 302 | 198 | *11 | 18 | 32 |
| Turkey | *636 | *816 | *840 | *158 | *236 | *361 |
| **Total** | **841** | **1332** | **1275** | **370** | **599** | **792** |

## Malaysia

*millions of US dollars*

| | Exports | | | Imports | | |
|---|---|---|---|---|---|---|
| Country | 1999 | 2000 | 2001 | 1999 | 2000 | 2001 |
| Bangladesh | 133 | 154 | 171 | 7 | 15 | 15 |
| Egypt | 310 | 225 | 210 | 13 | 16 | 10 |
| Indonesia | 1231 | 1707 | 1563 | 1757 | 2269 | 2241 |
| I.R. of Iran | 89 | 130 | 178 | 48 | 104 | 149 |
| Nigeria | 53 | 49 | 49 | 7 | 8 | 4 |
| Pakistan | 522 | 394 | 399 | 47 | 53 | 44 |
| Turkey | 284 | 200 | 367 | 49 | 44 | 43 |
| **Total** | **2622** | **2859** | **2937** | **1928** | **2509** | **2506** |

## Nigeria

*millions of US dollars*

| | Exports | | | Imports | | |
|---|---|---|---|---|---|---|
| Country | 1999 | 2000 | 2001 | 1999 | 2000 | 2001 |
| Bangladesh | 3 | 1 | 5 | 1 | 2 | 1 |
| Egypt | 1 | 2 | *1 | 4 | 4 | 8 |
| Indonesia | 171 | 401 | 389 | 226 | 260 | 252 |
| I.R.of Iran | | | | | | |
| Malaysia | 6 | 7 | 4 | 58 | 54 | 53 |
| Pakistan | 1 | | | 36 | 49 | 44 |
| Turkey | 22 | 120 | 207 | 41 | 50 | 76 |
| **Total** | **204** | **531** | **606** | **366** | **419** | **434** |

**Pakistan**

*millions of US dollars*

| Country | Exports 1999 | Exports 2000 | Exports 2001 | Imports 1999 | Imports 2000 | Imports 2001 |
|---|---|---|---|---|---|---|
| Bangladesh | 106 | 141 | 119 | 28 | 37 | 26 |
| Egypt | 34 | 46 | 45 | 37 | 31 | 31 |
| Indonesia | 121 | 111 | 95 | 175 | 171 | 187 |
| I.R. of Iran | 11 | 17 | 29 | 81 | 332 | 218 |
| Malaysia | 42 | 54 | 53 | 560 | 446 | 435 |
| Nigeria | 33 | 44 | 40 | 1 | | |
| Turkey | 36 | 99 | 87 | 147 | 83 | 38 |
| **Total** | **383** | **512** | **468** | **1029** | **1100** | **935** |

**Turkey**

*millions of US dollars*

| Country | Exports 1999 | Exports 2000 | Exports 2001 | Imports 1999 | Imports 2000 | Imports 2001 |
|---|---|---|---|---|---|---|
| Bangladesh | 26 | 26 | 15 | 25 | 26 | 22 |
| Egypt | 467 | 376 | 421 | 109 | 141 | 92 |
| Indonesia | 29 | 30 | 32 | 165 | 231 | 202 |
| I.R. of Iran | 158 | 236 | 361 | 636 | 816 | 840 |
| Malaysia | 37 | 39 | 35 | 219 | 269 | 239 |
| Nigeria | 37 | 46 | 69 | 24 | 132 | 228 |
| Pakistan | 129 | 53 | 31 | 25 | 82 | 101 |
| **Total** | **883** | **806** | **964** | **1203** | **1697** | **1724** |

**Source:** As some members could not provide them, all the intra-trade figures are taken from the Direction of Trade Statistics Yearbook 2002, thus also ensuring uniformity. In few cases indicated above with **(*)** where the data are not available in the Yearbook, the figures given for the other party of the bilateral trade are reproduced.

# PART. II

# COUNTRY PROFILES
# AND
# STATISTICS

# BANGLADESH

## BANGLADESH

Based on a record crop harvest and an industrial recovery, the economy maintained steady growth, despite external economic and internal political pressures. A deteriorating external environment is likely to pull down GDP growth a little in 2002. The economy should then pick up in 2003, reflecting a rise in both domestic and external demand. The Government needs to address structural issues in the external sector, in public finance, and in banking, if the economy is to achieve sustained growth over the medium term.

### Macroeconomic Assessment

Despite lingering external pressures and political disruptions, the economy achieved steady growth during 2001 with GDP expanding by 5.2 %, compared with 5.9 % in 2000. This performance was underpinned by an exceptional crop harvest and a rebounding industry sector.

Favourable weather, the increased use of high yielding varieties of crops, extended irrigation, and the ready availability of agricultural inputs such as seeds, fertiliser, and fuel at lower prices contributed to a record 26.8 million tons of food grain production. This represents a 7.6 % increase over the previous year and was over 2 million tons more than domestic requirements (calculated at 455 grams per person per day). Despite the record, the overall growth rate of the agriculture sector declined to 3.1 % from 7.4 % in 2000, due to a high base for comparison following several years of successive bumper crop harvests.

Industry sector growth improved to 7.2 % in 2001 from 6.2 % in 2000, due mainly to stronger manufacturing. Increasing to 6.3 % from 4.8 % in 2000, manufacturing expansion was underpinned by a rise in domestic demand and a rapid strengthening in the export-oriented garment industry. The output of domestic-market oriented industries, including food

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*Source: Compiled from IMF Publications* processing, chemicals, cement, and small-scale industries, also rose considerably. Greater availability of bank credit to the private sector and higher imports of raw materials and machinery also supported manufacturing growth. Value added in 2001 in electricity, gas and water supply together grew by a robust 7.4 % compared with 6.8 % in the preceding year, partly reflecting greater manufacturing activity. Growth in construction, however, rose marginally to 8.7 % from 8.5 % in 2000 because of an oversupply of commercial buildings and apartments.

Despite the overall improvement in revenue performance, the budget deficit declined only marginally to 6.1 % of GDP from 6.2 % in 2000 due to expenditure overruns. In the wake of declining availability of external resources, domestic financing of the budget deficit stayed at 3.6 % of GDP. This is a cause for concern, as domestic borrowing is costlier than foreign financing. As a result of this high level of domestic borrowing, the Government's domestic interest payment obligations as a ratio of revenues- reflecting debt service capacity – rose to 13.6 % in 2001.

Although money supply (M2) remained expansionary to accommodate fiscal spending, growth eased to 16.6 % in 2001 from 18.6 % in 2000. This was due to a decline in the foreign assets of the banking system and a moderation in credit expansion to the central Government. Nevertheless, the growth rate of government borrowing from the banking system remained at a high level of 19.7 % in 2001, with the bulk of the borrowing coming from the central bank. Credit growth to the private sector also climbed, from 10.7 % in 2000 to 16.9 % in 2001. This stemmed from the pickup in private sector economic activity, as well as from measures taken in 2000 to reduce the bank rate and reserve requirements, and to abolish the interest rate bands applicable to agriculture and SMEs.

Consumer price inflation dropped from 3.4 % in 2000 to 1.6 % in 2001, due mainly to increased production of food grain. Food inflation declined from 4.1 % to 0.9 % over this period, while non-food inflation remained unchanged at around 2.7 %. The value of the taka was adjusted twice against the dollar, in August 2000 and May 2001, resulting in a cumulative devaluation of 10.5 %. This, together with lower domestic inflation, led to a depreciation of the real effective exchange rate to a level similar to that prevailing at the beginning of 1998.

Over the course of 2001, the Dhaka Stock Exchange's all-share price index increased by 27.6 %. The capital market is still, however, at a nascent stage, with market capitalisation amounting to only USD 1.27 billion at the end of 2001 ( and USD 1.05 billion at the end of 2000) Despite some progress in reducing nonperforming loans, the finance sector remained under stress, with the proportion of such loans in the banking system amounting to around 34% at the end of 2001.

The export growth rate accelerated from 8.2 % in 2000 to 12.4 % in 2001, though it decelerated sharply as 2001 progressed because of the global economic slowdown. This affected apparel exports particularly, which, together with knitwear, have accounted for about three quarters of total exports in recent years. Import growth picked up from 4.8 % in 2000 to 11.4 % in 2001, due mainly to increased imports of intermediate and capital goods from the import-dependent domestic and export-oriented manufacturing sectors. A higher trade deficit was accompanied by a decline in overseas workers' remittances of 3.4 % These developments led to a widening of the current account deficit (excluding official grants) from 1 % of GDP in 2000 to 2.1 % in the following year.

Despite a mild improvement in the capital account, the overall balance deteriorated, resulting in an erosion of foreign exchange reserves from USD 1.6 billion (2.3 months' equivalent of imports) at the end of 2000, to only USD 1.3 billion (1.7 months' equivalent of imports) at the end of 2001. The country's outstanding external debt was around 34 % of GDP at the end of 2001, while the debt service ratio crept up from 7.2 % in 2000 to 7.5 % in 2001.

**Policy Developments**

The 2002 budget projects a revenue target of 9.8 % of GDP, 0.3 percentage points higher than the figure achieved in 2001. In the absence of significant new revenue-raising measures, the Government aims to achieve the higher target by improving the efficiency of tax administration, modernising the tax collection process, ensuring closer monitoring, and supervision and expanding coverage. After exceeding the revenue collection target in 2001 by

2 %, the revenue intake during the first half of 2002 was 2.4 percentage points lower than the target set for the period. This was due mainly to a significant reduction in import-based taxes and to relatively subdued domestic economic activity. Despite a number of initiatives to reduce costs, such as upward adjustments in administered prices, cancellation of a summit of the Non- Aligned Movement, limiting contracts under suppliers' credit, and freezing government recruitment, the Government will remain under pressure to contain the fiscal deficit. It continues to subsidize loss-incurring SOEs and its revenues are below target. Given these developments, the Government's original budget deficit target of 5.4 % of GDP for 2002 appears difficult to attain. Moreover, the Government is also unlikely to be able to reduce domestic financing of the budget from 3.5 % to 2.6 % of GDP, between 2001 and 2002, unless it takes steps to curtail unproductive and low-priority public expenditures, improve utilisation of foreign aid, and privatize SOEs.

As the prospect of a lower than expected revenue outcome in 2002 unfolds, the expansionary trend in monetary policy is likely to continue to accommodate increases in government borrowing from the banking system. This has resulted in a crowding out of private investment. The growth of credit from the banking system to the Government has accelerated considerably, from 21.4 % in July 2001 to 27.1 % in October. The growth rate of broad money (M2) on a year-on-year basis, however, declined marginally from 15.1 % in July 2001 to 14.1 % in October. To encourage lending to the private sector, the central bank reduced the bank rate from 7.0 % to 6.0 % also in October. Monetary policy is likely to remain expansionary for the duration of the forecast period.

The policy stance on exchange rate management remains unchanged with periodic adjustments in the exchange rate of the taka against the dollar as the main vehicle of management. In January 2002, the taka was devalued by a further 1.6 % against the dollar as foreign exchange reserves came under heavy pressure. External reserves decline to only USD 1.1 billion (1.5 months of imports) during early January 2002 after two Asian Currency Union payments were made. The Government recently imposed regulatory duties on nonessential imports and enhanced margin requirements for letters of credit to ease pressure on foreign exchange reserves. These measures are not, however, consistent with the spirit of past trade policy reforms and may introduce new distortions. As the probable range within which the taka needs to be adjusted to maintain competitiveness is likely to be quite small, the Government needs to consider other trade policy reform measures that remove distortions on the tariff front.

**Outlook for 2002-2003**

The global economic slowdown and developments following the events of 11 September in the US have considerably undermined the country's growth prospects for 2002. The resulting setback in export-oriented manufacturing and loss of investor confidence are also adversely affecting key production and services sector such as trade and transport, banking, insurance, ports, and shipping. Moreover, the sharp deceleration in export growth over recent months is also leading to considerably slower import growth, with negative consequences for the Government's revenue intake. The loss of employment in the sectors immediately affected by the global slowdown, including garments in particular, is likely to be substantial with adverse consequences for poverty reduction. Between July and December 2001, about 1,200 garment factories closed and an estimated 350,000 workers in the garment industry lost their jobs. Higher unemployment will also make it harder for the Government to achieve its goal of reducing income poverty by 25 % in 2005, from the levels that prevailed in 2000.

The GDP growth rate for 2002 is expected to decline to around 4,5 % due to a more subdued performance of export-oriented manufacturing and services, and lower agricultural growth. Based on the index of industrial production, manufacturing output declined by 2 % during the first 3 months of 2002 (July-September 2001) compared with the corresponding period of 2001. There appears to be a discernible downward trend with manufacturing output declining by 2,3 % in September 2001 compared with a year earlier. GDP growth is likely to pick up in 2003 to 5,7 %, due to a measured recovery in external demand, particularly in the US and EU, and to progress with the country's structural and economic reforms.

During the first 5 months of 2002 (July-November 2001), year-on-year export earnings fell by 10,9 %, with all major export categories registering declines. The granting of duty- and quota-free access to the US market to garment export from 72 Caribbean and Sub-Saharan African countries has disadvantaged the country's garment exporters. Imports, in terms of letters of credit opened, declined by 7 % during the first 5 months of 2002 over the corresponding period of the previous year, as exporters' demand for industrial raw materials dropped. The current account deficit in 2002 is projected to widen to 2,5 % of GDP on the assumption of an 8 % decline in exports, a 5 % decline in imports, and a gradual tapering off in remittances. Foreign exchange reserves are likely to be under mounting pressure from the expanding current account deficit. In 2003, the deficit is likely to decrease to around 2,1 % of GDP, aided by stronger export performance and an increase in workers' remittances as the world economy recovers.

The budget deficit is expected to remain high in 2002 at 6 % of GDP, mainly on account of a shortfall in revenue collections. The annual average rate of inflation remained broadly stable between end-June 2001 and end-October 2001. On a point-to-point basis, however, consumer prices rose marginally over this period due to a pick up in prices of non-food items. The inflation rate is expected to increase to 2,4 % in 2002 due to a further rise in administered prices and slower growth in crop production. This will, to some extent, be offset by relatively subdued domestic demand. In 2003, consumer prices are likely to edge up to around 2,6 % as the Government's expansionary fiscal and monetary policies contribute toward demand-pull inflation.

# BANGLADESH

| | 1999 | 2000 | 2001 |
|---|---|---|---|
| population (million) | 126.95 | 137.44 | |
| population growth rate | 1.90% | 1.90% | |
| adult literacy rate | 51.3% | | |
| unemployment rate | | | |
| GDP at current prices (million USD) | 44,759 | 45,422 | |
| GDP per capita (USD) | 353 | 330 | |
| share of sectors in GDP | | | |
| - agriculture | 26% | 26% | |
| - industry | 25% | 25% | |
| - services | 49% | 49% | |
| exchange rate (Taka/USD, period average ) | 49.085 | 52.142 | |
| average inflation rate | | 3.4% | 2.4% |
| total production of energy (thousand metric tons of oil equivalent) | 13857 | | |
| total consumption of energy (thousand metric tons of oil equivalent) | | | |
| total exports (millions USD) | 4520 | 5590 | 5736 |
| total imports (millions USD) | 8352 | 9001 | 9011 |
| export to D-8 countries (millions USD) | 97 | 118 | 103 |
| import from D-8 countries (millions USD) | 391 | 467 | 442 |
| public sector revenues (millions USD) | | | |
| expenditures (millions USD) | | | |
| external public debt (millions USD) | 15961 | 15098 | |
| debt service payments (millions USD) | 675 | | |

*Source: Statistical Yearbook of the OIC Countries 2002, SESRTCIC, Ankara*

# EGYPT

## EGYPT

### Macroeconomic Outlook

In the early 1990s, the Government launched an Economic Reform and Structural Adjustment Program (ERSAP) supported by a Standby Arrangement with the International Fund and a Structural Adjustment Loan from the World Bank, in addition to bilateral debt forgiveness/debt service relief from the Paris Club. This comprehensive program, designed to achieve macroeconomic stability in the wake of partial reforms implemented in the early 1980s and debt rescheduling in 1987, included: financial sector reform, interest rate liberalization, reductions in subsidies and price controls, exchange rate standardization, foreign trade liberalization, and public sector reform. The overarching goal was to create an open, market-oriented, decentralized economy receptive to foreign direct investment and private-sector participation.

Egypt is rapidly shifting towards a market-based economy, a transition that demands implementation of a consistent economic policy. Hence, real economic growth takes place in an enabling environment, while macro-and microeconomic institutions are rehabilitated.

The reform program was designed to be carried out in three main phases. The first focused on stabilizing the economy, improving public finance and exchange rate policies, stabilizing inflation, tightening monetary policy, and deregulating prices, markets and investment.

The main targets of the second phase were trade and investment issues, private sector reform, and banking sector restructuring. These reforms were implemented directly, through policy changes, and indirectly, through educational and other measures to improve economic and social welfare. Deregulation of prices, markets and investments was carried out

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*Source: Compiled from the book "Investing in Egypt 2003" prepared by the Egyptian Ministry of Foreign Trade.*

successfully. As the government came to realize the crucial role the private sector would play, it then began to exert increasing efforts to fostering and channeling such participation.

Reform policies are based on four independent pillars that must be consolidated in tandem to realize the nation's huge potential; investment, savings, institutional reform and export promotion. Egypt has completed the third phase of the economic reform program, which has been commended by the IMF "as an achievement that has few parallels."

The gradual price liberalization strategy has paid off, and currently, prices of all products are market-based. Railway fares, electricity, petroleum products and natural gas prices are adjusted continually in line with their international equivalents. Continued economic progress therefore is based principally on Egypt's large, diversified economy, expanding international opportunities, modest external debt levels, fulfilment of debt service requirements, political stability, sustainable GDP growth, and the potential for further economic growth as a result of continued structural reforms.

The following indicators summarize the main developments in the macroeconomic framework during the past decade. As a result of the comprehensive economic reform launched in 1990/91, the Egyptian economy had displayed positive trends. Economic growth accelerated from 1.9 % in 1991/92 to 5.3 % in 1999/2000.

The reform program has also been effective in reining in inflation rates that hovered around 20 % in 1991. The inflation rate fell sharply, reaching 3.8 % in 1998/99, 2.8 % in 2000 and 2.4 % in 2001; the steady decline is continuing, and the inflation rate will soon be in line with averages prevailing among Egypt's EU trading partners.

The events of 11 September and the international recession that followed have affected Egypt in a number of ways. Among the most affected areas were tourism, transport, exports and foreign direct investment. Most of the affected area are labour-intensive, and social tensions have sharpened with the resulting increase in unemployment and reduction in the income of less priviliged groups.

Egypt has one investment-grade sovereign credit rating from Fitch, and two below-investment ratings from Standard and Poor's and Moody's (Mergent).

**Well Diversified Economy**

Egypt has a well diversified economy, with no single sector contributing more than % 21 of GDP. Such a solid economic base reduces vulnerability to external shocks, and has enabled Egypt to attract foreign investments in a variety of fields.

Since the reform program began in 1991/92, the private sector has played an increasingly dominant role in growth. Private activities contributed to over 74 % of Egypt's total gross domestic product in 1998/99. The private sector has taken the lead in agriculture and irrigation, industry and mining, electricity, construction, transportation communications, storage, trade, finance and insurance, restaurants, hotels and housing.

Private investments exceeded 80 % of total investments in Egypt during 1999, reflecting the government's commitment to facilitating private sector participation. Furthermore, the government encourages individual business people and transnational corporations to invest in non-traditional areas, especially in financial services such as insurance, utilities and infrastructure through BOT and BOOT agreements – further proof of the government's successful reform policies. In addition, it is worth noting that economic growth was spearheaded by the private sector, underscoring the government's dedication to ensuring the transition from a state-driven to a private sector-driven economy.

**Agriculture**

The Egyptian economy is traditionally based on agriculture . Although only 4 % of the land area is arable, it is highly productive. Recognizing its significant role in the national economy, the Egyptian government places great importance to the agriculture sector. Agriculture accounts for about 20 % of GDP, about 34 % of total employment and 20 % of commodity exports. It helps in developing the industrial sector through expanding the market for industrial goods such as pesticides, chemical fertilizers, equipment and machines.

The average annual rate of growth of agriculture production increased from 2.6 % in the 1980s to 3.4 % in 1990s and to 3.8 % during the Fourth Five Year Plan 1997/98-2001/2002.

**Industry**

The diversification of the Egyptian manufacturing base, the expanding domestic market, plus the advancement in product competitiveness and quality, are attracting a growing number of multi-nationals to base their operations in Egypt.

Currently, manufacturing outputs stands at 20 % of total output, of which some 77 % is contributed by the private sector. The manufacturing sector is one of the top most attractive sectors for enterpreneurs in Egypt.

Improving the manufacturing sector was initially triggered by the government's vigorous privatization program, which in turn has laid the groundwork for easier foreign and domestic private investor ownership of public sector manufacturing enterprises. Virtually all manufacturing output in Egypt will be generated by the private sector.

Egypt has long enjoyed the comparative advantage in several sectors of its industrial base. Spinning and weaving and agro-industry are the lifelines of the industrial sector and have performed impressively, growing at a rate of 62 % between 1991 and 2001. These developments indicate increasing demand for these products, both domestically and internationally, and thus the promising potential for investments.

A fast-growing industry that is highly profitable and competitive is automotive assembly (including passenger cars, buses, mini-buses..), which feeds on as many as 70 other industries.

Another promising area is that of pharmaceuticals. The value of manufacturing production in the sector has more than doubled over the past five years to LE 3.3 billion, and prospects for further growth are envisioned.

A relatively new and attractive area is that of electronics and electrical equipment (including computers, VCRs, televisions, air conditioners, remote controls, medical equipment, e-cards, etc.) Computer software is another growing industry relying on the vast pool of qualified labour in Egypt.

Another industry worth mentioning is iron and steel, which began to take off after the 1952 Revolution. The largest and most famous steelworks are located in Helwan, south of Cairo. Today Egypt is the foremost producer of steel in the Arab region, followed by Saudi Arabia and Qatar. It accounts for 5.2 % of world 's steel production.

**Petroleum and Gas**

The energy sector is one of the major components of Egypt's trade balance. Petroleum and refined products represent almost 8 % of GDP and are a vital source of foreign exchange. Crude oil exports provide about 52 % of foreign exchange receipts from merchandise exports.

The current level of oil reserves is around 3.7 billion barrels, and the Egyptian government is vesting more efforts to expand on the available levels of oil production by encouraging more international oil companies to extend and expand their exploration activities in Egypt.

Crude oil production averages around 760,000 barrels /day . Around 73.5 % of oil output is refined domestically. Major efforts are being vested into increasing the refinery capacity. A private sector project is building a refinery of USD 1.5 billion in Alexandria. When coming on stream, the refinery would yield a yearly output of 5 million tons (100,000 barrels/day); most of which is destined for export purposes.

Subsequent gas discoveries have greatly encouraged the substitution of oil for gas products in the domestic households and industrial usage as well as power generation. A number of projects are being prepared also to encourage gas exports in the near future.

Eighty percent of thermal electricity was generated from natural gas, compared to 20 % ten years earlier. Presently, total natural gas reserves are at 45 trillion cubic feet (TCF) with annual production of 0.6 TCF.

**Socioeconomic Outlook**

Its labour force close to 18 million, is an excellent source of productive and inexpensive labour, combining semi-skilled, skilled and highly qualified workers; its businessmen have extensive experiences in the markets of neighbouring countries. The labour force has grown at an average rate of 2.7 % a year in recent times. Low wages have encouraged the use of labour intensive technologies.

Between 1981/82 and 1999/00, the workforce-population ratio rose from 26.4 % to 29.8 % reflecting society's ability to benefit from the population increase, and turn it into a catalyst for development.

In 1999, around 560 000 new job opportunities were created, easily absorbing the 498 000 workers that had entered the labour force that year, and therefore signaling a decline in unemployment. The unemployment rate, indeed, had already decreased from 9.2 % in 1991/92 to 8.1 % in 1998/99.

**Foreign Trade**

During 2000/01, the balance of payments witnessed a deficit of USD 852 million (0.9 % of GDP). The current account deficit, after widening to 3 % of GDP in 1997/98, fell to 1.2 % of GDP in 1999/2000 and was close to balance in 2000/01. These trends were supported by healthy capital inflows and foreign exchange reserves.

External debt indicators are exceptionally good and compare very positively by peer standards, in addition to having a favourable maturity profile. Egypt's outstanding debt stock and debt service obligations continue to fall relative to current account receipts and GDP. Egypt's external debt burden has been declining for several reasons: Paris Club debt restructuring, prudent fiscal and monetary policies, and economic reform measures.

Yarn, textiles and ready made garments make up the Egyptian economy's premium export sector. Textiles have enormous export potential, and offer the advantages of easy expansion and prompt results. In 2001, exports of ready-made garments and other textile goods reached USD 378 million - around 16 % of non-oil exports. The government has set up an export target of USD 1,095 million by the end of 2006, with an average growth rate of 15 %.

Agriculture and processed food exports have flourished due to the expansion of cultivable land during the period 1986-1992, which led to an upsurge in the number and diversity of export oriented products.

In the 1990s, agriculture was one of the main sectors targeted for economic reform, which aimed to utilize cultivable land efficiently. Investment, output volume and export quality all rose, with agriculture accounting for approximately 30 % of non-oil exports in 2001 (at a value of USD 719 million). Cereal exports increased from USD 105 million in 2000 to USD 144 million in 2001- a growth rate around 38 %. Sugar and related processed export goods increased from USD 24 million in 2000 to USD 34 million in 2001, growing at a rate of 41.5 %.

Processed foods constitute another of Egypt's pioneer industries, and demand on the world market is increasing. Always attuned to such global shifts, the private sector has invested intensely in this field. With regard to both sectors, the government's export target is USD 1,520 million by the end of 2006, with an average growth rate of 20 % for agriculture products ( anticipated at 1,220 million) and 22 % for processed food (to a value of USD 300 million).

Chemicals and pharmaceuticals are another promising area for export expansion , especially since Egypt has over half a century's experience in this field. This sector made up around 12 % of non-oil exports for 2001 (worth USD 278 million). The government intends to achieve export chemicals and pharmaceuticals worth USD 1,065 million by the end of 2006 ( an average growth rate of 20 %).

Egypt occupies a niche in global production of cements, ceramics, steel and reinforced iron (12 % of non-oil exports for 2001, worth USD 298 million, with USD 138 million for steel alone). Government export targets of USD 810 million by the end of 2006 imply an average growth rate of 22 %. Egypt has participated in many specialized international fairs, helping to open new markets in Africa and the Americas.

**Finance and Banking**

Egypt exhibits many strong, positive indicators. Foreign debt and debt service remain low and the maturity profile is highly favourable, with some 96 % of debt long-term and concessional. Foreign exchange reserves cover more than 10 months of imports. Significantly, the fiscal deficit decreased from 6.4 % of GDP in 1991/92 to 4.7 % of GDP in 1999/00. In addition, foreign debt as percentage of GDP has decreased markedly, from 77.9 % in 1991/92 to 27 % in 2000/01. Moreover, the current account deficit witnessed a drastic improvement, declining to 1.2 % in 1999/2000 from 1.9 % in 1998/99. Once again, these figures bear testimony to the government's success in managing this deficit by increasing non-traditional exports and attracting foreign direct investment.

Egypt successfully launched its dual inaugural Eurobond tranche of USD 500 million with a five-year maturity, priced at 275 basis points over a five-year US Treasury Bond offering a fixed coupon of 7.625 %. The second tranche of USD 1 billion, with a 10 year maturity, was priced at 335 basis points over a 10 year US Treasury Bond offering a fixed coupon of 8.75 %.

In 2000, in the field of banking, radical measures were taken to enhance market efficiency and liqudity. Chief among them is the introduction of the SWIFT clearing and settlement system, which got underway early in 2000. The Cairo Overnight Interbank Rate (CAIBOR) was subsequently launched, enhancing transparency and efficiency in the domestic interbank market and aiming to reduce market volatility and spreads between bid/ask rates.

The Central Bank of Egypt (established in 1960) is the monetary and banking supervisory authority in Egypt and enjoys full independence in running its operations. The governor of the CBE is a member of the Ministerial Economic Committee, a high level working group that aims to ensure the consistency of the economic policy. Currently 62 banks operate in Egypt; of these 28 commercial banks account for LE 338 billion of total assets; 31 business and investment banks represent LE 61 billion of total assets; and three specialized banks control LE 29 billion of total assets. In terms of ownership, there are seven public commercial and specialized banks, which currently dominate about 50 % of the market share, 35 private and joint venture banks, and 20 offshore banks. Commercial banks hold about 79 % of the total banking sector assets in Egypt ( excluding the CBE). Deposits have grown by an average of 11 % over the past six years. As per June 2001, total deposits with the banking system (excluding CBE) were LE 291 billion, of which LE 245 billion are time and savings deposits.

Indicators for Egyptian banking system are strong and reflect both stability and the potential for rapid, sustained growth. Capital adequacy ratios are consistently above the 8 % recommended by the international guidelines (the capital ratio for commercial, investment and business banks further improved to 10.2 % at end June 2001). Non-performing loans stood at 16.1 % in December 2001, but were fully provisioned from the bank's side. Banks in general have complied with all provisioning guidelines, with total provisions equivalent to 67.9 % of non-performing loans at end December 2001. Foreign exchange exposure is very limited and temporary and remains consistent with international guidelines. The loans-to-deposits ratio in foreign currency declined to 65 % in June 2001, and again to 61 % in April 2002, as against 92 % in June 1998 and its peak of 95 % in March 1998, which indicates declining foreign exchange exposure risks on the side of domestic agents.

# EGYPT

| | 1999 | 2000 | 2001 |
|---|---|---|---|
| population (million) | 62.65 | 63.98 | |
| population growth rate | 2.20% | 2.10% | |
| adult literacy rate | | | |
| unemployment rate | | | |
| GDP at current prices (million USD) | 88,781 | 90,646 | |
| GDP per capita (USD) | 1417 | 1420 | |
| share of sectors in GDP | | | |
| - agriculture | 17% | 17% | |
| - industry | 33% | 33% | |
| - services | 50% | 50% | |
| exchange rate (LE/USD, period average) | 3.405 | 3.690 | |
| average inflation rate | | 2.8% | 2.4% |
| total production of energy | 56916 | | |
| (thousand metric tons of oil equivalent) | | | |
| total consumption of energy | | | |
| (thousand metric tons of oil equivalent) | | | |
| total exports (millions USD) | 3535 | 6287 | 4140 |
| total imports (millions USD) | 15962 | 21965 | 12720 |
| export to D-8 countries (millions USD) | 125 | 191 | 130 |
| import from D-8 countries (millions USD) | 779 | 956 | 540 |
| public sector revenues (millions USD) | | | |
| expenditures (millions USD) | | | |
| external public debt (millions USD) | 26508 | 24852 | |
| debt service payments (millions USD) | 1478 | | |

*Source: Statistical Yearbook of the OIC Countries 2002, SESRTCIC Ankara*

# INDONESIA

# INDONESIA

**General Outlook of the Economy During 2000-2001**

The recovery in the Indonesian economy slowed in 2001 after a significant rebound in 2000: the economic growth rate was 3.5 percent in 2001, down from 4.9 percent in 2000. Several factors contributed to the slow down such as the weakening global economy and instability of the domestic, social and political conditions in the first semester. The Indonesian economy weathered the global slow down a little better than neighbouring economies where growth was slower; Malaysia at 0.4 percent, Thailand 1.8 percent, Singapore –2.1 percent, and South Korea 3.0 percent.

On a sector basis, economic growth in 2000 was highest in transportation and communications (9.38 %) followed by utilities (8.78 %) and manufacturing (6.10 %). In 2001, the highest growth sector was utilities, followed by transportation and communication, trade, hotel and restaurant sector. Inflation began to pick up from 2 percent in 1999 to 9.4 percent in 2000 and 12.6 percent in 2001. Factors underlying the increase in consumer prices included depreciation in the exchange rate and rapid growth in base money, averaging 18 percent in 2000 and 2001.

On the employment front, the labour force reached 95.7 million in 2000, and increased to 98.8 million in 2001, an increase of 3.3 percent. The increase of the labour force is mostly due to the increase in new labour market participants and an increase in the labour force participation rate, up from 64.1 percent in 2000 to 65.7 percent in 2001. However, most of the new participants entered the non-wage or informal sector in 2001. The overt unemployment rate was 8.1 percent in 2001[1].

[1] In 2001, the Central Bureau of Statistics adopted the OECD definition of unemployed, which includes those persons who have jobs but have not yet begun working and those self-employed persons who have set up businesses but not yet begun commercial operations. Thus, it is not possible to compare the unemployment rate in 2001 with earlier years.

**Fiscal Policy and Budget Performance**

**Fiscal Policy**

The role of the government through its fiscal policy during the crisis is very important. During this period, the government expenditure increased sharply to accomodate various fiscal programs such as the fuel subsidy, social safety net programs, as well as support for small and medium sized enterprises. However, the economic crisis reduced tax revenues, increased expenditures, especially those associated with servicing the new domestic debt, and this threatened fiscal sustainability in 1999 and 2000. In addition, the regional autonomy or decentralization laws, which included significant transfers amounting to 25 percent of revenues from the central government to local governments, posed a serious threat to fiscal sustainability in 2001 and beyond. However, in 2000 and 2001 measures were put in place to improve fiscal sustainability and the deficit was kept within the target 3.7 percent of GDP in 2001. These measures included transfer of spending functions to the regions, scheduled reduction in fuel subsidies, efforts to broaden the tax base, asset sales under IBRA and streamlining the expenditures. Public finance policy in 2002 is directed at creating a sound budget, maintain fiscal sustainability and provide some room for fiscal stimulus within the deficit target.

The improvement in Indonesia's relationship with international agencies and groups has resulted in funding support by CGI and continuation of debt rescheduling with Paris Club and London Club. These funding measures contributed to achieving the 2002 budget targets.

**Budget Performance**

During the last two years, government revenues and grants increased, from Rp 187,8 trillion (16.6 % GDP ) in 1999/2000 to Rp 286,0 trillion (19.5 % GDP) in 2001. The increase is mainly supported by the increase in tax revenues from Rp 125,9 trillion (11.1 % GDP) in 1999/2000 to Rp 185.3 trillion (12,6 % GDP in 2001). Although the economic crisis shrank the tax base, steps taken to intensify tax collection have contributed to improve budget revenues. Non-tax revenues have also increased from Rp 61,9 trillion (5,5 % GDP) in 1999/2000 to Rp 100,7 trillion (6,9 % GDP) in 2001. Revenues from oil and gas make up the largest portion of non-tax revenues: Rp 45,5 trillion (4.0 % GDP) in 1999/2000 and Rp 79,4 trillion (5.4 % GDP) in 2001. Meanwhile revenues of grants from donors also increased during the crisis.

Public expenditures have also increased sharply over the last two years, up from Rp 231,9 trillion (20.4 % GDP) in 1999/2000 to approximately Rp 340,3 trillion (23.2 % GDP) in 2001. The increase comes mainly from the expansion of budget allocation for central government from Rp 202,0 trillion (17.8 % GDP) in 1999/2000 to around Rp 258,8 trillion (17.6 % GDP) in 2001 and the rise in revenue transfers to regions from Rp 29,9 trillion (2.6 % GDP) in 1999/2000 to Rp 81,5 trillion (5.6 % GDP) in 2001.

**General Economic Forecast for 2001-2002**

During the first semester of 2001, the Indonesian economy faced several threats to its recovery including accelerating inflation and depreciation of the rupiah exchange rate, increased interest rates, and rising uncertainty over the domestic political and security situation. The slowdown in the global economy was harder than initally anticipated and this affected exports and economic growth.

The macro economy began to stabilize after Megawati became President of the Republic of Indonesia in July 2001, although the 11 September attack and the slow response from the government over threats to foreigners residing in Indonesia further affected exports and dampened investor confidence to the end of the year. Overall, the economy grew by 3.5 percent in 2001, inflation reached 12.6 percent and SBI interest rates peaked at around 17 percent in December 2001.

The World Economic Outlook published in May 2001 estimated that world economic growth will pick up in 2002, increasing from 3.2 percent to 3.9 percent. The improvement mainly supported by growth in the USA and Japan. During the first semester of 2002, economic indicators have indicated an improvement in the world and Indonesian economy. Although still remains fragile, the macro economy has improved significantly since December. The exchange rate appreciated to go down below Rp 9,000 by July 2002, inflation shows a declining trend and interests are beginning to fall. The real sector appears to be gaining momentum for a recovery, albeit fragile. Economic growth (YoY) improved from 1.6 percent in the last quarter of 2001 to 2.4 percent in 2002 Q1 and 3.5 percent in 2002 Q2. This growth has been realized from both the increase in both private and public consumption as well as and exports that had declined since September 2001 but started to pick up in the second quarter. Moreover, the government is on track to maintain fiscal sustainability, which is in turn has feed in exchange rate appreciation and interest rate cuts. The strengthening of rupiah exchange rate, which was partly due to the improved political and security situation, reduced risk of doing business in Indonesia. Banking sector also began to show the signs of recovery. Credit to the private sector has continuously increased since the first quarter of 2002 and NPLs have declined. This has in turn improved the solvency of banks as reflected in many banks' CAR ratios.

Based on these trends, the target growth rate of 4 percent for 2002 is achievable. Meanwhile, a stable money supply and the strengthening of the rupiah will further reduce inflation which is estimated to decline to 9.5 percent by year-end. The rupiah exchange rate is estimated at Rp 9.500 and the average three-monthly SBI interest rate is expected to fall below 16 percent soon. In general, the prospects for the Indonesian economy in 2002 looks better than in 2001.

## INDONESIA

| | 1999 | 2000 | 2001 |
|---|---|---|---|
| population (million) | | 206 | |
| population growth rate | | 6.19% | |
| adult literacy rate | 89.79% | 89.93% | 89.27% |
| unemployment rate | 6.36% | 6.08% | 8.10% |
| GDP at current prices (millions USD) | 139,531.5 | 152,735.7 | 145,635.7 |
| GDP per capita (USD) | 687.9 | 742.0 | 697.2 |
| composition of GDP by sectors : | | | |
| - agriculture | 19.61% | 17.03% | 16.39% |
| - industry | 37.21% | 41.12% | 40.87% |
| - services | 43.18% | 41.87% | 42.74% |
| exchange rate (Rp/USD, end of period) | 7,100 | 9,350 | 10,288 |
| average inflation rate | 2.01% | 9.35% | 12.55% |
| total production of energy (terrajoule) | 8,874,956 | 9,153,659 | 9,276,101 |
| total consumption of energy (terrajoule) | 3,525,855 | 3,812,582 | 3,969,856 |
| total exports (millions USD) | 48,665 | 62,124 | 56,321 |
| total imports (millions USD) | 24,003 | 33,515 | 30,962 |
| export to D-8 countries (millions USD) | 2330 | 3145 | 3071 |
| import from D-8 countries (millions USD) | 1011 | 1853 | 2393 |
| public sector revenues (millions USD) | 30,498.8 | 25,216.5 | 29,897.3 |
| public sector expenditures (millions USD) | 38,046.3 | 28,216.8 | 34,435.8 |
| external debt (millions USD) | | | |
| - government | 75,862 | 74,916 | 72,197 |
| - private | 72,235 | 66,777 | 66,946 |

# IRAN

## IRAN

### A: Performance of the Economy in 1379 (2000/2001)

Performance of the Iranian economy improved in 2000/01, after two years of stagnation and sluggish growth (1997-99) owing to slowdown in world economic growth as the consequence of global financial crisis and the associated fall in crude oil prices. Following rebound in world crude oil prices and adoption of sound economic policies, positive trend of economic recovery was observed. The growth of oil proceeds along with increase in non-oil exports in 2000/01 led to a remarkable improvement in current account.

The above mentioned favourable conditions together with sound monetary and fiscal policies aiming at liquidity control and curbing inflation, and also strengthening foreign exchange market, provided the ground for the implementation of the economic reform package set for the first year of the Third Five Year Development Plan ( 3rd FYDP).

### National Income

According to preliminary estimates, GDP growth at constant 1990/91 prices reached 5.9 percent, owing to the increase in oil, manufacturing, trade and construction activities. Despite the continuation of drought in the period of 1998-2001, the value-added in agriculture group grew by 3.8 percent. The value-added in manufacturing and mining group also grew by 8.9 percent, indicating the continued recovery and improvement in production in 2000/01. The growth in the value-added in all activities in the services group, except for the public services sector, reached 5 percent in 2000/01.

### Agriculture

The agriculture sector witnessed a continued drought in 2000/01 and thus did not enjoy a favourable condition. The average rainfall in two consecutive years of 1999/00 and 2000/01 equaled 148.3 millimeters, and was the lowest during the past 20 years. The unfavourable climatic conditions resulted in a reduction both in the area under cultivation and the yield per hectare of major farm corps. Production of grains (wheat, barley, and rice) fell by 9.8

percent and reached 11.745 thousand tons in 2000/01. Production of cotton grew by 12.7 percent. Production of tobacco, sugar beet and oil seeds fell by 4.5, 21.9, and 8.9 percent respectively in 2000/01.

In 2000/01, the banks' contribution to financing of the agricultural sector was continued, and thus the outstanding facilities extended by banks to non-public sector grew by 31.1 percent and reached Rls. 29,653.5 billion.

**Manufacturing and Mining**

Manufacturing and mining sectors enjoyed favourable factors such as current account surplus which supported the recovery of the government fiscal position, reduction in inflationary expectations, stable foreign exchange market and sound monetary policies pursued in 2000/01.

According to preliminary figures, the value-added in manufacturing and mining grew by 9.6 and 6.5 percent in 2000/01 respectively, performing better than projected for these sectors in the 3rd FYDP (8 and 5.5 percent, respectively).

In 2000/01, the non-public sector deposits with banks increased by 31.3 percent and reached Rls. 223,952.3 billion. The demand and time deposits enjoyed growth of 38.1 and 27.1 percent respectively. Central Bank's claims on government declined by 1.9 percent and reached Rls. 60,859.0 billion. According to the banks' credit performance in 2000/01, the credit facilities extended by banks and non-bank credit institutions to non-public sector increased by 30.8 percent compared with 1999/00.

**Capital Market**

The stock market enjoyed a significant growth in 2000/01 due to improvement of economic conditions. The number and value of shares in transaction and number of companies listed on the TSE, all are indicative of the boom in this market.

The ratio of value of transactions at TSE to average liquidity and to the GDP increased to 4.3 and 1.6 percent respectively in 2000/01 from 3 and 1.2 percent in 1999/00. On the basis of 2000/01 budget law, participation papers of Rls. 2300 billion were floated and sold out for the implementation of government projects. The Central Bank also issued participation papers Rls. of 1,590 billion in this year to mop up excess liquidity.

**Price Trends**

The average consumer price index, as a measurement of inflation, declined to 12.6 percent in 2000/01 as compared to 20.1 percent in 1999/00, which was much lower than the target set in 3rd FYDP. Improvement in economic conditions and enhanced public confidence in the stability of the economy and implementation of non-expansionist fiscal policy were among the factors which helped reduce the inflation in 2000/01.

**B. Performance of the Economy in 1380 (2001/02).**

The Iranian economy achieved notable developments with the implementation of 3rd FYDP, covering 2000/01-2004/05 period . The Third Development Plan triggered the start-up of bold measures for the gradual transition of the economy to a market-oriented one.

High economic growth in 2001/02 took place in an environment of declining inflation and improved external position against the background of sustained economic reforms. This performance has been facilitated by sound economic policies, particularly utilizing the increased oil revenues to reduce the external debt burden, building up international reserves, accumulating sizable savings in the OSF and reducing foreign exchange and trade restrictions.

**National Income**

Preliminary estimates for major economic variables indicate that the overall economic activity in 2001/02 remained strong for the second consecutive year. Real GDP grew by 4.7 percent, despite lower oil production in compliance with OPEC quotas.

During 2001/02, the value-added in oil and gas group declined by 8.4 percent, while the decreasing trend of the value-added in farming sector was reversed. Thus, the value-added in agriculture group grew by 4.7 percent, which is a significant increase as compared to the previous year (2000/01).

Preliminary figures for national expenditures indicate that the upward trend of gross fixed capital formation, which had started since two years ago, continued and grew by 9.9 percent in 2001/02 as compared to the previous year.

**Agriculture**

Based on preliminary figures, production of the most basic farm crops increased in 2001/02, owing to the rise in rainfall by 22.5 percent compared to the previous year. Production of grains increased by 17.9 percent and reached 13,851 thousand tons. Wheat output grew by 16.9 percent, reaching 9,453 thousand tons. In 2001/02, production of livestock (redmeat, milk, poultry and eggs) increased by 2.9 percent as compared to the previous year.

The credit facilities extended by banks and other financing institutions to agriculture sector also grew by 30.3 percent in 2001/02.

**Manufacturing and Mining**

The growing trend of activities in manufacturing and mining sector indicates private sector's tendency for further investment in this sector. The production index of the large scale manufacturing establishments increased by 6.4 percent in 2001/02 compared to the previous year. The value-added in manufacturing and mining sectors grew by 10 and 9.6 percent respectively in 2001/02, showing favourable performance of these sectors.

The credit facilities extended by banks and non-bank credit institutions to the manufacturing sector (non-public) grew by 45.8 percent in 2001/02 compared to the previous year and amounted to Rls. 58.3 thousand billion.

**Balance of Payments**

The developments in international crude oil market and gradual implementation of the new foreign exchange and trade regulations, provided for in the 3rd FYDP Law, improved the balance of payments in 2001/02. Broad-based deregulations implemented in foreign trade, replacing non-tariff barriers with tariffs, domestic financing of foreign trade, and freer use by non-oil exporters of their foreign exchange proceeds were all among policies, which helped the non-oil export rise in 2001/02.

The non-oil exports and imports grew by 9.2 and 20.2 percent, respectively. Including oil exports, the trade balance enjoyed a surplus of USD 5,578 million in 2001/02. The current account balance decreased by 52.1 percent compared to previous year and amounted to USD 5,985 million in 2001/02. Total external debt amounted to USD 7,214 million, of which USD 2,652 million was short-term debt. The Central Bank's international reserves and OSF balance increased by USD 4,760 million in 2001/02.

**Labour Market**

Employment has been one of the important priorities in government program in recent years. According to the projections of the Management and Planning Organization, 490 thousand job opportunities were created in 2001/02, bringing the number of employed population to 16 million persons. However, the unemployment rate remained almost unchanged at about 16 percent of the total active labour force.

The high growth rate and the young structure of the active population, migration from rural to urban areas, considerable number of refugees, and the flexibility of Labor Act are among main issues of labor market in Iran.

**Fiscal Policy and Budget Performance**

The stabilizing effects of budget on the national economy and its non-inflationary feature continued in 2001/02, and brought about further fiscal discipline in the government. In 2001/02, government overall revenues grew by 19.9 percent compared to the previous year. The crude oil export revenues, in real terms, constituted 59.7 percent of government revenues. The tax revenues also grew by 18.1 percent but were realized 14. 5 percent less than the projected figures.

In 2001/02, the Direct Tax Act was revised to lower the tax base and help simplify corporate and personal income tax rates. Tax administration also improved as a result of establishment State Tax Organization. Government expenses increased by 17.8 percent in

2001/02, of which 81.3 percent was current expenditures and 18.7 percent was development expenditures. The drastic rise in the wage of public sector employees caused an increase in government's current expenditures in 2001/02. Thus, the budget had a deficit of Rls. 3,380.1 billion, 88 percent of which was financed through sale of participation papers.

**Monetary Policy**

In 2000/01, the monetary policies were aimed at curbing inflation while also meeting financial requirements of productive sectors. The liquidity and inflation targets were determined in the framework of monetary policies set in the 3rd FYDP. In 2001/02, the liquidity grew by 28.8 percent and the facilities extended by banks and non-bank credit institutions to non-public sector grew by 39.1 percent. The significant increase in banking facilities has resulted in the reduction of the bank's reserve requirement ratios by 5 percent. Sight deposits grew by 27.5 percent and non-sight deposits grew by 32.2 percent in 2001/02.

In 2001/02, the Money and Credit Council (MCC) determined the ceiling of participation papers to be issued by the private sector at Rls. 5,000 billion. Moreover, to mop up excess liquidity (M2), the MCC authorized the Central Bank to issue participation papers based on 3rd FYDP Law. Establishment permits were issued for two private banks in the first quarter of 1380 (2001/02), and a non-bank credit institution was turned into a Bank in January 2002.

**Capital Market**

With the improvement in economic conditions in 2001/2002, the Tehran Stock Exchange (TSE) activites enjoyed a boom. The number of traded shares increased, and share price and cash dividend indexes improved significantly in 2001/02. Traded shares grew by 1.4 percent in number reaching 1,705.6 million, while decreased by 14.7 percent in value amounting to Rls 7,830.4 billion. In 2001/02, the number and value of shares offered by public sector and banks fell by 38.3 and 79.2 percent respectively.

On the basis of 1380 (2001/02) budget law, a total of Rls. 5,100 billion participation papers were issued and totally sold out. In compliance with the 3rd FYDP Law, the Central Bank also issued Rls. 10,000 billion participation papers, of which Rls. 9,443.6 billion were sold out in 2001/02.

**Price Trends**

The positive impact of increased foreign exchange revenues on government's fiscal position, improvement in BOP, increase in imports and supply of goods and services, and more importantly an increase in public confidence in economic stability were altogether among the factors which curbed the inflation in 2001/2002. Thus, the increase in CPI, as the measurement of inflation, was confined to 11.4 percent, which is 1.2 percent lower as compared to 2000/01.

**C: Economic Outlook for 1381 (2002/03)**

The prospect for the Iranian economy is promising in the medium-term. A stable international crude oil market coupled with the reform package adopted in line with the objectives of the Development Plan have effectively stabilized the Iranian market and strengthened both consumer and investor's confidence. The economic objectives could be attained, as being supported by high foreign exchange reserves and low external debt.

More importantly, the utilization of new sources of deficit financing, i.e. domestic participation papers and foreign bonds, has helped the government in the execution of more labour- intensive projects.

The performance figures for the first two years of the plan indicate government's commitment to fulfill the reform package. However, in the short-term, macroeconomic stability shall receive greater focus through pursuing policies envisaged in the plan. The growth outlook for the current Iranian year 1381 (2002/03) is relatively favourable. The real GDP growth is expected to reach 6 percent (including oil) and 6.6 percent (without oil), as compared to 4.7 percent in the previous year (2001/02). Meanwhile, inflation will moderately pick up to about 15 percent from 11.4 percent in 2001/2002, due to the expansionist impact of the previous year's high liquidity (M2) growth.

# I. R. OF IRAN

| | 1999/2000 | 2000/2001 | 2001/2002 |
|---|---|---|---|
| population (million) | 63.817 | 63.862 | 64.907 |
| population growth rate | 1.58% | 1.66% | 1.64% |
| adult literacy rate | | | 97% |
| unemployment rate | 15.95% | 16.05% | 16.63% |
| GDP at current prices (billion Rials) | 430,549.5 | 568,192.6 | 663,390.1 |
| GDP per capita (thousand Rials) | 6,746.6 | 8,897.2 | 10,220.6 |
| composition of GDP by sectors : | | | |
| - agriculture | | 13.6% | 13.4% |
| - oil and gas | | 17.8% | 15.2% |
| - manufacturing and mining | | 19.0% | 20.1% |
| - services | | 51.3% | 53.2% |
| exchange rate (IRR/USD, market rate) | 8,657.68 | 8,188.13 | 8,008.45 |
| inflation rate (CPI 1997=100) | 20.1% | 12.6% | 11.4% |
| total production of energy (million bushel equivalent of crude oil) | 1607.1 | 1769.8 | |
| total consumption of energy (million bushel equivalent of crude oil) | 646.1 | 673.3 | |
| total exports (millions USD) | 21,030 | 28,461 | 23,904 |
| total imports (millions USD) | 13,433 | 15,086 | 18,129 |
| export to D-8 countries (millions USD) | 841 | 1332 | 1275 |
| import from D-8 countries (millions USD) | 370 | 599 | 792 |
| public sector revenues (billion Rials) | 47,828.2 | 45,192.3 | 50,522.3 |
| public sector expenditures (billion Rials) | 68,219.3 | 85,847.3 | 104,772.0 |
| total external debt (million USD) | | | |
| - short term | 3,618 | 3,678 | 2,652 |
| - medium and long term | 6,739 | 4,275 | 4,562 |
| debt service | | | |

# MALAYSIA

# MALAYSIA

## A. Progress and Achievements of the Economy During 2000-2001

### GDP Growth and Per Capita Income

The Malaysian economy rebounded strongly in 2000 after recovering from the sharp output decline in 1998 and early 1999 following the financial crisis. Real Gross Domestic Product (GDP) reached USD 55.1 billion in 2000, recording a high growth of 8.3 percent. While growth was supported by strong external demand, it was rising private consumption and the strong revival in domestic investment that were the main contributors to economic growth. The strong private investment was seen in several industries where a level of production and capacity utilization has expanded in response to rising demand.

The Malaysian economy remained resilient in 2001 in the face of ever challenging and uncertain external environment. While the world economic slowdown was more severe than expected and the unprecedented September 11 events in the United States had widespread implications for all countries, Malaysia was able to steer away from serious economic contraction. Real GDP growth for the year remained in positive of 0.4 percent in 2001. The slowdown in economic activity, together with weaker consumer and business confidence throughout most of 2001, led to a sharp decline in private demand, particularly private investment. However, this trend was more than countered by strong growth in public sector demand. Net exports contributed only marginally to sustain aggregate demand.

Overall, during the 2000-2001 period, the Malaysian economy grew at an average rate of 4.3 percent per annum. Following the modest rate of economic growth, GDP per capita decreased by 3.5 percent to USD 3,667 in 2001 from USD 3,832 in 2000. In terms of purchasing power parity, per capita income declined from USD 8,360 in 2000 to USD 8,340 in 2001.

**Growth in the Main Economic Sectors**

In 2000, the economy on the supply side remained broad-based with all sectors registering positive growth. The value added of the manufacturing sector registered a strong growth of 19.1 percent, driven by the double-digit expansion of both export and domestic-oriented industries. Growth of the agriculture, forestry and fishing sector remained marginal at 2.0 percent. In the mining sector, there was a marginal increase of 1.9 percent in output, reflecting the small increase in crude oil production of 681 thousands barrels per day (bpd) compared with 691 thousands bpd in 1999. Natural gas production increased by 10.5 percent to 4,367 million standard cubic feet per day (mmscf/d) compared with 3,952 mmscf/d in 1999, mainly to meet higher domestic consumption and improved external demand. Value added of the construction sector registered a positive growth of 1.0 percent after declining by 4.4 percent in 1999. The growth is due mainly to the implementation of several large public and privatized infrastructure projects and new investment in the residential sector. In tandem with the significant improvement in the economic activities in major sectors of the economy, the services sector recorded a stronger growth of 5.7 percent compared to 4.5 percent in 1999. Growth was primarily from the transport, storage and communication sub-sector, which increased by 11.0 percent; wholesale, and retail trade, hotels and restaurants by 4.8 percent while the finance-related services sector expanded by 4.4 percent.

In 2001, the slowdown in major industrial countries and the downturn affected the overall performance of the manufacturing sector in the global electronics cycle. The production of export-oriented industries, which was relatively resilient in the first quarter of 2001, was adversely affected by the pronounced slowdown in external demand in the subsequent quarters. As a result, the manufacturing value added for 2001 as a whole declined by 6.2 percent.

In a moderate growth environment, pro-growth policies to stimulate domestic activities resulted in growth of the services sector being sustained at a high level of 5.7 percent in 2001. Growth continued to be broad-based with the intermediate services group (comprising transport, storage and communication; and finance, insurance, real estate and business services) expanding at a faster rate than the final services group. The fiscal stimulus programmes, privatization of infrastructure projects, housing development and low interest rates contributed to a stronger growth of 2.3 percent in the construction sector. The value added in the agriculture, forestry and fishery sector expanded and the mining sector grew by 1.8 percent and 1.6 percent, respectively.

**Prices and Inflation.**

Inflation remained subdued in 2000. Annual growth of the consumer price index (CPI ) was only 1.6 percent in 2000, mainly because of the relative stability of the exchange rate, low rate of inflation abroad, lower prices for many commodities, and excess capacity in several sectors of the economy. The increase in bus fares and in retail prices of several petroleum products, as well as the higher sales tax on alcoholic beverages and cigarette and tobacco products in year 2000 had the effect of pushing up CPI but the increase was not significant. The trend continued into the first half of 2001. For the whole of 2001, inflation was only 1.4 percent. The moderate appreciation of the ringgit against non-US dollar currencies, as well as lower prices paid by the producer (Producer Price Index) which fell by 5.0 percent in 2001 also contributed to lower inflation in 2001. During the 2000-2001 period, the CPI grew at an average rate of 1.5 percent per annum.

**Unemployment**

The labor market situation improved significantly in 2000. Strong economic growth led to more jobs being created and a decline in retrenchments. Therefore, the unemployment rate declined to 3.1 percent from 3.4 percent in 1999, well below the full unemployment rate of 4.0 percent. In 2001, the labor market, felt the impact of the slowdown in economic activity, particularly with retrenchment in the manufacturing sector. However, given the flexibility of labor market, alternative measures adopted by employers (such as pay cuts and temporary layoffs) helped contain the number of workers retrenched. During the year, the slower growth environment resulted in both the total employment and labor force expanding at moderate rates of 4.5 percent to 9.3 million workers and 4.3 percent to 9.6 million persons, respectively. The unemployment rate edged upwards from 3.1 percent in 2000 to 3.6 percent in 2001. A total of 38,116 workers were retrenched compared with 25,236 in 2000, with 75.6 percent from the manufacturing sector. The electronics and electrical products sub-sector accounted for almost half (45.7 percent) of the total numbers of workers retrenched.

The number of job vacancies increased more moderately, by 6.0 percent to 131,459 in 2001 compared with 124,070 in 2000.

## B. External Sector

### External Trade

Malaysia's external position remained fundamentally strong despite the slowdown in the global economy. On the trade account, the impact of the world economic slowdown and the global electronic downturn on Malaysia's external demand had been significant as growth in merchandise exports, which remained positive since 1997, declined by 11.7 percent in 2001. Almost all categories of exports were adversely affected, particularly electronic and non-household electrical appliances as well the primary commodities such as crude oil and palm oil. Nevertheless, given the existing structure of high import content in exports, coupled with moderation in domestic demand condition, merchandise imports also declined by 10.6 percent in 2001. This has helped to contain the decline in the trade surplus at USD 16.2 billion in 2001 from USD 18.0 billion in 2000.

The services account, on the other hand, registered a significantly smaller deficit of USD 2.8 billion in 2000 and USD 2.2 billion in 2001, reflecting the market improvements in the travel account and the smaller amount of payments related to export and export activities. With lower corporate earnings arising from weaker exports during the year, the deficit in the income account also improved to USD 6.7 billion compared with deficit at USD 7.5 billion in 2000 on account of lower repatriation of profits and dividends. On the whole, the surplus in the current account remained large at USD 8.5 billion or 9.4 percent of GDP in 2000, though it narrowed slightly to USD 7.3 billion or 8.3 percent of GDP in 2001.

### Terms of Trade

Improvement in productivity and quality as well as the stable exchange rate contributed to Malaysia's export competitiveness in 2000 with the improvement of 0.8 percent in export prices and the decline of 0.4 percent for import prices. The terms of trade improved by 1.3 percent. However, in 2001 the terms of trade declined by 1.5 percent because export prices contracted by 1.4 percent and import prices remained unchanged. The decline in the terms of trade was due to the decline in export prices of major primary commodities, such as crude petroleum, palm oil, rubber saw logs, tin and LNG.

**Foreign Direct Investment**

Gross inflow of foreign direct investment (FDI), which constituted a part of net private capital in-flows, continued to expand rapidly at 6.7 percent to record USD 5.7 billion in 2000 and contributed 48.8 percent of total private investment. However in 2001, gross inflow of FDI contracted by 33.0 percent to USD 4.8 billion, as a result of the reduction in cross-border capital flow and mergers and acquisitions as well as the slowdown in global economic activities.

**External Debt**

In 2000, Malaysia's external debt (including public, private sector and short-term debt) position improved to USD 42 billion. This was mainly due to the short term debt, which declined significantly by 22.1 percent to USD 4.6 billion, equivalent to 10.9 percent of total external debt and 15.4 percent of international reserves. The improvement in debt situation was reflected in the ratio of external debt to GDP, which declined to 46.7 percent in 2000 from 54.0 percent in 1999.

The total external debt outstanding increased to USD 45.6 billion in 2001, equivalent to 51.8 percent of GDP. The increase reflected mainly the higher borrowing of (USD 6.4 billion) by the Federal Government to finance the fiscal deficit. Malaysia's external debt service ratio, at about 5.9 percent of exports of goods and non-factor services, remained manageable.

**Exchange Rate**

In 2000-2001, the ringgit exchange rate remained pegged to the US dollar at the rate of RM 3.80 per US dollar, an arrangement that has been effective since 2 September 1998. In terms of its trade-weighted nominal effective exchange rate, the ringgit appreciated 6.8 percent in 2000 and 5.5 percent in 2001, in line with the appreciation of US dollar. The pegged rate regime continued to be supported by the strong fundamentals of the economy as reflected by the strong current account surplus, the low rate of inflation and the high level of reserves.

**C. Fiscal Policy and Budget Performance**

Prior to the financial crisis in 1997, the Federal Government achieved a budget surplus for 5 consecutive years, 1993-97. From 1998 to 2001, the Federal Government budget incurred deficit, largely because of expansionary fiscal policy designed to support economic recovery. The thrust of fiscal policy in the 2000 and 2001 budgets remained expansionary, aimed at stimulating domestic demand. The expansionary policy was designed to support economic activities that could further strengthen economic recovery, enhance the nation's competitiveness, and continue the agenda of a caring society.

In line with the domestic-led growth policy, the Government announced an additional pre-emptive fiscal package of 4.3 billion ringgit on 25 September 2001. This is an addition to the earlier pre-emptive package aimed at stimulating domestic economic activities as well as alleviating the negative impact on the low-income group and the disadvantaged. Although fiscal policy has been expansionary since 1998, Malaysia still enjoys fiscal flexibility, and the continued expansionary budget in 2001 would not create risks in the economy. This is because of the Federal Government debt at a manageable and sustainable level.

In terms of Federal Government expenditure allocation, priority was given to education and skills training, rural development, agriculture and low-cost housing and health services as well as industrial and infrastructure development. The objectives were to increase allocation on projects with strong linkages to the economy to ensure maximum stimulus to growth, minimal leakage in terms of import while meeting socio-economic targets.

Regarding tax policy, the Government continued with its tax reform programmes aimed at improving tax buoyancy and tax collection. Emoluments constitute the largest component of operating expenditure. As for development expenditure, education, transport infrastructure and trade and industry were the biggest components.

## D. Financial and Monetary Policy

Monetary policy in 2000 and 2001 was directed at supporting economic growth and maintaining financial stability. The low and stable inflation environment enabled the conduct of monetary policy to remain accomodative. With the absence of inflationary pressure, Bank Negara Malaysia's three month Intervention Rate was maintained at 5.5 percent ( it peaked at 11 percent in 1998). The accomodative monetary policy stance was able to provide the foundation for strengthening economic fundamentals.

The money supply continued to expand in 2001, albeit at a more moderate pace in line with the weaker economic activities, with M1 increasing by 3.2 percent (2000: 6.5 percent), M2 by 2.2 percent (2000: 5.2 percent) and M3 by 2.9 percent (2000: 5 percent). However despite the more challenging environment, lending by the banking system continued to expand with higher loans extended to the household sector, particularly for the purchase of residential property and passenger cars.

### Stock Exchange

In line with other regional bourses, the KLSE (Kuala Lumpur Stock Exchange) commenced in the 2001 year on a bearish undertone as a result of weak global economic conditions and market volatility. Nevertheless, the benchmark KLCI breached the 700-point level in a pre-Chinese New Year rally and continued to rise to close at 727.73 points, an increase of 7.1 percent at end-January (end- December 2000: 679.64 points). The up-trend, however, could not be sustained and the KLCI plunged below the 600 point-level to close at 584.50 points in April. Market sentiments improved in July, mainly due to some developments in corporate mergers and acquisitions as well as the Government's firmer stand on corporate restructuring. The KLCI rose steadily to close at 659.40 points in July and ended higher at 687.16 points in August. The KLCI was poised to continue its upward trend, breaching the 700- point level in intra-day trading on 10 September and ending at 690.54 points on 11 September. Nevertheless, following the attack on the US, the KLCI along with other major and regional bourses, fell to close lower at 615.34 points at end-September. Total volume transacted on the KLSE, however declined by 45.6 percent to 33,081 million units while average daily turnover registered 180 million units in the first nine months.

**Saving and Investment**

Overall, the country maintained high levels of saving. In 2000 the gross national saving (GNS) in current prices increased by 8.2 percent to USD 32.9 billion or 36.5 percent of GDP. Of the total GNS, 54,8 percent was generated by the private sector and 45.2 percent by the public sector. However, in 2001, GNS decreased by 14.1 percent to USD 28.3 billion or 32.1 percent of GDP due mainly to a decline in saving by private sector. (-13.3 percent, to USD 15.6 billion or 17.7 of GDP). The decline of private sector saving was affected by lower income resulting from weaker export earnings as well as greater uncertainities in employment opportunity.

In 2001, real gross fixed capital formation declined by 2.8 percent to USD 6.9 billion compared with an increase by 25.7 percent in 2000. Private investment expenditure declined sharply by 19.9 percent, reflecting the negative impact of lower external demand and excess capacity in certain sectors of the economy, particularly in the export-oriented manufacturing industries. However, public investment expenditure maintained its double-digit growth of 19.4 in 2000 and 14.5 in 2001.

**E. Outlook for 2002.**

Given the improving outlook of the global economy and the expected pickup in world trade in tandem with a gradual upturn in the electronic sectors, the Malaysian economy is well placed to strengthen further in 2002. With GDP expanding by 2.5 percent in the first half of 2002 and expected to strengthen further in the second half, the full year growth is projected to be in the range 4-5 percent. In line with economic recovery, GDP per capita is expected to increase by 4 percent to USD 3,814 in 2002. Per capita purchasing power parity is estimated to increase by 3.6 percent to USD 8,643 compared with USD 8,340 in 2001.

On the supply side, all sectors of the economy are expected to register positive growth rates with growth accelerating in all sectors except for agriculture, which is projected to moderate to 1.1 percent, due to lower palm oil production. The services sector which is expected to expand by 5.3 percent is envisaged to continue to be the driving force in generating economic growth, contributing 3.0 percentage points to GDP growth in 2002. Growth in the sector is expected to emanate from the finance, insurance, real estate, and business services sub-sectors, in line with the upturn of the economy and improving domestic demand, and is complemented by significant improvement in the manufacturing sector.

The outlook for inflation depends primarily on the speed and strength of the economic recovery. Prices should increase moderately as demand conditions improve, since some excess capacity may remain for much of 2002. The inflation rate of the year is projected at 1.9 percent . Total employment is forecast to grow by 3.2 percent to 9.8 million while the labor force projected to expand by a slightly lower rate of 3.1 percent to 10.2 million. The unemployment rate is, thus, anticipated to further decline from 3.6 percent in 2001 to 3.5 percent in 2002, with the economy continuing to remain in full employment.

On the balance of payments, merchandise exports are forecast to register 4.5 percent growth in 2002 as the global economy strengthens. However, a stronger surge in imports, due to the replenishment of low inventories and to higher demand for intermediate input from ICT exporters, will likely reduce the merchandise trade surplus to USD 17.9 billion. With a forecast of net services deficit around USD 2.3 billion, the current account is expected register a surplus of USD 6.1 billion or 6.5 percent of GDP in 2002.

Towards this end, the government will continue to institute appropriate fiscal and monetary policies to support the recovery momentum. The measures implemented in 2002 budget are expected to continue to improve business environment through not only demand side measures, but also supply side initiatives.

In 2002, the fiscal deficit is expected to narrow to 4.7 of GDP in 2002, due to strong revenues stemming from an expansion of tax base as GDP growth accelerates. However, the total external debt is expected to increase by 6.2 percent USD 48.4 billion equivalent to 51.7 percent of GDP. The increase is mainly due to higher borrowing by the Government to finance the envisaged fiscal deficit. The debt services ratio is expected to stabilize at 5.8 percent of the export of goods and non-factor services in 2002.

# MALAYSIA

| | 1999 | 2000 | 2001 |
|---|---|---|---|
| population (thousand) | 22,711.9 | 23,494.9 | 24,012.9 |
| population growth rate | 2.4% | 3.4% | 2.2% |
| adult literacy rate | | | |
| unemployment rate | 3.4% | 3.4% | 3.6% |
| GDP at current prices (millions USD) | 79,148 | 90,041 | 88,050 |
| GDP per capita (USD) | 3,485 | 3,832 | 3,667 |
| exchange rate (USD/RM) | 3.8 | 3.8 | 3.8 |
| inflation rate | 2.8% | 1.6% | 1.6% |
| total production of energy (thousand metric tons of oil equivalent) | | | |
| total consumption of energy (thousand metric tons of oil equivalent) | 33060 | 32472 | |
| total exports (millions USD) | 84,550 | 98,153 | 88,199 |
| total imports (millions USD) | 65,491 | 82,195 | 73,857 |
| export to D-8 countries (millions USD) | 2,622 | 2,859 | 2,937 |
| import from D-8 countries (millions USD) | 1,928 | 2,509 | 2,506 |
| public sector revenues (billions USD) | | 16,3 | 20,9 |
| operating and development expenditures (billions USD) | | 22,3 | 26,1 |
| national external debt (billions USD) | | 42 | 45,6 |
| national external debt ( as of GDP) | | 46.7% | 51.8% |

# NIGERIA

## NIGERIA

**Background**

Nigeria experienced a rebound in economic activity in 2000, spurred by increased public spending of the windfall gains stemming from higher oil prices and by a buoyant oil sector. Real GDP is estimated to have grown by 3.8 percent in 2000. Notwithstanding a sharp pick-up in activity in the non-oil sector, overall growth is projected to slow to 3.0 percent in 2001 owing in part to a reduction in Nigeria's OPEC oil production quota by more than 9 percent during the first quarter of 2001. At the same time, increased public spending has stoked inflationary pressures. Inflation, measured by the 12-month increase in the consumer price index, rose to 18 percent in March 2001 from 0,2 percent in December 1999.

The inflationary impact of the expansionary fiscal policy led the official exchange rate of the Naira to appreciate in real effective terms by close to 13 percent in 2000. However, at the same time the premium in the parallel exchange market rose significantly. Aided by the increase in the price of oil by about 71 percent, the current account moved to a surplus of 5 percent of GDP in 2000 from a deficit of about 10 percent of GDP in 1999. As a result, gross international reserves increased to USD 9,4 billion from USD 5,4 billion over the same period.

Fiscal policy, and management of the windfall gains from the substantial oil price increases in particular, is playing a key role in economic developments in 2000 and 2001. These gains- defined as oil revenue in excess of USD 20 per barrel (so-called excess proceeds)- amounted to USD 4 billion (10 percent of GDP) in 2000 and are projected at USD 3,7 billion (9,6 percent of GDP) in 2001. On account of the constitution adopted in 1999, that gives state and local governments full and

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*Source: Compiled from IMF Publications* automatic right to their shares of oil revenues, almost one half of the excess proceeds which accrued in 2000 was distributed to sub-federal governments in the second half of 2000, and the remainder in the first quarter of 2001.

Against the backdrop of the windfall gains, the 2000 budget envisaged a sharp increase in consolidated government spending to over 43 percent in 2000 from 38 percent of GDP in 1999. The sub-federal levels increased their expenditures by about 6.6 percentage points of GDP, while federal Government expenditures declined by about 1.3 percentage points. This outcome reflected a combination of the elimination of extra-budgetary outlays (3 percent of GDP in 1999) and a sharp increase in personnel costs of 2.4 percent of GDP, following a substantial increase in public service wages in May 2000. Actual spending levels in 2000 were about 6.5 percentage points of GDP greater than they would have been, had the government saved all of the windfall gains.

The budget for 2001 envisages a further increase in consolidated government spending, which should rise to about 53 percent of GDP. Federal Government capital expenditure accounts for about 40 percent of this increase and spending by sub-federal levels for the rest. In response to concerns that the size of the budget might threaten macroeconomic stability and also compromise the quality of spending, the authorities have decided to limit federal expenditure, thereby bringing projected consolidated government expenditure in 2001 to about 50 percent of GDP. Compliance with due process requirements, which is considered necessary to safeguard the quality of spending, is likely to result in lower levels of capital expenditure than budgeted. Had the government saved all the excess proceeds in 2001 and not distributed the carryover of excess proceeds from 2000, consolidated government spending would have been about 10 percentage points of GDP lower than currently envisaged.

Monetary policy has not offset the liquidity injected by the fiscal stance. On the contrary, the minimum rediscount rate (MRR) was reduced in three steps to 14 percent in December 2000 from 18 percent in December 1999 and the cash reserve requirement was reduced in two steps to 10 percent from 12 percent during the same period. This, in conjunction with the unsterilized increase in foreign reserves by USD 4 billion-the amount of excess oil proceeds in 2000-resulted in reserve money growth of 40 percent.

Since early 2001, the CBN has tightened monetary policy stance. The MRR was raised in three steps by 2,5 percentage points to 16,5 percent (accompanied by increases in interest rates on treasury bills and CBN certificates), the cash reserve requirement was raised by 2,5 percentage points to 21,5 percent, and the liquid asset ratio increased to 40 percent from 35 percent. As a result of these measures, market interest rates rose to between 30 and 40 percent in late April and May from about 17-20 percent in early 2001.

In response to the pressures in the exchange market stemming from expansionary fiscal policy, the CBN reverted to the pre-reform (i.e. pre October 1999) system of selling foreign exchange in the Inter-bank Foreign Exchange Market (IFEM) at a fixed rate, except for step adjustment in mid- December 2000 and early April 2001 that devalued the Naira by 10 percent. Consequently, the differential widened between the IFEM rate and the open interbank market-where banks trade among themselves at freely negotiated exchange rates-and with the parallel rate, and at the time of intensified pressures in April 2001 had reached 15 percent and 20 percent, respectively. In the parallel market, the Naira lost about 30 percent of its value between December 1999 and May 2001. As very large amounts of foreign exchange were sold to deal with these pressures, foreign revenues have increased only modestly during the first five months of 2001, notwithstanding continued high foreign exchange inflows from oil.

On structural reforms, the government successfully sold four global systems for Mobile Communications (GSM) licenses and has brought to the point of sale NITEL/M-Tel and several other public enterprises. However, progress on implementing the appropriate regulatory frameworks for telecommunications and power has been slower than originally envisaged. The Anti-Corruption Commission was inaugurated in September and investigations are now under way on some 20 cases. The Auditor General's report on the 1999 accounts was submitted to the National Assembly in February 2001 while the federal civil service audit was completed in December 2000.

Macroeconomic developments and policies in 2000 and early 2001 were at variance with the programme in support of which the Stand-By Arrangement had been approved. In particular, inflation and federal government spending exceeded the programme targets by a substantial margin and the CBN's liquidity absorption operations were more limited than expected. While the end-2000 target on net international reserves was met, the CBN's foreign exchange management included some administrative measures that gave rise to a multiple currency practice. In addition, structural reforms fell behind schedule.

It is important to recognise the advantages and potential that could make Nigeria Africa's greatest economic power. Massive oil resources and even more vast natural gas resources are the country's best known and most (though not fully) developed asset. A population of more than 120 million, 60 percent of whom live in abject poverty, comprises an enormous, as yet scarcely tapped, market and labour force. Moreover, Nigerian civil society, despite the country's troubles, is among the liveliest and most firmly established on the continent. Among many of the more than 250 ethnic groups present, skilful engagement with trade and entrepreneurial activity substantially predates the British colonial era.

Nigeria currently has the capacity to produce about 2,2 million barrels per day of crude oil from its 22,5 billion barrels of proven reserves as it demonstrated in the first half of 2001 before two levels of OPEC quota limitations became effective later in the year. For 2002 Nigeria's quota is just under 1,8 million barrels per day, so its OPEC quota is imposing an opportunity cost of somewhere between 400.000 and 450.000 barrels per day of output, worth some USD 3 billion at USD 20/barrel. That is a substantial commitment to OPEC price support in an economy with a GDP equivalent to less than USD 38 billion per year. Before OPEC quota production limitations, Nigeria was exporting about 1.8 million barrels per day, with half of that oil destined for the US, about one-quarter for EU markets and the rest for Asia and other markets. The high proportion of exports out of total production (80 percent) illustrates how little oil is used domestically in a country with the largest population in Africa, and indicates how rudimentary its state of industrial and commercial development is.

Natural gas reserves currently estimated at 123 trillion cubic feet have prompted one analyst to describe Nigeria as "a gas province with an oil rim". To date, three-quarters of the gas produced in Nigeria has been flared (burned off at the well), a resource-wasting and environmentally destructive practice in any case, but especially so when the large Nigerian population could benefit so much from productive use of relatively cleanburning natural gas. Progress toward utilising more of the gas produced has occurred lately, notably the opening of a USD 3,8 billion liquefied natural gas, or LNG plant at Bonny in 1999, but that facility is oriented at exportation of gas and not domestic utilisation and it has not yet been linked to the oil fields where much of the associated natural gas is being flared. Increased domestic use of natural gas is widely voiced objective, but achieving it promises to be a long-term process because a transportation and distribution pipeline grid must be built from scratch. Developing Nigeria's gas network, and possible pipeline links to neighbouring countries, would take years even under optimal political and financial circumstances.

In the meantime, the drive to curtail flaring will largely focus on re-injection-collecting gas that would otherwise be flared and returning it under pressure to the ground, an operation that can often enhance the recovery of associated oil deposits-while the infrastructure and market for local and regional gas consumption slowly expand. But, foreign investment will be needed to build this network and since its business would be oriented on domestic consumption, political stability is much more of a consideration for foreign investors than it is in developing offshore and coastal oil and LNG facilities.

Nigeria's failure to put its natural gas bounty to effective use is just one example of how its natural advantages have not been levered into economic development to benefit the entire country. Roads are in very poor condition, there is just one telephone line for every one hundred persons, and power cuts limiting electricity availability to a few hours daily are common. The country's nominally installed electric power capacity stands at about 6.000 megawatts (MW), an incredibly small power production base to support 120 million citizens. But, deferred repairs to generating stations have reduced the actual available capacity well below that so that perpetual shortages of electricity are a serious impediment to investment and growth.

**Balance of Payments**

Since oil contributes 90-95 percent of Nigeria's export earnings (as well as 40 percent of GDP and 80 percent of government revenue), it is not surprising that the country's balance of payments reflects changes in the world price of oil and Nigeira's obligations to OPEC to restrict its production and exports. Nigeria's current account balance has swung back and forth from surplus to deficit a number of times in just the past five years as world oil prices first declined in 1997-8 (to such a degree that the average price received for oil in 1998 was less than USD 13/barrel), then shot up in 1999 and 2000 (so that the average price received averaged USD 28/barrel). According to IMF staff report, the current account balance in 2000 was a surplus of USD 2 billion as compared to a deficit of more than USD 3 billion in both 1998 and 1999. The merchandise trade balance is dominated by oil exports, although LNG exports will be an expanding source of export earnings in coming years. Even in years of very low oil prices such as 1998, Nigeria tends to maintain a surplus in merchandise trade, although the surplus may be quite smaller close to zero. In years of high oil prices, the trade balance moves strongly into surplus as in 2000 when it was USD 38 billion.

Nigeria runs persistent deficits within its current account on factor service payments and on net income payments to foreigners. This is because of its reliance on foreign oil company partners to operate its oil and gas facilities and because of its payments on its substantial foreign debt. These categories of payments have been in deficit by an average of more than USD 6 billion annually over the past five years. Like many populous developing nations around the world who cannot provide sufficient employment opportunities for their citizens, Nigeria receives a persistent annual inflow of remittances from Nigerians who work abroad. In recent years such unilateral transfers have provided an inflow of funds into Nigeria of about USD 1,7 billion per year, an amount equivalent to almost five percent of GDP.

The capital and financial account does not include a large volume of official capital transactions as a result of past borrowing by the government from multilateral lenders like the World Bank and the IMF. But, over the past few years, the official capital account in the Nigerian balance of payments has resulted in a net outflow of funds as amortisation payments on existing debt have exceeded new loan disbursements. Because of its oil and gas wealth, the IMF and World Bank do not categorize Nigeria as an "HIPC" (Highly Indebted Poor Country), but it has been able to renegotiate the terms of some of its estimated USD 30 billion in foreign debt with its international creditors in recent years.

Flows of private capital into Nigeria are overwhelmingly related to development of oil and gas facilities. Because of the structure of the joint venture agreements under which these facilities are built, the investment inflows are categorized as direct investment rather than loans. Direct investment from abroad has averaged about USD 1,4 billion per year over the past five years and about two-thirds of that has been destined for the oil and gas sector. There is virtually no portfolio investment or private borrowing activity in the Nigerian financial account as its citizens, businesses and banks are not credit-worthy entities with whom the international capital markets would deal.

The overall balance of payments (i.e. the sum of the current plus capital/financial account balances) has been in deficit in most recent years due to the volatility in the current account. But Nigeria has been able to maintain its gross international reserves at about USD 10 billion as of year-end 2001, a level that has increased from about USD 7 billion in 1997. It has been able to do this in large part by accumulating arrearages on its international payment obligations its creditors essentially have extended it credit when it did not repay as scheduled. In 2000, debt rescheduling provided over USD 20 billion in effective financing for the balance of payments, clearing an equivalent amount of past arrearages from the books.

## NIGERIA

| | 1999 | 2000 | 2001 |
|---|---|---|---|
| population (million) | 108.95 | 115.22 | |
| population growth rate | 2.40% | 2.40% | |
| adult literacy rate | | | |
| unemployment rate | | | |
| GDP at current prices (millions USD) | 36,572 | 39,431 | |
| GDP per capita (USD) | 336 | 342 | |
| composition of GDP by sectors : | | | |
| - agriculture | 39% | 39% | |
| - industry | 33% | 33% | |
| - services | 28% | 28% | |
| exchange rate (Naira/USD, period average) | 92.338 | 101.697 | |
| average inflation rate | 0.2% | | 18% |
| total production of energy ( thousand metric tons of oil equivalent) | 15716 | | |
| total consumption of energy ( thousand metric tons of oil equivalent) | | | |
| total exports (millions USD) | 12000 | 21685 | 20604 |
| total imports (millions USD) | 7609 | 8942 | 11484 |
| export to D-8 countries (millions USD) | 204 | 531 | 606 |
| import from D-8 countries (millions USD) | 366 | 419 | 434 |
| public sector revenues (millions USD) | | | |
| expenditures (millions USD) | | | |
| external public debt (millions USD) | 22673 | 32950 | |
| debt service payments (millions USD) | 835 | | |

*Source: Statistical Yearbook of the OIC Countries 2002, SESRTCIC, Ankara*

# PAKISTAN

# PAKISTAN

## A. Pakistan's Economic Performance During July 2001- June 2002

Against a backdrop of declining economic growth, stagnant exports, growing debt burden, rising poverty, poor state of social indicators, and deterioration in governance, last year's (1999-2000) economic performance offered grounds for optimism. A modest recovery in growth, strong rebound in agriculture, broad-based growth in large-scale manufacturing (excluding sugar), lowest inflation in two decades, containment of monetary growth at targeted level, a significant increase in exports, and improvement in the trade and current account balances were some of the positive developments of the fiscal year 1999- 2000. With a view to consolidating the last year's gain in some areas and making further progress in others, the government set modest targets for the key economic variables for the fiscal year 2000-01. Some of these targets had to be revised as a result of some exogenous factors. This report reviews the performance of the economy for the fiscal year 2001-2002.

### GDP Growth Rate

Pakistan's economic growth has slowed in the 1990s. Against an average growth of slightly above 6.0 percent in the 1980s, economic growth slowed to an average of 4.9 percent in the first half and further to 4.1 percent in the second half of the 1990s. More importantly, though the real GDP growth decelerated to an average of 3.1 percent during 1996-1999 but it improved to 3.9 percent in 1999-2000 due to an impressive recovery in agriculture, which grew by 6.1 percent in the preceding year. However, growth stimulus from agriculture petered out as its output squeezed by 2.6 percent next year which in turn brought a downturn in the national output growth to 2.5 percent in 2000-2001 compared to 3.9 percent in 1999-2000. The GDP growth again picked up to 3.6 percent in 2001-2002 despite drought conditions, heightened border tension created by India, and September 11, 2001 events. Anyhow this revival in the GDP growth was due to positive growth in agriculture (1.4 %), manufacturing (4.4 % ), commodity producing sectors (2.1 %), services sector (5.1 %) etc.

## Agriculture

Agricultural growth suffered a severe setback during 2000-2001 as a result of the catastrophic drought, which also continued during 2001-2002. Notwithstanding severe water shortage, overall agriculture registered a positive growth of 1.4 percent in 2001-2002 as against 6.1 percent in 1999-2000 and a decline of 2.6 percent last year. The major crops i.e. (wheat, cotton, and rice) registered decline in their respective production in the range of 1.2 percent (cotton), 2.9 percent (wheat) and 19.2 percent rice. However, the overall positive growth of 1.4 percent in agriculture in 2001-2002 has been supported by positive growth in minor crops (1.0 %), livestock (3.4 %), fishing (4.0 %) and forestry (1.1 %).

## Manufacturing

The large-scale manufacturing (LSM) was targeted to grow at 6.5 percent in 2001-2002 against minus 0.7 percent in 1999-2000 and plus 8.6 percent in 2000-2001. As a result of the events of September 11, 2001 and consequent developments, the target was revised downward to 3.2 percent. The fiscal year 2001-2002, however, started with a rising trend until September 2001. The events of September 11 and their aftermath adversely affected the performance of the manufacturing to 0.6 percent in October and turned negative to the extent of 5.7 percent in November 2001, that was the peak of Afghan War. Once the war ended, the large-scale manufacturing staged an impressive recovery during the second half of the fiscal year. The cumulative growth of LSM during July-June 2001-2002 was 4.3 percent. The items indicating positive changes were L.C.Vs (21. 9 %) flakes and detergents (20.9 %) , trucks (19.9 %), petroleum products (14.1 %), cotton cloth (13.4 %), sugar (9.5 %), motor cycles (13.1 % ). The items indicating decrease in production are phos. fertilizers (-51.9 %), tractors (-25.3 %), buses (-17.8 %), paints and varnishes (-17.7 %), cigarettes (-5.1 %), beverages (-2.0 %) and cosmetics (-5.6 %).

## Price and Inflation

Inflation on the basis of Consumer Prices Index (CPI) was 3.5 percent in 2001-2002 as against 4.4 percent in the year 2000-2001 and 3.6 percent in 1999-2000. Food and non-food inflation in 2001-2002 were 2.2 percent and 4.0 percent, respectively. Inflation was originally targeted at 6.0 percent for the fiscal year 2000- 2001 but tight monetary policies accompanied by prudent fiscal management have been responsible for relatively lower inflation in 2001-2002.

### Unemployment

About 3.25 million persons of labour force were estimated as unemployed in 2001-2002, compared to 3.19 million in 2000-2001 and 2.35 million in 1999-2000. The overall rate of unemployment is said to be stagnant at 7.8 percent for the last 2 years (1999-2002). It is higher in urban areas (9.9 %) than in the rural areas (6.9 %).

### B. Foreign Trade

### Exports

Exports during July-June 2001-2002 registered a decline of 0.7 percent from USD 9201.6 million in 2000-2001 to USD 9134.6 million but are higher than USD 8569 million in 1999-2000. The decline in exports in 2001-2002 has come primarily from the export of primary commodities (-14.8 %). Within **primary commodities**, exports of wheat registered a substantial increase, while exports of other major items registered a decline. The textile manufactures and other manufactures witnessed an increase of 0.4 percent and 1.3 percent respectively. Within **textile manufactures**, exports of bed wears, towels and readymade garments have registered substantial growth. This export growth has been achieved in the midst of declining unit values of Pakistan's major exports in the range of 3.1 to 31.4 percent. It may be noted that Pakistan has lost USD 298.7 million in export earnings because of the decline in unit values of its major exports. Had unit values of Pakistan's exports remained at last year's level, the export growth would have been 2.5 percent as against decline of 0.7 percent during July-June 2001/2002.

### Imports

Imports during July-June 2001/02 declined by 3.6 percent, from USD 10728.9 million in 2000-2001 to USD 10339.6 million but were slightly higher than USD 10309 million in 1999-2000. The major decline in imports in 2001-2002 was observed in the food group (-16.9 %) followed by petroleum group (-16.5 %). However, the import of machinery, textile and metal groups showed an increase of 6.5 percent and 15.9 percent and 20.1 percent respectively. Excluding petroleum group, imports have increased by 2.2 percent. Furthermore, **non-oil and non-food imports** have increased by 5.2 percent.

**Balance of Trade**

The decline in imports (3.6 %) during July-June 2001/02 has caused trade balance to improve by 21.1 percent to USD 1205 million in 2000/01 from USD 1527.3 million of the last year. The trade deficit in 1999/00 was USD 1740 million.

**Workers' Remittances**

Workers remittances during July-June 2001/02 amounted to USD 2389.1 million as against USD 1086.6 million of the same period last year, indicating a rise of 119.9 percent. The workers' remittances were only USD 984.0 million in 1999/00.

**Foreign Exchange Reserves**

Foreign exchange reserves held by the State Bank of Pakistan stood at USD 4804.9 million on end-June 2002, showing a substantial increase of 131.5 percent over the level of USD 2075.8 million as on end- June 2001 and USD 1352 million on end- June 2000.

**Exchange Rate**

Pak rupee-dollar (US) inter-bank floating exchange rate for the month of June 2002, averaged Rs. 60.1 as against Rs. 60.4 prevailing in the open market, showing a premium of Rs. 0.3 per US Dollar or 0.5 percent while this rate for the month of June 2001 averaged Rs.63.4 as against Rs.66.4 prevailing in the open market, showing a premium of Rs. 3.0 per US dollar or 4.7 percent. However, the average exchange rate had been Rs.51.8, Rs.58.4 and 61.4 per US dollar in 1999/00, 2000/01 and 2001/02 respectively. The average exchange rate during July-October 2002 Rs. 59.0 = 1 US dollar.

**C. Fiscal and Monetary**

**Fiscal Performance**

Large fiscal deficit has emerged as one of the major sources of macroeconomic imbalances in Pakistan. The government is fully aware of the consequences of maintaining a large fiscal deficit and therefore has taken a series of fiscal measures to bring the fiscal deficit down to

5.1 percent of GDP in 2001/02 from 6.4 percent in 1999/00, which is still slightly higher than 4.6 percent in 2000/01.

The annual target for the federal tax collection by the CBR for the fiscal year 2002/03 has been fixed at Rs.460.0 billion compared to the actual tax collections of Rs. 348.1 billion in 1999/00, Rs. 393.9 billion in 2000/01, and Rs. 403.9 billion in 2001/02. During 2001/02, the direct taxes have increased by 11.9 percent while indirect taxes have decreased by 1.9 percent on net basis. Within indirect taxes, the sales tax have registered a growth of 8.8 percent while the custom duty have decreased by 25.4 percent and the central excise duty has declined by 4.7 percent over the last year. The higher tax collection target 2002/03 would further help to reduce fiscal deficit to 4.0 percent in 2002-2003.

The total revenue as percent of GDP (market prices) have increased from 16.0 percent in 2000/01 to 16.6 percent, which is slightly lesser than 16.7 percent of GDP in 1999/00. However, the expenditure have increased from 20.6 percent of GDP in 2000/01 to 21.6 percent of GDP in 2001/02 but were lower than 23.5 percent in 1999/00.

**Monetary and Credit Developments**

During fiscal year 2000-01, money supply was contained at 9.0 percent as against 9.4 percent in 1999-00. It has increased to 14.8 percent in 2001-02 mainly due to huge build-up of net foreign assets. The private sector was provided enough credit to upgrade its productive capacity. The government has also taken several measures to revive sick industrial units. The previously dormant Industrial Development Bank of Pakistan (IDBP) had been reactivated to revive the economy through manufacturing sectors. The commercial banks extended substantial credit during 2000-01. Credit to the private sector amounted to Rs. 57.6 billion in 2000-01, as compared to Rs. 22.9 billion only in 1999-00.

**Performance of Scheduled Banks**

The banking sector has been undergoing a complex, painful but comprehensive phase of restructuring since 1997, with a view to make it sound, efficient, and at the same time forging its links firmly with the real sector for promotion of savings, investment and growth. Capital base of scheduled banks has improved significantly since December 1997. Assets quality, earning and profitability and management soundness of the scheduled banks have further improved in 2000-01 and 2001-02.

**Stock Market**

The stock market remained under pressure during 2000-2001, which witnessed some bearish tendencies due to continuous selling pressure by foreign funds and confusion among market players regarding the implementation of T+3 settlement system. KSE share index declined by 10.1 percent while aggregate market capitalization had shrunken by 13.4 percent.

The comprehensive socio-economic policy package announced by the government in December 1999 and other corrective measures have largely improved the performance of the stock market during 1999-00 and first half of 2000-01 as the monthly average of Karachi Stock Exchange (KSE) share index increased to 1512 points in 1999-2000 from 1005 in 1998-99.

During the fiscal year 2001-2002, Pakistan's stock market also recorded best performance despite unprecedented shock of 11th September 2001, and huge military pressure posed by India in the eastern border. The stock market showed visible sign of recovery from the very beginning of the calendar year 2002. The bullish business activity starting in the month of January 2002, which continued to become stronger day-by-day, remained uninterrupted till end June 2002. The KSE share index recorded a growth of 29.5 percent during 2001-02, which increased from 1366.4 points in June 2001 to 1770.1 points in June 2002. Similarly aggregate market capitalization recorded a growth of 20.14 percent, which increased from Rs 339.2 billion in June 2001 to Rs 407.6 billion in June 2002.

**Savings and Investments**

The total investment as percent of GDP, which was 16 percent in 1999-00, had declined to 15.9 percent in 2000-01 and further to 13.9 percent in 2001-02. Similarly, the fixed investment as percentage of GDP had also declined from 14.4 percent in 1999-00 to 14.3 percent in 2000-01 and further to 12.3 percent in 2001-02. However, the public sector investment had increased from 6.0 percent of GDP in 1999-00 to 6.3 percent in 2000-01 and declined to 4.7 percent in 2001-02, but in line with the government's conscious policy decision to create greater space for the private sector. The private sector fixed investment as percentage of GDP also declined from 8.4 percent in 1999-00 to 8 percent in 2000-01 and further to 7.6 percent in 2001-02. However, the national savings as percentage of GDP has increased from 14.1 percent in 1999-00 to 15.1 percent in 2000-01 and further to 15.4 percent in the fiscal year 2002, mainly on account of a significant improvement in the current account balance, which in turn eliminated the need for recourse to foreign savings to finance domestic investment.

The clouded investment climate is likely to wither away and fixed investment is expected to increase from 12.3 percent to 14 percent of GDP in 2002-03 and to 15 percent by 2003-04. The contributions are expected to come from both public and private investment, which are expected to rise from 4.7 percent to 5.5 percent and from 7.6 percent to 8.5 percent of GDP respectively. As a result of falling foreign savings, national savings is expected to decline from 15.4 percent to 13.5 percent of GDP in 2002-03.

**D. Foreign Private Investment**

The inflow of foreign investment in Pakistan has been declining since 1995-96 for a variety of reasons, including the saturation of investment in power sector; the East Asian financial crisis of 1997; economic sanctions and freezing of foreign currency accounts of May 1998; the IPP and the HUBCO issues, particularly the way it was handled in the past; low levels of foreign exchange reserves and threat of default on external payments obligations; and disarrayed relations with the International Financial Institutions (IFIs).

Over the last two and a half years, the government has succeeded in removing the above listed constraints. For example, all the IPP issues including the HUBCO one have been resolved; foreign exchange reserves have reached a comfortable position; economic fundamentals have improved, all economic sanctions have been lifted, Pakistan has acquired high credibility for its reform programme from IFIs; and stability in the exchange rate has been restored. Investment climate has further improved because of Pakistan's enhanced status in the global order.

The events of 11 September 2001 have created, some temporary difficulties as far as foreign investment is concerned. During the outgoing fiscal year (2001-02), the total foreign private investment stood at USD 474.6 million as against USD 543.4 million in 1999-00 and USD 182.0 million in 2000-01. Foreign direct investment (FDI) stood at USD 484.7 million as against USD 469.9 million in 1999-00 and USD 322.4 million in 2000-01. Portfolio investment has witnessed sharp inflow in recent months, resulting in neutralizing all outflows of the last year. During the last year, the outflow stood at USD 182.0 million which has been brought down in the 2001-02. The outflow has now turned into inflow in July- October 2002-03 (USD 4.6 million). FDI inflow has witnessed tremendous boost and stood at USD 399.1 million in July –October 2002-03 as against USD 119.6 million . The net foreign private investment stood at USD 403.7 million as against USD 403.7 million in the corresponding period of the last year. Almost 63 percent of FDI has come in oil and gas and power sectors, followed by 7.1 percent in trade, 4.4 percent in transport, 3.8 percent in textiles and so on.

**E. General Economic Forecast for 2002-2003**

Despite serious difficulties arising on account of the events of September 11, Pakistan's economy has performed relatively better than other economies around the world. Industrial production has picked up barring February 2002, inflation is low, rupee has strengthened, foreign exchange reserves have reached to a comfortable position, remittances have already crossed the current year's target, stock market performance has been one of the best around the world, trade deficit has ben reduced, current account recorded surplus, and most importantly total foreign investment is up by 161 percent. The economy is expected to perform better during the ongoing fiscal year (July-June) 2002-03. As such, the GDP growth target for 2002-03 has fixed at 4.5 percent, supported also by higher growth in agriculture (2.6 %) and large-scale manufacturing (6.0%) etc. The exports and imports are expected to grow by 14.0 percent and 7.4 percent respectively which will reduce the trade deficit from USD 1205 million in 2001-02 to USD 700 million in 2002-03. Similarly, the fiscal deficit is also estimated to decline from 5.1 percent of GDP in 2001-02 to 4.7 percent of GDP in 2002-03. The exchange rate is likely to remain stable at around Rs.59=1 USD during 2002-03.

# PAKISTAN

| | 1999/2000 | 2000/2001 | 2001/2002 |
|---|---|---|---|
| population (million) | 136.00 | 139.08 | 142.07 |
| population growth rate | 2.24% | 2.22% | 2.16% |
| adult literacy rate | 47.1% | 49.0% | 50.5% |
| unemployment rate | 7.82% | 7.82% | 7.82% |
| GDP at current factor cost (millions Rs) | 3147167 | 3416252 | 3726611 |
| GDP at current prices (billions USD) | 60.8 | 58.5 | 60.5 |
| GDP per capita (USD) | 441.0 | 414.0 | 427.0 |
| composition of GDP by sectors : | | | |
| - agriculture | | 24.6% | 24.1% |
| - industry | | 21.8% | 21.8% |
| - services | | 53.6% | 54.2% |
| exchange rate (1 USD=Rs, average) | 51.77 | 58.44 | 61.43 |
| average inflation rate | 3.6% | 4.4% | 3.5% |
| total production of energy (oil/000 barrel, local) | 20,395 | 21,084 | 23,195 |
| total consumption of energy (oil/000 barrel, local) | 17,768 | 17,648 | 16,960 |
| total exports, fob (millions USD) | 8,569 | 9,202 | 9,135 |
| total imports, fob (millions USD) | 10,309 | 10,729 | 10,340 |
| export to D-8 countries (millions USD) | 383 | 512 | 468 |
| import from D-8 countries (millions USD) | 1,029 | 1,100 | 935 |
| public sector revenues (as % of GDP) | 16.7% | 16.0% | 17.4% |
| public sector expenditures (as % of GDP) | 23.5% | 21.3% | 23.4% |
| disbursed and outstanding debt (millions USD) | 25,359 | 25,555 | n.a. |
| debt servicing (millions USD) | 1,512 | 1,961 | n.a. |

# TURKEY

## TURKEY

### A Brief Introduction

A stand-by arrangement was in place at the end of 1999 to support Turkey's thrive for economic stability and disinflation. The economic program envisaged far reaching structural reforms and prudent fiscal policies along with a crawling exchange rate regime. In the first weeks after taking office, the coalition Government managed to pass a reform of the banking sector, further streamline the tax system, amend the constitution to introduce rules for international arbitration and include privatization concept in the Constitution, and most important, raise the retirement age as a corner stone of a fundamental reform of Turkey's social security system amidst the turbulent days after a big tremor hit the Turkish industrial heartland in the northwestern Turkey.

Turkey has continued with this ambitious and comprehensive economic programme with the official support of both the IMF and the World Bank at the beginning of 2000. The approval of the candidacy of the country for the full membership to the European Union further contributed to the economic reform efforts by providing a road map in designing economic policies. The 2000 program has been successful for sometime but the difficulties of surviving with a pegged exchange rate regime inevitably appeared. Questions on the exchange rate system and some slippages in the reform agenda raised the concerns on the strength of the program and the willingness of the Government. The stance of the Government was tested in markets once in November 2000 and later on February 2001. The second attempt proved to be insurmountable and the exchange rate was floated in February 2001. The Government put together another economic program to remove uncertainties in the market and lay the basis for growth while continuing to address the decades long inflation problem in the economy and high budget deficit by the public debt.

The new economic program that was put in place following the crisis in February 2001 has three main pillars:

- a new exchange rate regime
- a substantial tightening in the fiscal policy, and
- an ambitious structural reform agenda

The previous program that was put in place by the end of 1999 had a pegged FX rate regime. This led to an acceleration of the real appreciation of the TL. The resulting sharp widening in the current account deficit and the disparity among inflation, interest and depreciation rates led the market participants to question the sustainability of the whole program. Turkey introduced a floating exhange regime in order to increase the resilience of the economy to external schocks and also to prevent a build-up of imbalances that often characterize fixed FX regimes.

The second main pillar of the program is the sustained fiscal adjustment. The fiscal position has been strengthening as evidenced by the primary surplus, which turned into 5.7% of GNP in 2001 from –2 % of GNP in 1999. This strong fiscal adjustment was achieved despite the severe contraction in the economy in 2001. Therefore, as the cyclically adjusted primary surplus implies, the fiscal effort behind this adjustment is even larger than it looks.

Tight fiscal stance will continue and 2002 consolidated public sector primary surplus is expected to reach 6.5 % of GNP compared to the figure of 5.5 % of GNP in 2001. With the expected economic recovery and lower real interest rates, the targeted primary surplus should facilitate a decline in the public debt ratio over time. This in turn should lead to further declines in interest rates. As a result, it is expected that the net debt of the public sector will come down significantly from 92% of GNP in 2001 to 81 % of GNP by the end-2002.

The third main pillar of the program is the ambitious structural reform agenda. Under the strengthened economic program adopted in May 2001, major strides have been made in stabilization and reform. Important structural reforms to lay the foundation for a more competitive market economy have been launched, with emphasis on increased transparency and greater separation between politics and the management of economic institutions and scaling down the government sector and limiting its role to effective market regulation and ensuring social justice.

As efforts to reducing the weight of public sector in the economy have started to bring about more transparent and business-friendly environment, dynamic private sector will soon take the opportunity to attain the standards of global businesses and will have the potential to compete with most of the world corporations. The benefits of these reforms will become even more evident over the coming years, leading to rapidly rising living standards and preparing Turkey for full membership in the European Union.

Major reforms were introduced in banking, social security and agricultural sectors and key laws relating to banking reform, fiscal transparency, deregulation, and the independence of the central bank have been enacted. On another front, structural measures are being implemented to ensure that the fiscal gains are sustained. These measures include a new tax reform plan, introducing a new Public Procurement Law consistent with EU standards, introducing a new financial management law, and eliminating all extra budgetary funds.

Turkey is also building a consensus on broader reforms in public administration, municipal finance and local administrations to modernize its public institutions. In the meantime, through an ambitious privatization program, Turkey wants to remove the last vestiges of state ownership in the industrial sector and encourage further private entry into energy, telecommunications and other infrastructure. Along with many other political and social initiatives, it all adds up to one of the most interesting periods of change in Turkey since the reforms of the early 1980's when Turkey started to integrate with the rest of the world.

The Government is ambitious in implementing all these reform legislation both to restructure the economy and to comply with the EU standards.

In order to ensure higher sustainable growth, Government is committed to continue and further structural reforms around three pillars for 2002 and beyond; completing financial sector reforms; supporting more dynamic private sector development; and strengthening a smaller and more efficient public sector. Remaining financial sector reforms are aimed at ensuring effective prudential regulation of private banks, the eventual privatization of all state banks, and a more effective corporate restructuring framework. Private sector development will be supported through accelerated privatizations and initiatives to create a more stable and inviting investment climate including administrative streamlining, rapid land accesss and site development, pro-active investment promotion and regular high-level Investor Council meetings.

**General Outlook of the Economy**

Following the financial crisis in November 2000 and February 2001, the crawling peg proved to be unsustainable and was replaced with a floating exchange rate regime. Nevertheless external developments, in addition to the problems in the banking sector, the payment system and the public finance, increased the uncertainty in the Turkish economy and adversely affected the expectations in 2001. Due to the contraction in domestic demand stemming from excessive real depreciation in Turkish Lira (TL) and high real interest rates, the GDP declined by 7.4 % in 2001.

The value added in agriculture, industry and services declined by 6.1, 7.5 and 7.6 percent, respectively in 2001. The factor income from abroad declined drastically in 2001 and the contraction in the Gross National Product (GNP) was 9.4 %, 2 percentage points higher than that of the GDP.

Consumption and investment expenditures contracted sharply in 2001 with private and public consumption declining by 9 % and 8.6 % respectively. Gross fixed capital investment declined by 31.7 % in 2001. Private fixed capital investment decreased by 35.1 %, particularly as a result of a 49.6 % decrease in machinery and equipment investments. The decrease in public fixed capital investment was 22 % in the same year.

Indicators on the production side revealed signs of economic recovery in the first half of 2002 and GDP grew by 5.2 % in this period. In this development the second quarter growth had played an important role and the GDP growth rate had reached to 8.2 % in this quarter. This strong recovery came from the improvement in business sentiment supported by declining interest rates and appreciation of the TL with the strong help of the foreign resource obtained from IMF. In the same period, total consumption increased by 0.7 % and the total fixed investment decreased by 11.8 %.

According to the results of the Household Labor Force Survey by the State Institute of Statistics (SIS), the unemployment rate increased from 6.6 % in 2000 to 8.5 % in 2001. In the first quarter of 2002, the unemployment rate was 11.8 % whereas in the second quarter of the year it realized as 9.6 %. This means that in the first half of 2002, unemployment rate increased approximately 3 % with respect to the previous year's same period. In the third quarter of 2002, the unemployment rate realized as 9.9 %.

Contraction in economic activity in 2001 caused a decline in employment in the industry and services sector, while employment in the agricultural sector increased. The shares of the agriculture, industry and services sector in total employment realized as 35.4 %, 18.3 % and 46.2 % respectively in the same year. The unemployment rate increased in urban areas where industrial activities are concentrated, particularly due to the lay-offs, and the rate of idle labor force recorded 6 % in 2001. This rate was 5.4 % in rural areas in the same year.

The net nominal wages of workers covered by collective bargaining agreements in the public sector increased by 36.6 % in 2001, representing an 11.5 % decline in real terms. Civil servant salaries increased by 48.6 % in nominal terms, representing a 3.8 % decrease in real terms. In the same year, the net minimum wage increased by 32.6 %, resulting in a 14.1 % decline in real terms. In the public sector, collective bargaining agreements covering 2003 and 2004 will be signed in the second half of 2002 and in the first quarter of 2003.

The 12 month increases in the Wholesale Price Index (WPI) and the Consumer Price Index were 88.6 % and 68.5 %, respectively, in 2001. The main reasons behind the substantial rise in inflation rates with respect to the previous year could be stated as the failure to restore confidence in the markets after the switch to the floating exchange rate regime following the February 2001 crisis, the long duration of uncertainty and its impact on exchange and interest rates, and the high rate of price adjustments made by the government.

The downward trend in inflation rates were observed in the first ten months of 2002. This tendency can be attributed to insufficient domestic demand in the first half of 2002, the limitation of the monetary expansion by the Central Bank's strict adherence to the monetary program, the wage and salary increases in the public sector being kept in line with the program targets, and the strengthening of the Turkish Lira in the period from November 2001 to May 2002, which led to a decline in the cost of imports. As a result, the rates of increase in the WPI; private manufacturing industry prices (core inflation) and the CPI, in the first ten months of 2002 were 25.5 %, 23.1%, and 24 % respectively. It is expected that the year-end inflation targets ( 35 % for CPI, 31 % for WPI) will be attained considering that the budgetary performance is in line with the targets and the implicit inflation targeting by the Central Bank. This estimation is also supported by the developments in the first nine months of 2002 and the decline in inflationary expectations, as shown by the Central Bank's expectation survey performed in the same period.

**Foreign Trade and Balance of Payments**

In year 2001, merchandise imports as fob reached to USD 39.748 billion whereas merchandise export was realized as USD 35.258 billion . Hence, in 2001 the trade deficit amounted to USD 4.490 billion, as compared to approximately USD 22.375 billion in 2000. The current account balance produced a surplus of approximately USD 3.573 billion in 2001, as compared to a deficit of approximately USD 9.819 billion in 2000.

The economic slowdown and the depreciation of the Turkish Lira have led to a marked turnaround in the external current account in 2001, with a surplus of USD 3.5 billion realized for the full year despite the anticipated loss of tourism and export receipts in the last quarter. For 2002, a small current account deficit is projected, reflecting the combined effect of the September 11 schock, the economic recovery, and a more stable real exchange rate after the large real depreciation in 2001.

During January-September 2002 period, the trade deficit amounted to USD 4,981 million, increasing by 28.8 % compared to the same period of 2001. The current account surplus realized at USD 180 million in January-September period, compared to a surplus of USD 2,758 million in the same period of 2001. As of November 22, 2002, Central Bank reserves were approximately USD 26.1 billion.

**Fiscal Policy and Budget Performance**

The budget of 2001 was prepared with the aim of increasing the primary surplus and ensuring debt sustainability. To this end, measures to increase revenues and provide discipline on expenditures were introduced at the end of 2000 and 2001, in line with the economic program. Within this framework, restrictive measures such as limiting public recruitment and decreasing non-interest expenditures in real terms were taken. In addition, the measures put into force in 2000 to increase revenues were sustained in 2001. As a result of the implementation of these measures, the ratios of budget revenues and expenditures to the GDP were recorded as 28.6 % and 44.3 %, respectively. Thus, the budget deficit and the primary surplus ratios to the GDP were 15.7 % and 6.9 %, respectively in 2001.

In the January- September period of 2002, expenditures were recorded as 80 quadrillion Turkish Liras, while revenues registered as 55.4 quadrillion liras, leading to a budget deficit of 24.6 quadrillion liras. This implies a 46 % increase in expenditures and a 52.3 % increase in revenues, compared to the same period of the previous year. The high rate of increase in domestic interest payment in particular contributed to the rise in total expenditures. However, the primary surplus 14.7 quadrillion liras for the January - September period of 2002 indicates an improvement over the targeted level.

**Financial and Monetary Policies, Including Performance of the Banking System, Stock Exchange, Domestic Savings and Investments**

The switch in the exchange rate regime and the abolishment of the exhange rate as a nominal anchor necessitated a review of monetary policy in 2001. In this regard, a more active use of monetary policy was adopted to restrict the inflationary effects of rapid real depreciation in the Turkish Lira in an environment of banking sector restructuring and floating exchange rate. In this context, upper limits for net domestic assets and lower limits for the changes in net international reserves were introduced and announced as performance criteria. Due to the abolishment of the exchange rate as the nominal anchor, the monetary base was resorted to as both the intermediate target and the nominal anchor in the formation of inflationary expectations of the economic agents. During 2001, the monetary base increased parallel to the target inflation and growth rate, while the short-term interest rates were used actively to eliminate inflationary pressures.

To bring the central banking practice in Turkey in line with EU norms and international standards, the law governing the Central Bank of the Republic of Turkey (CBRT) was amended. According to this amendment, price stability became the primary objective of the Central Bank, which thus gained the autonomy necessary to determine the monetary policy tools while implementing an inflation targeting policy. Furthermore, after the transition period ending in November 2001, direct lending by the Central Bank to the Treasury was terminated completely. By these amendments, the necessary legal framework, allowing the Central Bank to adopt an inflation targeting policy whenever the conditions are met, was established.

In 2002, monetary base continued to serve as nominal anchor in the design of the monetary program. In line with the inflation target and growth projection, the money base growth was determined to be 40 %. The CBRT has continued to determine short-term rates in a forward-looking manner to steer the economy toward the targeted inflation of 35 % during 2002. Positive improvements in inflation expectations, return of stability in exchange rates, the absence of demand pressures and the encouraging progress in the implementation of the economic program led to interest rate cuts by the CBRT.

In the transition period to inflation targeting regime, the monetary base will continue to serve as nominal anchor of the program. In this context, the monetary policy will resume to respect the quantitative targets to attain the inflation target determined by the Government and CBRT. Upon the fulfillment of the prerequisites for the inflation targeting (IT), the CBRT envisions to introduce it formally before the end of the year.

The Central Bank announced that the monetary indicators would be kept under control during 2002 with revisions whenever considered necessary. During the first half of 2002, net international reserves and monetary base were monitored as performance criteria while net domestic assets were followed as the indicative target. At the end of February, April and June the targeted values for the reference aggregates were realized.

Positive developments as regards the stability of financial markets have been observed during the January-May 2002 period. In line with its aim of controlling inflation, the Central Bank used short-term interest rates as a policy tool and reduced them gradually parallel to the developments in the economy. Since May 2002, the CBRT has been closely monitoring the macroeconomic developments in order to limit the effects of the volatility in the markets on the economy.

As a result of the taken steps towards financial liberalization, drastic changes in the structure of the Turkish banking sector were experienced during the 1980s and the 1990s. In this period, the number of banks and the total assets of the sector increased rapidly. However, the insufficiency of the own funds, the small scale and segmented structure of the system, low asset quality, the lack of internal auditing and risk management, and the low level of governance due to inadequate efficiency and transparency were negative characteristics of the Turkish banking sector. Due to those negative elements, the Turkish banking sector has remained fragile and sensitive to both internal and external shocks for the last 20 years. As a matter of fact, the banking sector incurred high costs due to the realization of both interest rate and foreign exchange risks following the crisis in November 2000 and February 2001. The total assets of the banking sector were USD 133.5 billion and USD 155.2 billion in 1999 and 2000 respectively, and reduced to USD 110.8 billion by the third quarter of the 2001. The total assets of the commercial banks in the same years were USD 127.2 billion, USD 148.3 billion and USD 106.4 billion dollars respectively. Related to the negative impact of the crisis, the number of commercial banks, totalling 62 at the end of 1999 and 61 by the end of 2000, decreased to 46 by the end of 2001 and to 43 by June 2002. During the same periods, the share of public banks in the total assets of the banking sector reduced considerably. In 1999 and 2000, the weight of public bank assets in the total banking sector was approximately 34 %, but this ratio was 27.2 % as of the third quarter of 2001.

In order to eliminate the instability, which deepened in the aftermath of the November and February crisis, and to strengthen the banking sector, the Banking Sector Restructuring Program was introduced by the Banking Regulation and Supervision Agency (BRSA) in May 2001. The program consisted of four components.

- restructuring the state banks both financially and operationally with the ultimate aim of privatization,

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| | 1999 | 2000 | 2001 |
|---|---|---|---|
| population (millions) | 64.815 | 65.784 | 66.774 |
| population growth rate | 1.44% | 1.41% | |
| adult literacy rate | 85.7% | n.a | 87.4% |
| unemployment rate | 7.7% | 6.6% | * 8.5% |
| GDP at constant prices (millions USD) | 183,214 | 198,389 | 148,029 |
| GDP at current prices (millions USD) | 305,188 | 411,885 | 289,549 |
| GDP per capita (USD) | 2,836 | 2,986 | 2,139 |
| composition of GDP by sectors : | | | |
| - agriculture | 15.3% | 14.1% | 12.9% |
| - industry | 23.2% | 23.3% | 25.3% |
| - services | 61.5% | 62.6% | 61.8% |
| exchange rate (1 USD= TL, end of period) | 540,098 | 671,765 | 1,446,638 |
| average inflation rate (CPI) | 68.8% | 39.0% | 68.5% |
| total production of energy (thousand tons equivalent petroleum) | 28,797 | 27,934 | 27,407 |
| total consumption of energy (thousand tons equivalent petroleum) | 78,511 | 82,628 | 78,098 |
| total exports, fob (millions USD) | 29,326 | 31,664 | 35,258 |
| total imports, fob (millions USD) | 39773 | 54074 | 39748 |
| export to D-8 countries (millions USD) | 883 | 806 | 964 |
| import from D-8 countries (millions USD) | 1,203 | 1,697 | 1,724 |
| public sector revenues (millions USD) | 73,642 | 121,950 | 86,310 |
| public sector expenditures (millions USD) | 118,574 | 172,484 | 129,534 |
| total external debt (millions USD) | 102,954 | 119,664 | 115,084 |
| debt service | | | |

(*) : in 2002, unemployment rate is 10 %