

ASIAN DEVELOPMENT

Outlook 2004

Special Chapter:

Foreign Direct Investment in Developing Asia



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Foreword

The *Asian Development Outlook 2004* is the 16th edition of the annual comprehensive economic report on the developing member countries of the Asian Development Bank (ADB).

ADO 2004 provides a detailed analysis and assessment of macroeconomic conditions—including fiscal, monetary, and balance-of-payments developments—for 41 Asian and Pacific economies for 2003, as well as projections for 2004–2005. It also provides a broad diagnosis of macroeconomic challenges and future growth prospects for the region's economies.

The recovery in major industrial countries remained subdued in the first half of 2003, but strengthened considerably in the last 2 quarters of the year and in early 2004, mainly in the United States and Japan, as economic growth in the euro zone was insipid. Despite the upturn in growth, inflation remained generally low while in Japan deflation abated. Hence, monetary policies stayed highly accommodative in major industrial countries. Such a policy stance is likely to continue for most of 2004 with a tightening of monetary policy and higher interest rates likely later in the year and in 2005. Fiscal policies in major industrial countries, which have also been expansionary, are expected to become more neutral to moderately contractionary over 2004–2005.

The economies of developing Asia and the Pacific generally showed remarkable resilience in 2003. Despite the uncertainties caused by the Iraq conflict, high oil prices, and the outbreak of the severe acute respiratory syndrome (SARS) epidemic, gross domestic product growth reached 6.3% in 2003, much better than expected earlier in the year and making it the most dynamic region in the world. Average inflation remained low at 2.3%. The region also posted a sizable aggregate current account surplus of 4.2% of gross domestic product.

Two notable features characterized economic developments in the region over the past 2 years. The first is the emergence of the People's Republic of China as a major engine for intraregional trade, a trend that accelerated in 2003 as exports from the rest of the region to that country continued to surge. The second is the increasing importance of consumer demand as a domestic source of

growth; with some exceptions, consumer spending in 2003 was a significant boost for many regional economies.

Given the strong economic fundamentals in the region, and with the outlook for major industrial countries brighter over the next 2 years, the economies of developing Asia and the Pacific are expected to expand by a robust 6.8% in 2004 and 6.7% in 2005. Such growth performance is expected to be increasingly broad based as domestic demand, particularly business investment, strengthens further, and as external demand, including intraregional trade, remains buoyant. There are, however, several significant risks to this outlook. First, geopolitical risks such as terrorist acts or an epidemic outbreak such as SARS or more recently the avian flu remain a reality. Second, imbalances in the recovery of industrial countries hold significant risks for developing Asia's economies, as their recovery might not be sustainable. Finally, the rapidly increasing regional economic interdependence and the surge in intraregional trade, while a very positive development for the region, also carries uncertainties.

ADO 2004 contains a theme chapter discussing foreign direct investment (FDI) in developing Asia and the Pacific. Such investment in the region has grown rapidly in recent years, both facilitating and being attracted by the region's economic dynamism. Governments throughout the region have been striving to find the best policy mix for FDI that will maximize the net benefits for their economies. The chapter discusses recent trends in FDI flows in the region, their impact on the domestic economy, and the importance of the policy context in which these flows occur. While incentives and regulations targeting FDI may have some effect, a conducive environment for domestic investment and competition is more important.

Tadao Chino

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