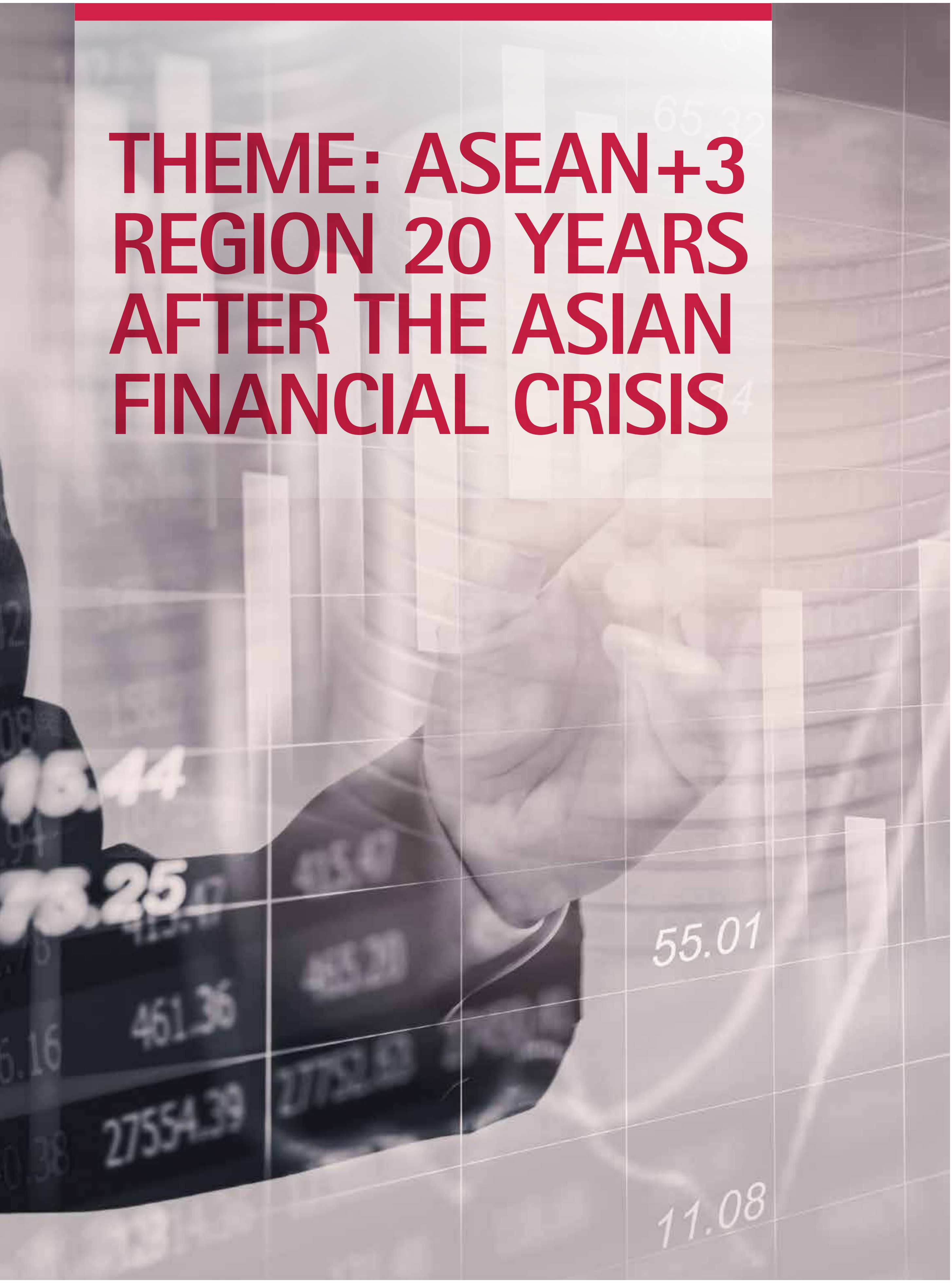
THEME: ASEAN+3 REGION 20 YEARS AFTER THE ASIAN FINANCIAL CRISIS



1 2017 marks 20 years after the Asian Financial Crisis (AFC), a landmark event in the ASEAN+3 region that has shaped the subsequent foundations and trajectory of economic growth and regional integration, as well as policymakers' perspectives on crisis management and resolution. In particular, the AFC highlighted the urgent need for regional financial cooperation in crisis management and resolution, which has resulted in the Chiang Mai Initiative under the ASEAN+3 Finance process, its subsequent expansion into the Chiang Mai Initiative Multilateralisation (CMIM) Agreement, and the creation of AMRO as an independent macroeconomic surveillance unit supporting the CMIM.

2 This section traces the evolution of the ASEAN+3 region in each decade after the AFC, and the prospects and challenges moving forward.

1. 1997 – 2006: Rebuilding Foundations

3 The first decade after the AFC was a period of economic consolidation after a sharp negative shock, and of rebuilding foundations for economic growth. With the AFC, the policy focus in the region shifted abruptly from economic growth to regaining and maintaining external and financial stability. The recovery path necessitated fundamental and painful policy adjustments in exchange rate regimes, corporate and financial sector reforms, fiscal consolidation, and reforms in prudential regulation.

Recap of the causes

4 While it is usually stated that the AFC started in Thailand in July 1997 when the Thai baht came under severe speculative pressure, the vulnerabilities in the region had been building for some time. The AFC was caused by a combination of macroeconomic imbalances (even though government budgets were broadly in balance and inflation rates were modest), external developments, and weaknesses in the financial and corporate sectors. The external imbalances were a reflection both of strong private capital inflows and of high domestic private investment rates, and were exacerbated, prior to the crisis, by the appreciation of the USD, to which the currencies of the economies concerned were formally or informally pegged.

5 Leading up to the AFC, capital flows into the region had surged, drawn by high economic growth, low inflation and relatively healthy fiscal performance, financial sector and capital account liberalization, formal or informal exchange rate pegs and various government incentives. The capital inflows fueled rapid credit expansion in Korea, Malaysia and Thailand, which contributed to an investment boom (mainly in real estate) and asset price inflation (especially in Malaysia and Thailand). This in turn encouraged more capital inflows and lending.

6 Under pegged exchange rate regimes, the broadly stable exchange rate led both borrowers and lenders to underestimate the risks from excessive foreign currency exposure. Maturity mismatches in banks' portfolios, and currency mismatches on corporates' balance sheets and highly leveraged positions of the borrowers proved to be the Achilles' heel of these economies. Meanwhile, banks were increasingly exposed to credit and foreign exchange risks and to maturity mismatches, to the extent that foreign borrowing was short term and domestic lending long term, thus increasing the financial vulnerability to outflows. Rapid growth also strained banks' capacity to assess risk adequately. The lax prudential regulatory and supervisory practices in the crisis-hit economies also contributed to the problem.

7 The vulnerabilities differed slightly across crisis-hit countries. In Thailand, the vulnerabilities stemmed from excessive unhedged foreign currency borrowing in the banking sector under the fixed exchange rate regime; in Indonesia, it was due to unhedged foreign currency borrowing in the corporate sector; in Malaysia, it was the high leverage of the corporate sector; and in Korea, it was mainly in the form of foreign liabilities of non-bank financial institutions and the corporate sector. Non-bank financial institutions had grown rapidly before 1997 as a result of easier licensing requirements (Thailand) and less stringent regulations, including lower capital requirements (Korea and the Philippines) than those applied to commercial banks. Merchant banks in Korea and finance companies in Thailand were the first institutions to face liquidity shortfalls, and many became insolvent and had to be shut.

8 Nevertheless, the vulnerabilities were similar enough for contagion spread rapidly across the region as investors withdrew. While the ASEAN+3 region was affected as a whole, the most adverse impact was on the larger ASEAN economies and Korea. Thailand, Indonesia, Korea and the Philippines[40] sought financial assistance from the IMF. Tough austerity measures were adopted to help restore confidence, stem capital outflows and support the weakening currency. Some countries also introduced capital control measures to stop capital outflows, with varying degrees of success.

[40] Support for the Philippines was in the form of extending and augmenting the existing IMF-supported program for the Philippines in 1997, and arranging a stand-by facility in 1998.

Recovery from the AFC

9 Significant and often painful policy adjustments by the affected economies eventually enabled them to rebuild the foundations for economic growth. Exports led the recovery, and the highly depreciated exchange rates boosted export price competitiveness. Exports were further boosted by the deepening of regional value chains with China's WTO accession in end-2001 and Vietnam's WTO accession in 2007. Steady global economic growth in the advanced economies provided the tailwinds to the export-led recovery in the region. As a result of their growth rebound and reserve accumulation, the crisis economies which borrowed from the Fund made an early exit from Fund programs.

Table 1.1 Different crises, different responses

	After AFC	After GFC
What led the recovery?	Exports	Domestic demand
Level of Investment	Fell and remained below trend	Remained low
Capital flows	Did not return immediately	Returned immediately
China	Led the surge in intra-regional exports	Rebalancing towards more domestic consumption
Japan	Pull-back of Japanese banking flows from Asia	Increase in Japanese bank flows to Asia
Share of China, Korea and Japan in ASEAN's total trade	Accounts for around 18% of ASEAN trade in 1999	Share increased to 31%
Productivity growth	Healthy growth via technology	Moderated

10 The region's recovery path from AFC can be contrasted with its path in the Global Financial Crisis (GFC) that affected the region ten years later in 2008-9, which did not have the same sharp negative shock of the AFC (see Table 1.1 and Figure 1.1). GDP growth collapsed during the AFC as economic fundamentals in the region deteriorated, while during the GFC, growth only dipped slightly and recovered quickly as fundamentals were stronger and the crisis did not originate from the region.

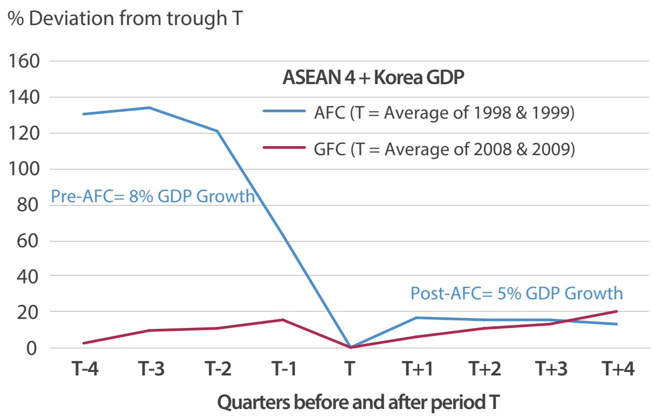
11 Comparing the region's recovery following the AFC and the GFC, three features of the recovery during the AFC stand out:

(a) Exports, facilitated by sharply depreciated currencies and robust external demand (notably, a robust U.S. economy), led the V-shaped recovery for the crisis-hit economies in ASEAN-4 and Korea after the AFC. By 1999, GDP growth had recovered to pre-crisis levels and for the next eight years until 2007, GDP growth averaged 4.0 to 6.0 percent in the crisis-hit economies, which while steady, was 1.0 to 2.0 percentage points below pre-crisis growth levels.

(b) Private investment in the crisis-hit economies declined sharply during the AFC reflecting widespread corporate failure, and never fully recovered. To some extent, this reflected the correction in excesses in real estate and infrastructure spending. Coupled with the decline in public investment arising from fiscal consolidation, this slump in investment spending lowered productivity growth and hence potential output growth for years to come.

(c) Capital inflows took time to return to the region after the AFC. This reflected the battered state of the corporate and banking sectors in the crisis-hit economies, which had to undergo a prolonged period of consolidation, often supported by fiscal resources.

Figure 1.1 Different growth trajectories during the AFC and GFC



Note: Data is calculated by taking percentage deviation of quarterly aggregated GDP before and after the crisis years from the average aggregated GDP during crisis years.
Source: National Authorities

12 After the AFC, exports led the recovery in crisis-hit economies and the move towards more flexible exchange rate regimes added a boost to export competitiveness. The current account balance of ASEAN-4 economies and Korea swung from deficit to surplus in a short period of time on the back of strong exports and a collapse in imports (Figure 1.2).

13 The rebound in exports also reflected supportive external demand conditions from a robust U.S. economy, and the concurrent emergence of China as the major player in the region's production networks from the early 2000s. Exports were further boosted by the deepening of regional value chains with China's and Vietnam's WTO accession. Steady global economic growth in the advanced economies and in China also provided tailwinds to the recovery in the region (regional trade integration is elaborated on in the next section). The rebound also meant that the economic adjustment, although painful, took place largely without a permanent spike in unemployment levels in these economies.

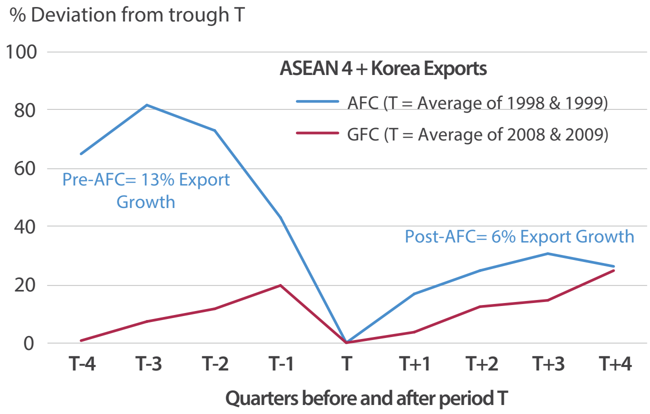
14 On a less benign note, from a savings-investment perspective, the large current account surplus also reflected

an investment slump rather than a savings glut (Figure 1.3). Investment recovered to above trend level some 10 years after the AFC (Figure 1.4). Real investment in Asia has been lower than what macroeconomic fundamentals would suggest and this reflected the correction in real estate, construction and equipment spending following the construction boom which led to the crisis. Investment as a share of GDP fell by some 12.0 percentage points following the AFC and has remained flat at about 10.0 percentage points below pre-AFC levels ever since. This structural decline in fixed investment reduced the potential growth of these economies which has been about 1.0-2.0 percentage points lower than before the AFC.

15 The investment decline likely reflected the protracted rebuilding of damaged corporate balance sheets as well as disruptions in domestic and external sources of financing, with the consolidation in banking systems hindering lending, and also a decline in capital flows to the major regional EMs. The AFC saw an abrupt reversal of capital flows in response to the worsening economic fundamentals which took some time to recover. Total inflows returned to the region in earnest only around 2002 (Figure 1.6).

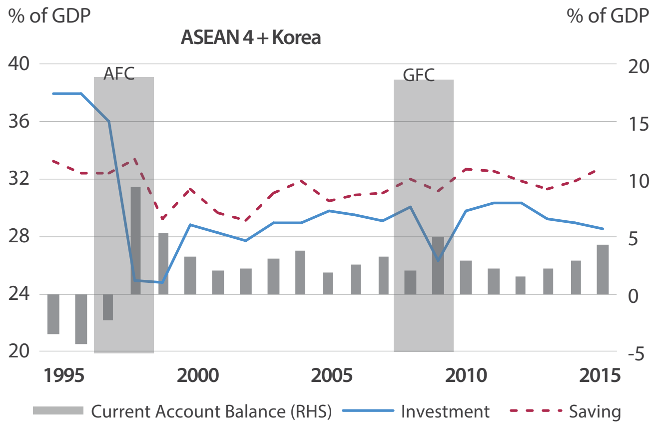
16 Private capital flows were relatively slow to return after the AFC, as compared to after the GFC. The behavior of capital flows after the crises is a major point of contrast between the AFC and the GFC. After the GFC, yield-seeking capital inflows into the ASEAN+3 region recovered quickly and buoyed the recovery through low-cost financing and credit. This is especially true of Japanese banks which have substantially increased their lending and portfolio investment to Asia, filling the void left by European and U.S. banks after the crisis. On the other hand, Japanese banks' cross-border lending to Asia fell by around 24.0 percent to 30.0 percent on average during and immediately following the AFC. This pullback continued until 2004, when Japanese bank lending turned positive, and surged after the GFC. During 2013 and 2014, Japanese bank lending increased sharply by 40.0 percent to 50.0 percent with Thailand accounting for more than half of the inflows from Japan. At the same time, Japan's Official Development Assistance (ODA) was sustained in the decade after the AFC, partly offsetting the decline in Japanese bank lending (Figure 1.8). (Intra-regional flows are elaborated on in the next section).

Figure 1.2 Exports led the recovery after the AFC



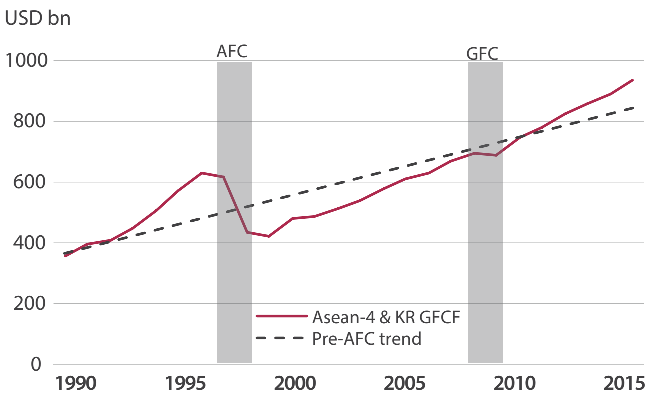
Note: Data is calculated by taking percentage deviation of quarterly aggregated exports before and after the crisis years from the average aggregated exports during crisis years
Source: National Authorities

Figure 1.3 The reversal of regional current account deficit to surplus during the AFC was mainly due to an investment slump[41]



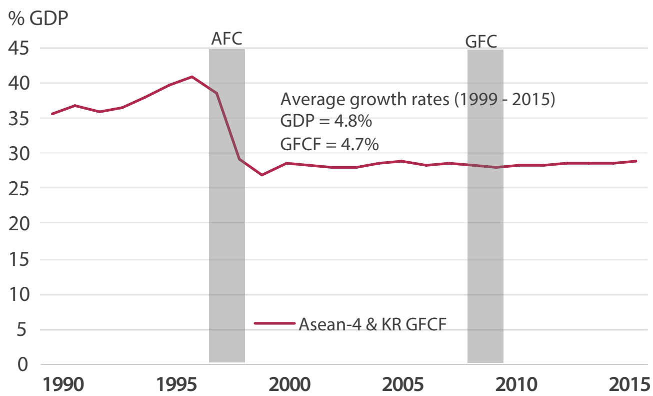
Source: IMF

Figure 1.4 Actual Gross Fixed Capital Formation (GFCF) has been below trend in ASEAN-4 economies and Korea



Source: World Bank

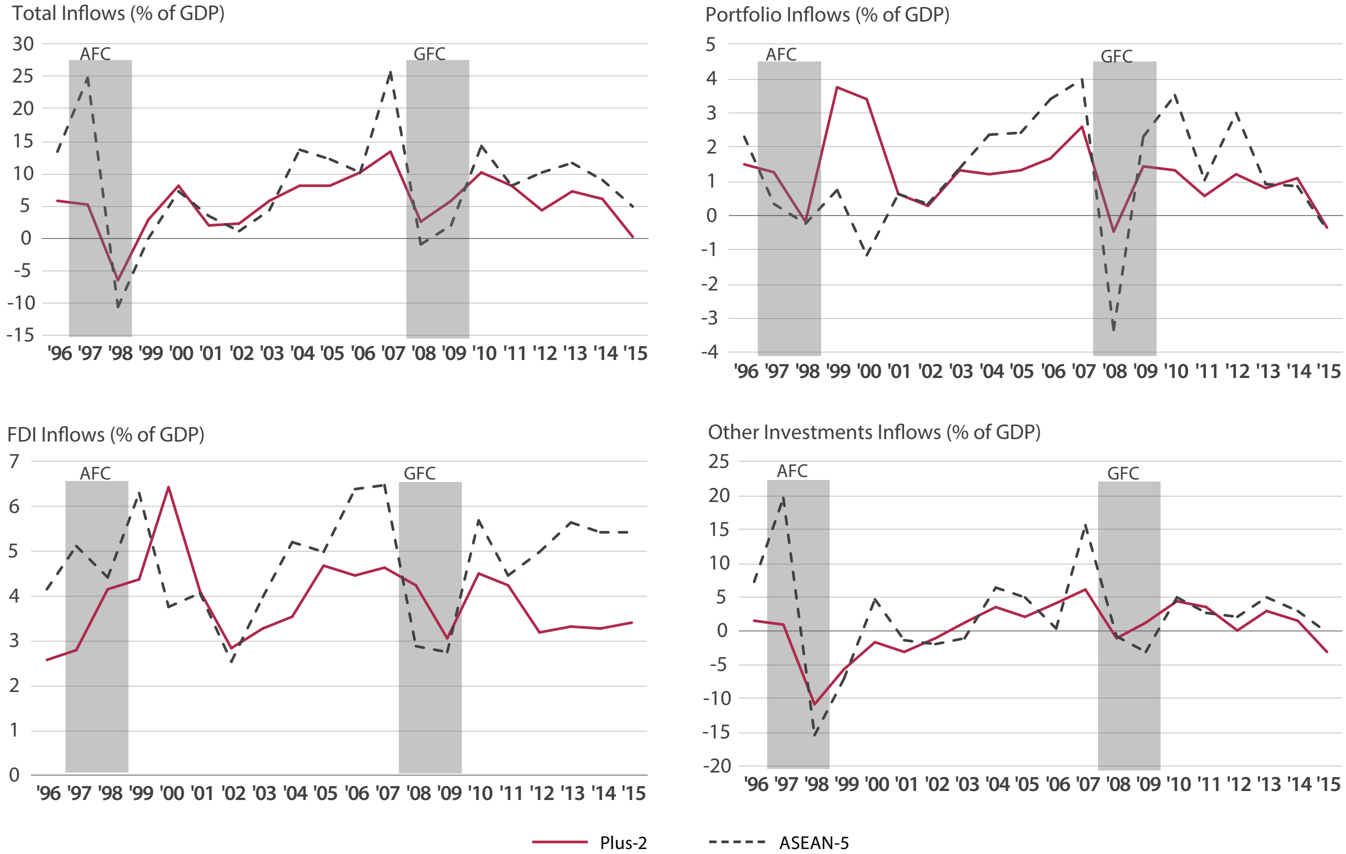
Figure 1.5 The level of investment to GDP ratio has fallen and remained flat in ASEAN-4 economies and Korea



Source: World Bank

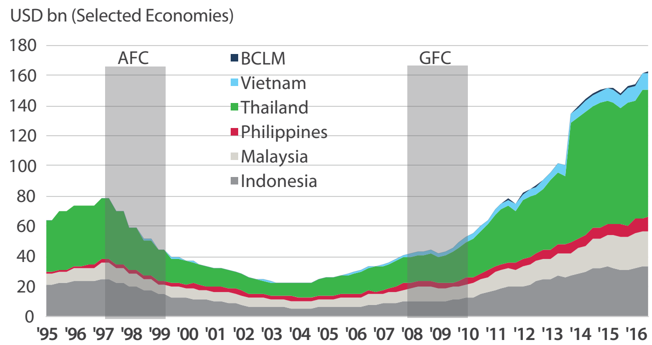
[41] Some regional economies such as in Indonesia, Thailand and Malaysia had their current account deficits turned to surplus during the AFC.

Figure 1.6 Gross Capital Inflows (China, Korea and ASEAN-5 economies)



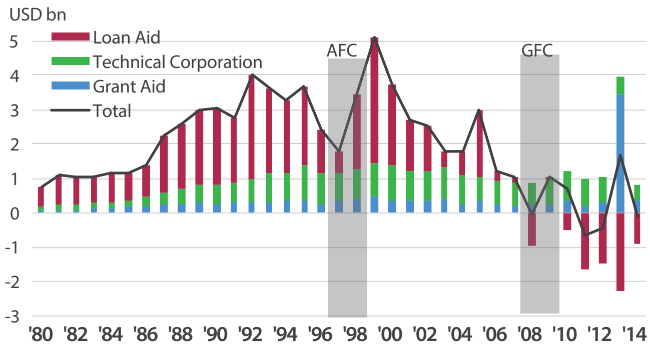
Notes: Plus-2 refers to China, Hong Kong and Korea. ASEAN-5 refers to Indonesia, Malaysia, the Philippines, Singapore and Thailand.
Source: National Authorities

Figure 1.7 Japanese banks' claims to ASEAN (ex-Singapore) declined after the AFC but surged after the GFC



Note: Data based on BIS Consolidated Statistics which capture the worldwide consolidated positions of banks headquartered in BIS reporting countries, including positions of their foreign affiliates but excluding intragroup positions.
Source: BIS Consolidated Banking Statistics

Figure 1.8 Japanese ODA to the ASEAN+2 economies was sustained in the decade after the AFC



Notes: The CLMV joined ASEAN at 1995 (Vietnam), 1997 (Lao PDR and Myanmar) and 1999 (Cambodia). Singapore and Brunei graduated from ODA recipient status in 1996. Hong Kong and Korea graduated from ODA recipient status in 1997 and 2000 respectively. 2014 data for Korea is not available
Source: Japan Ministry of Foreign Affairs

More Robust and Flexible Policy Framework after the AFC

17 In the aftermath of the AFC, policymakers in the region fundamentally changed their policy framework and macroeconomic management, to improve flexibility in their policy mix to deal with external shocks. Key among these changes was a more flexible monetary framework, fiscal and financial sector consolidation, and better prudential oversight to deal with emerging financial stability risks.

18 In monetary management after the AFC, regional policymakers became more skilful at managing the "trilemma" of exchange rate flexibility, monetary policy and capital mobility. Leading up to the AFC, the regimes of fixed nominal exchange rates against the USD turned out to be a source of instability rather than stability. After the AFC, the ASEAN-4 economies moved from a tightly pegged exchange rate regime to a more flexible one. This allowed them to gain more monetary policy autonomy in the context of a more open capital account. Four countries adopted an inflation targeting regime (Table 1.2) that committed the central bank to an explicit inflation target, which kept inflation in check and provided a foundation for sustained growth. The greater transparency and other institutional reforms that come with an inflation targeting framework have, over time, enhanced central bank credibility and help anchor price stability more firmly.

19 The crisis-hit economies of ASEAN-4 and Korea have also committed to fiscal reforms to strengthen their fiscal positions. For instance, some of them have set ceilings on fiscal deficits and/or debt-to-GDP ratios. They have also broadened and diversified their tax base (especially in countries dependent on oil and gas revenue). These measures have anchored fiscal policies and stabilized debt-to-GDP ratios at lower and more sustainable levels (Figure 1.9). The Philippines and Thailand have improved their fiscal balance over the years, while Indonesia and Malaysia's fiscal balances have been adversely affected by weak commodity-related revenue in recent years (Figure 1.10).

20 In addition, ASEAN-4 economies and Korea have undertaken a series of structural reforms which have strengthened the resilience of their financial systems to shocks and improved the balance sheets of their corporate and financial sectors. These reforms have encompassed many key areas, including financial and corporate restructuring, adoption of new laws to address corporate bankruptcy and governance, improving of labor market flexibility, strengthening of market competition and easing of foreign ownership. More importantly, greater efforts were made on institutional reforms to improve their risk management capabilities and strengthen their prudential supervision and regulations with the adoption of a more risk-based approach to supervision. Steps have also been taken to reduce relationship-based lending practices that were the norm before the AFC.

21 The crisis countries, for instance, sought to strengthen their supervisory and regulatory powers through the introduction of new laws and new financial supervisory agencies, closure and merger of financial institutions, accompanied by the promotion of transparency and disclosure of quality data. New legislation strengthened autonomy for central banks, including in Indonesia, Thailand and Korea, and across the region, deposit insurance schemes and agencies were established. Along with financial restructuring, Korea embarked upon corporate restructuring, with focus on improving corporate governance, competition, and financial and operational restructuring. In Thailand, the government conducted comprehensive financial sector restructuring, including encouraging M&A of small financial institutions, adopting Basel capital standard and IAS 39 accounting standard on loan-loss provisions, and facilitating the establishment of private asset management firms. Malaysia and the Philippines also implemented various bank restructuring programs.

22 As a result, in the financial sector, nonperforming assets were dealt with, directed lending curtailed and banking systems recapitalized and privatized. These policy efforts in reforming the financial sector were also complemented by fiscal consolidation and reform. This reform process meant stronger balance sheets in both the public and private sectors, which provided a firm foundation to weather the GFC when it hit the region in 2008-9. Contrasting the experience during the AFC where Asian corporates with corporate debt and FX mismatches were battered, Asian corporates remained relatively unscathed during the GFC.

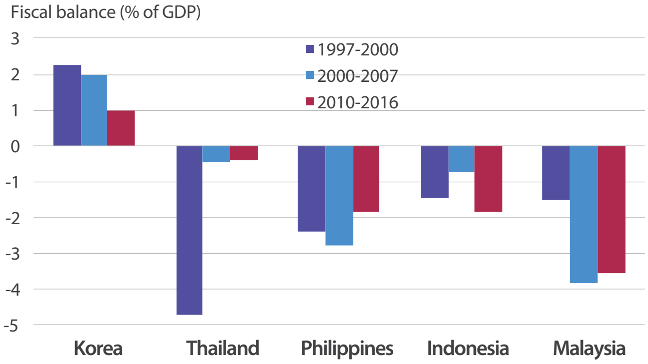
Table 1.2 Inflation Targeting Adopters

Country	Inflation Targeting Adoption date
Indonesia	Q3 2005
Korea	Q2 1998
Malaysia	Fixed exchange rate (before 2005)
Philippines	Q1 2002
Thailand	Q2 2000

Figure 1.9 Declining public debt in some economies

Note: Data for Indonesia starts from year 2000.
Source: IMF

Figure 1.10 Narrowing fiscal deficits in some economies



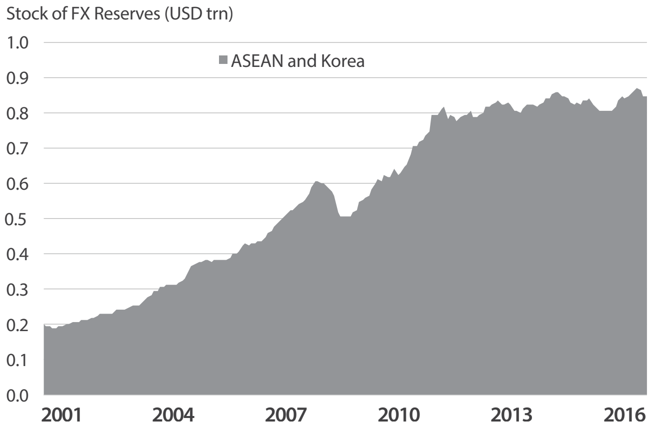
Note: Korea's data includes Social security funds (SSF).
Source: IMF

Foundations for Growth and Regional Financial Cooperation

23 A decade after the AFC, the fundamentals and external positions of the crisis-hit economies had improved remarkably with a significant build-up in FX reserves (Figure 1.11). With rising current account surpluses (Figure 1.12) and net capital inflows gradually returning into the region, Asian economies took the opportunity to build up their foreign exchange reserves substantially in the decade after the AFC. Reserves of ASEAN-4 and Korea increased by three times between the periods 1994-96 and 2000-2007 and the ASEAN+3 region's reserve holdings have grown to over 50.0 percent of global reserves. This was motivated by their experience during the crisis and the desire to build up buffers as insurance against future liquidity crises. These reserves were accumulated mainly through sterilized interventions which reflected their efforts to self-insure against future liquidity crises. The reserves have proved useful and act as a shock absorber during periods of capital outflows.

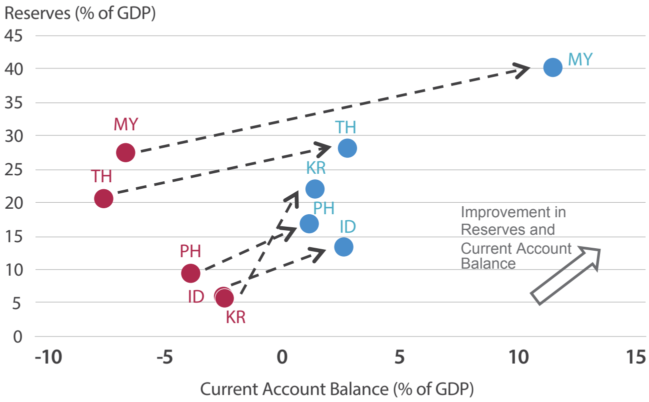
24 While the AFC could have caused an inward-looking response from the region and led it to permanently close its capital account to international trade and investment flows, this did not occur. Instead, the regional economies focused on reducing their external and fiscal vulnerabilities and on building up buffers against future potential crises. The improved macroeconomic management framework after AFC, in particular in improving resilience and buffers against external shocks, allowed the region to reap the benefits from intra-regional trade and FDI flows (the theme of the next section). The AFC also marked the beginning of deeper ASEAN+3 regional financial cooperation in the face of a common crisis, with the Chiang Mai Initiative beginning as a series of bilateral swap arrangements following the meeting of ASEAN+3 Finance Ministers in Chiang Mai, Thailand, in May 2000. Box C outlines the development of the Chiang Mai Initiative into the CMIM, and the role of AMRO in supporting this regional safety net.

Figure 1.11 The stock of foreign reserves has increased over time



Source: National Authorities

Figure 1.12 Reserves have increased and the current account balance has improved



Note: Red dots denote 1994-1996 average while blue ones denote 2000-2007 average.
Source: IMF

Box C. AMRO in Supporting the Implementation of the Chiang Mai Initiative Multilateralisation (CMIM) Agreement

AMRO was established to contribute to securing the economic and financial stability of the region through conducting regional economic surveillance and supporting the implementation of the CMIM. The CMIM is a multilateral currency swap arrangement among ASEAN+3 members, which came into effect on 24 March 2010. Its core objectives are (i) to address balance of payment and short-term liquidity difficulties in the ASEAN+3 region, and (ii) to supplement the existing international financial arrangements. The contracting parties to the CMIM Agreement comprise 13 finance ministries and 14 central banks of ASEAN+3.

In 2000, in the wake of the AFC, ASEAN+3 financial authorities decided to strengthen their financial cooperation through the establishment of Chiang Mai Initiative (CMI), comprising a network of bilateral swap agreements among members. In 2010, the CMI was multilateralized into a single contractual agreement called the CMIM Agreement and the total size of the CMIM facility was expanded and set at USD120 billion. The evolution of the CMI into the CMIM marked an important milestone, exemplifying the members' strong commitment to continuously improve and promote financial stability in the region. The CMIM was further strengthened in 2014 by doubling the size to USD240 billion and raising the IMF de-linked portion to 30.0 percent, and lengthening the maturity and supporting period. A crisis prevention facility, CMIM Precautionary Line (CMIM-PL) was introduced, in addition to the existing CMIM Stability Facility (CMIM-SF) for crisis resolution function.

AMRO's Milestones

February 2009
ASEAN+3 Finance Ministers agreed to establish an independent regional surveillance unit to promote objective economic monitoring.

March 2010
The CMIM Agreement came into effect.

April 2011
The AMRO was established as a company limited by guarantee in Singapore in accordance with Singapore's Companies Act.

July 2014
The amended CMIM Agreement came into effect.
Key points of the amendment:
(i) Size doubled to USD 240 billion
(ii) IMF de-linked portion was raised from 20.0 percent to 30.0 percent
(iii) A crisis prevention facility, CMIM Precautionary Line (CMIM-PL) was introduced
(iv) The maturity and supporting period of CMIM facilities were extended

October 2014
ASEAN+3 members successfully completed the signing of the AMRO Agreement to establish AMRO as an international organization.

February 2016
The AMRO Agreement entered into force, thereby establishing AMRO as international organization with full legal personality.

2. 2007 – 2016: Rebalancing and Leveraging Regional Integration

Context of the GFC

25 The tailwinds provided by robust external demand came to an abrupt halt in 2008-9 with the GFC taking a large toll on the advanced economies of the U.S. and the Eurozone. Global trade growth has not recovered since, limiting the contribution of exports to growth in the ASEAN+3 economies. However, the massive monetary policy stimulus by the U.S. and the Eurozone resulted in a prolonged period of low global interest rates, creating conditions for the ASEAN+3 region to rebalance and shift from exports to domestic demand as a driver of growth, with investment and consumption facilitated by credit and low financing costs. Yield-seeking capital flows from advanced economies to emerging markets, including in the ASEAN+3 region, provided easy liquidity conditions. At the same time, higher commodity prices led by demand from China benefitted commodity exporters in the region, and eased fiscal constraints.

26 At the same time, the region's continued openness to trade, FDI and capital flows after the AFC enabled the region, especially the smaller ASEAN economies, to reap the benefits from growing regional integration and the emergence of China in regional trade and FDI. With China's accession to the WTO in 2001, it became the central node of a dynamic regional production network, absorbing exports from the rest of Asia. The rise of China as a production platform in this vertically-integrated supply chain for electronics and other products provided the impetus for intra-regional trade to thrive. Intra-regional trade within ASEAN+3 grew from 45.0 percent in 2000 to 47.2 percent in 2015, comparable to the Eurozone's 46.1 percent in 2015. In particular, China's share of intra-regional exports increased from 19.4 percent in 2000 to 25.6 percent in 2009. In this same period, the ASEAN economies of Cambodia, Lao PDR, Myanmar and Vietnam (CLMV) reaped the benefits of greater integration in regional trade and investment flows.

Growing Regional Integration: Emergence of China

27 The region has benefited greatly from China's rapid integration in the global economy, with deepening and diversified trade flows. China's imports from ASEAN economies are diversified in terms of both product types and source economies (Figure 2.1). Most of China's capital goods imports from ASEAN, including transport equipment, are from the ASEAN-5 economies of Thailand, Malaysia, Singapore, Indonesia and Vietnam. For intermediate goods imports, China has diversified its imports over the past 10 years from the larger ASEAN economies to include the other ASEAN economies of Brunei, Cambodia, Lao PDR and Myanmar. This may reflect the integration of smaller economies into the global value chain, with intermediate goods imported into China for final processing. For consumption goods imports, China has also diversified its imports over the past ten years from ASEAN, with a significant rise in consumption goods imported from Vietnam.

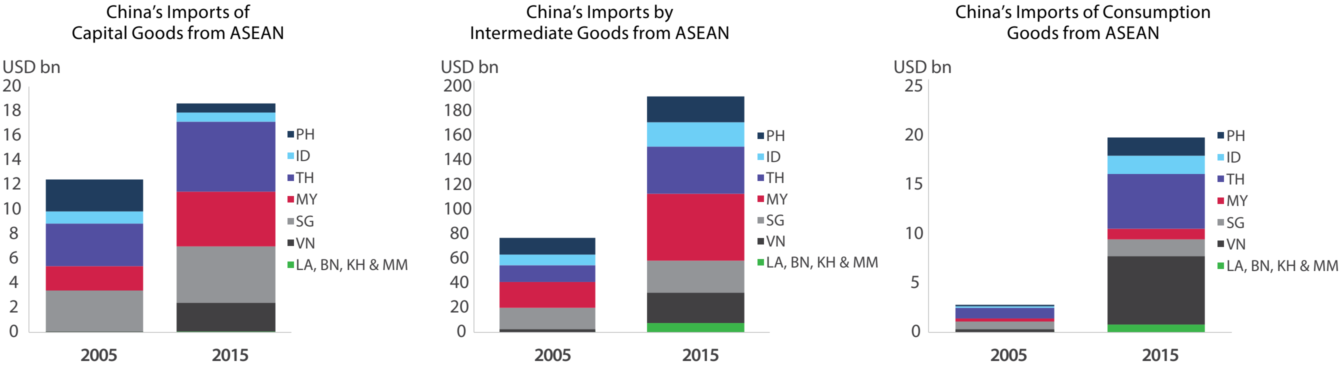
28 While China has absorbed imports from the region to support its investment-driven growth, its import intensity of growth has declined in recent years. Coinciding with the decline in China's fixed asset investment as a share of GDP, China's intensity of imports (in volume terms) relative to the size of the economy has declined since 2011 (Figure 2.2). This suggests that compared to the past, China's growth has become less import-intensive. With the rebalancing away from investment-driven growth, import intensity will likely decline. Economic literature[42] also attributed the decline in import intensity to a decline in intermediate goods imports, as China moves up the global value chain and on-shores parts of the supply chain back to China, including to its less developed western regions.

29 China's rebalancing from investment- and resource-intensive growth has altered its composition of import demand from the region, a trend expected to continue. The near-term spillovers from demand rebalancing in China will depend on the level and type of exposure to China, as there is considerable variation within the region on the types of exports to China, ranging from countries that export mainly commodities to those exporting capital goods. For example, Brunei's and Indonesia's exports to China are mainly in mining products, while exports from Cambodia, Lao PDR and Myanmar are mainly garments, wood/metals and precious stones respectively. On the other hand, the exports from Korea, Malaysia, Vietnam, Singapore and Thailand to China are mainly in machinery, electrical and transport equipment (Figure 2.3). In the short term, economies with heavy exposure to China's investment (such as exports of capital goods and related parts) will be vulnerable to a structural downward shift in demand.

30 Notwithstanding that a major share of China's imports

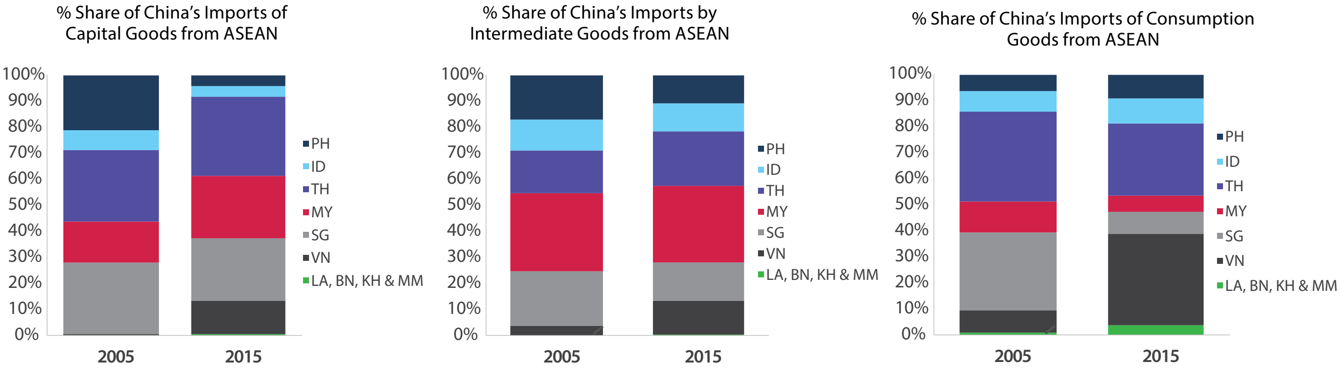
[42] See Kee and Tang (forthcoming), "Domestic Value Added in Exports: Theory and Firm Evidence from China" American Economic Review.

Figure 2.1(a) China's Imports from ASEAN by Major Import Classification (in USD terms)



Source: UN Comtrade

Figure 2.1(b) China's Imports from ASEAN by Major Import Classification (in % of China's Imports)

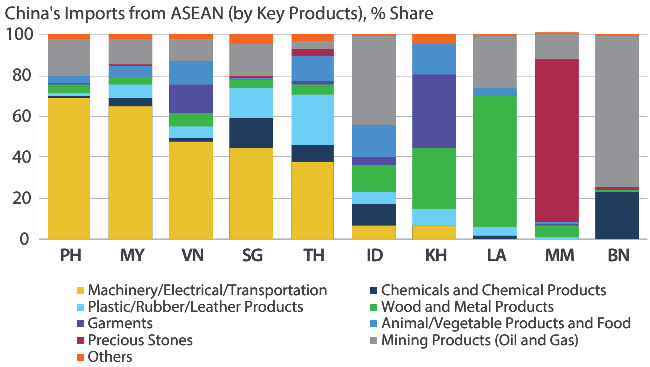


Source: UN Comtrade

Figure 2.2 China's import intensity relative to its economy has declined with its rebalancing

Sources: National Authorities and AMRO staff estimates

Figure 2.3 Exposure to China differs from one economy to another depending on the type of products (ASEAN Economies, 2015)

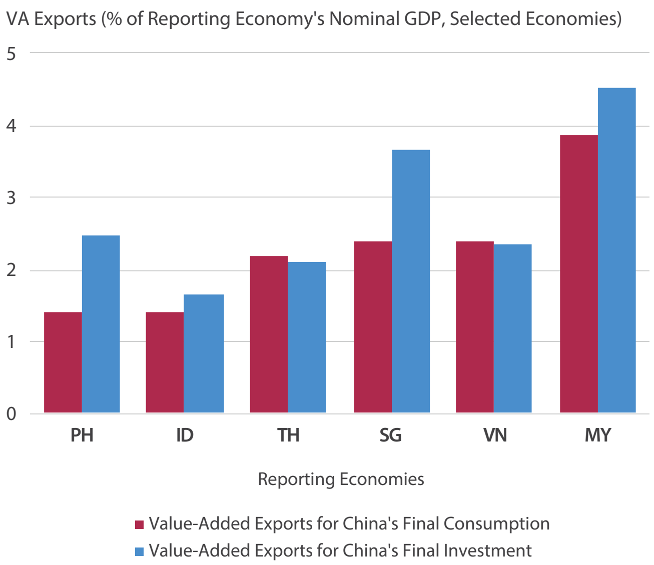


Source: World Trade Atlas

was destined for final demand in the advanced economies, China has increasingly become a key final demand destination for regional exports as well, reflecting its growing affluence and the rapid rise of the middle class. Figure 2.4 shows that while regional economies' exports (in value-added terms) to China were largely for final investment demand, this may be shifting to final consumption demand with China's rebalancing, which is a secular trend. Economies in the region that can better capture the rising consumption demand in China will tend to benefit from this shift.

31 China's consumption of tourism services in the region is a prime example of its rising demand for services from the region. Since 2009, China's outbound tourism has expanded at an exponential rate of 16.6 percent until 2015, particularly to Korea, Japan, Thailand and Cambodia (Table 2.1). Not only did the number of visitor arrivals grow, tourist expenditures in the destination countries (notably Thailand, Singapore and Malaysia) also increased. In the region, the tourism receipts from China have helped to offset the decline in merchandise exports. Development of the tourism industry may also be a means of economic diversification for smaller ASEAN countries (such as the CLMV countries), where the tourism industry has significant potential.

Figure 2.4 Regional economies that can tap rising consumption demand in China will likely benefit (selected economies, 2011)



Source: OECD

Table 2.1 Tourists from China (excluding Hong Kong) have accounted for a rapidly growing share of tourists into most regional economies

	Number of Chinese Tourists in 2016 (mn)	Share of China's Tourists in Total Overseas Tourists Going into Regional Economy (%)		
		2009	2012	2016
Brunei*	0.04	0.4	0.5	0.5
Cambodia	0.8	6.3	9.3	16.6
Indonesia*	1.2	6.2	8.5	12.0
Japan	5.0	14.8	17.1	26.5
Korea	8.1	17.2	25.5	46.8
Lao PDR*	0.4	6.4	6.0	10.2
Malaysia*	2.1	4.3	6.2	7.9
Myanmar*	0.04	n.a.	n.a.	0.9
Philippines	0.7	5.1	5.9	11.3
Singapore	2.1	9.7	14.0	13.8
Thailand	8.8	5.5	12.5	26.9
Vietnam	2.7	14	20.9	26.9
Total	**32.0**	**7.8**	**12.0**	**20.6**

Notes: *Data for Brunei, Indonesia and Myanmar as of 2015; data for Lao PDR as of 2014. Data for Malaysia include arrivals from Hong Kong.
Source: National Authorities

Intra-regional FDI Flows

32 Parallel with this rise in intra-regional trade flows, intra-regional inward FDI flows have expanded strongly in recent years, notably in ASEAN, reflecting the shifting comparative advantages of ASEAN economies, and their growing participation in global value chains (GVCs).[43] The deepening intra-regional investment also reflects the recycling of domestic savings to productive investments within the region. Of the FDI inflows towards ASEAN, intra-ASEAN investors have become the largest source of inflows in 2015. The share of intra-ASEAN investment in total FDI flows to the region rose to 18.4 percent in 2015, while the inflows from E.U. countries are on a downward trend. In aggregate, the investments from the Plus-3 economies command a sizeable share of inward FDI to ASEAN, amounting to about 26.1 percent in 2015 (29.9 percent including Hong Kong). Within the Plus-3, Japan has maintained its status as a key investor in ASEAN whereas the investment shares of China and Korea have been trending upwards in recent years (Figure 2.5).

33 In terms of destination, intra-regional FDI from ASEAN+3 tends to largely flow into the ASEAN-5 economies, while some BCLMV countries have also benefitted from the inflows. Among the large ASEAN economies, recent data shows that Singapore[44] and Indonesia received substantial shares of intra-regional investment. Among the BCLMV economies, Vietnam and Myanmar attracted relatively large FDI inflows from the ASEAN+3 region. In particular, Vietnam witnessed a large share of FDI inflows from the Plus-3 economies, which is comparable to those in Indonesia and Thailand. It is noteworthy that Singapore, the largest FDI recipient in ASEAN economies,

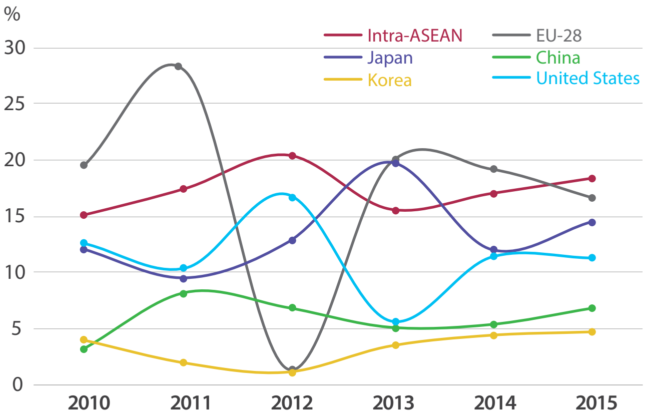
[43] United Nations Conference on Trade and Development (2013). "Global Value Chains: Investment and Trade for Development," Chapter 4 of World Investment Report 2013. New York and Geneva: United Nations.
[44] Some of these FDI flows reflect the activities of companies that have used Singapore as a hub for the region.

accounts for significant shares of intra-ASEAN investments in key destinations, especially Indonesia. (Figure 2.6).

34 Empirical evidence suggests that inward FDI has positive statistical relationships with GVC participation and economic growth. According to a comprehensive empirical study on 187 countries by UNCTAD (2013), inward FDI stock data during the sample period of 1990-2010 tends to show a strongly positive correlation with their GVC participation rates, especially in low-income countries.[45] In turn, it is also found that a rise in GVC participation growth rates is likely associated with faster GDP per capita growth rates. In a similar vein, our simple analysis of GVC participation and GDP per capita growth rates in the region lends some support to the arguments based on international evidence. GVC participation rates in the ASEAN+3 rose by 12.0 percentage points on average during 1995-2009 when the FDI inflows surged as aforementioned (Figure 2.7). The region's GVC participation ratio (54.0 percent) exceeded the Eurozone's (52.3 percent) in 2009. Furthermore, the fitted line on a two-way scatter plot shows that GVC participation growth rates have a tendency to go hand-in-hand with GDP per capita growth rates (Figure 2.8).

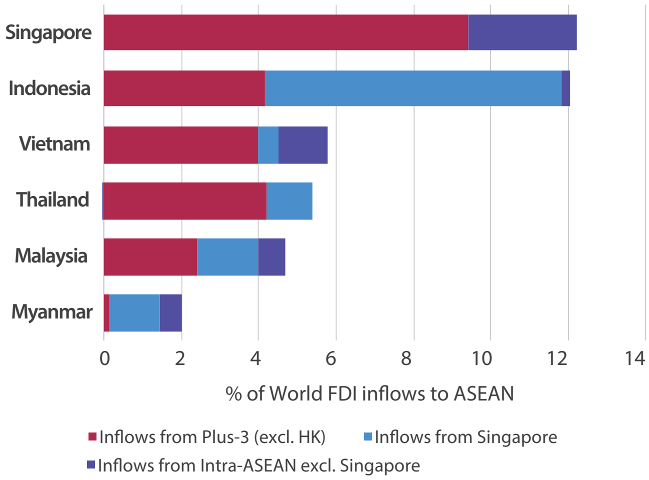
35 These intra-regional FDI flows have been key in promoting industrial upgrading in the CLMV economies. CLMV economies have increasingly attracted FDI inflows

Figure 2.5 Share of FDI Inflows to ASEAN by Source Region, economy



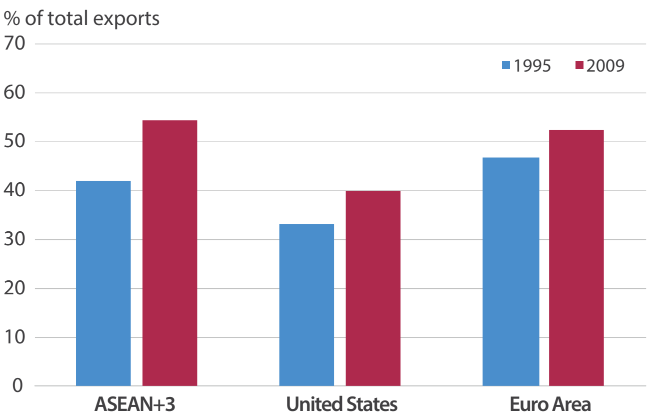
Source: ASEANstats

Figure 2.6 Intra-regional FDI Inflows (Selected ASEAN Economies, 2015)



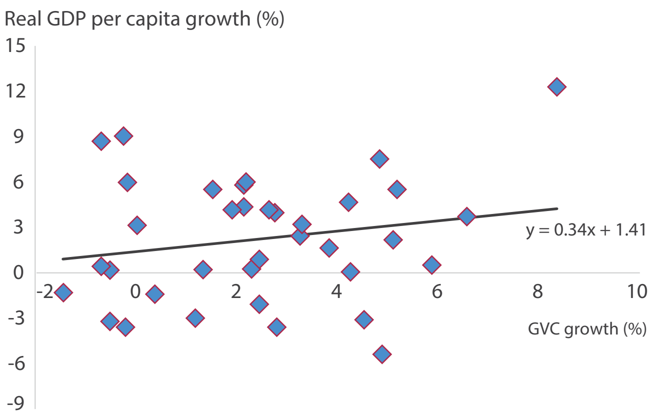
Source: ASEANstats

Figure 2.7 Global Value Chain Participation Rates by Region



Notes: The OECD indicator is expressed as the sum of share of foreign inputs and domestically produced inputs used in third countries' exports in a country's total exports. For region, cross-country averages are displayed.
Sources: OECD, AMRO staff calculations

Figure 2.8 Correlation Between Growth in GVC Participation and GDP per Capita for ASEAN+3 (1995-2008)



Note: The line is obtained from a regression of the annualized real GDP per capita growth on the annualized GVC participation growth for 12 economies in ASEAN+3, except for Myanmar and Laos, for 1995, 2000, 2005 and 2008.
Sources: OECD, IMF, AMRO staff estimates

[45] The GVC participation rate is defined as the share of its exports being part of a multi-stage trade process, which can be obtained as the sum of share of foreign inputs and domestically produced inputs used in third countries' exports in a country's total exports.

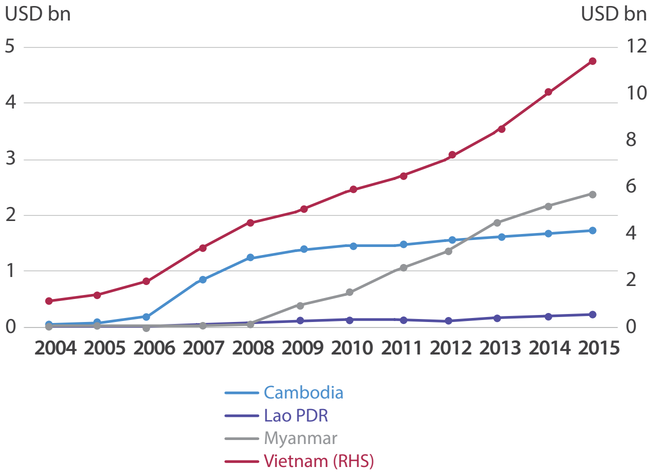
from the Plus-3 economies in recent years, prompted by lower production costs, rapid economic growth and natural resource endowment. With the rapid development of the CLV countries and the opening up of Myanmar, FDI inflows into these economies have been rising especially in areas such as manufacturing, finance and infrastructure. By source, China remains one of the dominant investors in several CLMV countries. In Cambodia, Chinese companies became the largest manufacturing investor, responsible for about half of the FDI into the manufacturing sector (such as garments). In Laos and Myanmar, China invests mainly in infrastructure projects. Japan and Korea have also been active investors, especially in the manufacturing, real estate and financial industries (Table 2.2). For instance, Korean firms have been rapidly expanding investments in the CLMV (Figure 2.9). Box D discusses the recent developments in intra-regional inwards FDI flows in CLMV economies further.

Table 2.2 Plus-3 and ASEAN Shares of FDI Inflows to CLMV Countries

Host	Source	2013	2014	2015
Cambodia	China	22.5	32.1	31.6
	Japan	3.0	4.9	3.1
	Korea	14.0	6.2	4.2
	ASEAN5	19.1	11.2	14.9
Lao PDR	China	35.1	67.3	61.6
	Japan	0.4	0.2	7.0
	Korea	2.5	1.4	4.2
	ASEAN5	4.7	11.8	7.6
Myanmar	China	30.2	7.5	1.9
	Japan	1.4	4.0	3.4
	Korea	0.0	1.2	1.3
	ASEAN5	44.6	69.8	74.5
Vietnam	China	10.7	2.3	3.2
	Japan	26.6	10.5	8.1
	Korea	19.9	35.3	29.6
	ASEAN5	23.0	16.4	17.6

Notes: All the figures are expressed in terms of the percentage of total FDI inflows. ASEAN5 includes Indonesia, Malaysia, Philippines, Singapore, and Thailand.
Source: ASEANstats

Figure 2.9 Korean FDI Stocks in CLMV Countries



Source: ASEAN Investment Report 2016

Box D. Recent Developments in Inward FDI Flows in CLMV Economies

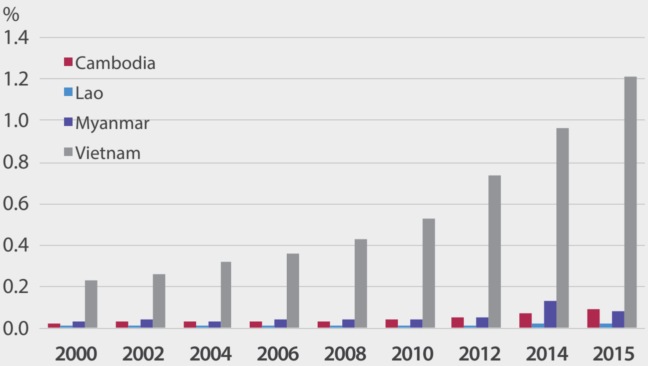
CLMV are amongst the world's fastest growing economies, with the region's exports commanding a sizeable share of GDP, reflecting their increased interconnectedness in the global economy. Due to their close proximity to China and competitive factor markets, CLMV economies have attracted sustained large inward FDI globally as well as from major regional economies. This Box describes the recent developments in inward FDI flows to the CLMV economies, including the outlook and potential risks ahead.

Following an export-led growth strategy, the CLMV's exports have expanded rapidly in recent years. From 2011 to 2015, exports grew from 52.5 percent to 64.4 percent of GDP. Although small in absolute terms, the global export market share of the four nations quadrupled from 0.3 percent in 2000 to 1.4 percent in 2015 (Figure D1), with major export partners including the E.U., the U.S., China, India, Japan and ASEAN. Major export commodities include garments, agricultural commodities, electronics, electricity, and oil. More importantly, the CLMV and China have become more closely integrated as reflected in the rapid expansion of CLMV bilateral trade with China (Figure D2). The share of the CLMV trade to China's total trade has increased four-fold from 0.7 percent in 2000 to 3.0 percent in 2015.

The expansion in exports reflects the exponential rise in inward FDI in various industries, from both within and outside the region, serving as an important growth driver and a major source of employment for the CLMV economies. Although the CLMV have attracted FDI inflows from countries inside and outside the region, a large part of investment inflows is still from major regional economies, including China, Hong Kong, Japan, Korea and Singapore. In terms of sector, the inward FDI is mainly concentrated in manufacturing (mostly garments, electronics), power, mining, oil and gas, financial activities, accommodation, construction and real estate.

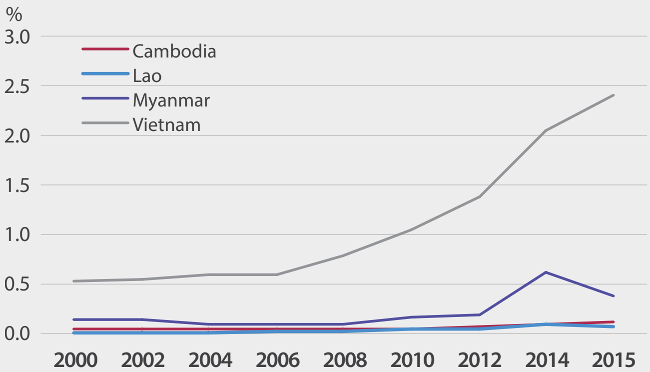
For example, inward FDI in Cambodia, although still flowing largely into garments, has seen some diversification into other light manufacturing sectors, such as electronics, bicycles, etc., as reflected in the increasingly diversified export products. In Lao PDR, inward FDI in hydropower still constitutes a large portion of total FDI. In contrast, Myanmar has made remarkable progress in developing a sustainable industrial base. Although the country's inward FDI in the manufacturing sector remains limited at present, the establishment of special economic zones (e.g. in Thilawa) will be of fundamental importance for its manufacturing development in the longer run. Vietnam has become less reliant on garment manufacturing and diversified into other sectors (electronics and machinery) while having transformed itself into a production hub for many large global technology manufacturers (Figure D3).

Figure D1. CLMV's total export market share has been rising over time



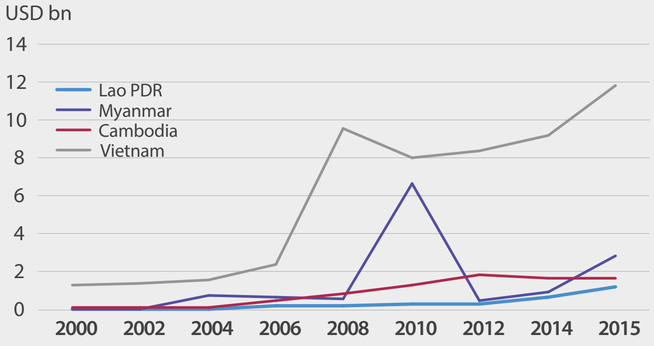
Sources: World Integrated Trade Solutions, World Bank

Figure D2. A similar trend is observed in CLMV's share in China's bilateral trade



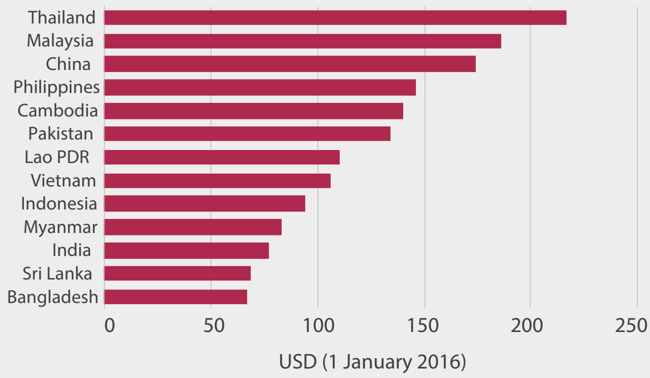
Sources: World Integrated Trade Solutions, World Bank

Figure D3. Inward FDI flows to CLMV reflects the rising participation in GVCs



Source: UNCTAD

Figure D4. Monthly Minimum Wage in the Garment Industry (Selected EMs)



Source: ILO

Reflecting their comparative advantages, the CLMV have benefited from rising intra-regional FDI inflows and become one of the most attractive investment destinations for major economies in the world. The outlook for inward FDI in CLMV economies remains positive, and the sub-Mekong region is poised to attract sustained FDI inflows, largely due to stable macroeconomic environment, cheap and abundant young labor force, strategic location, improved investment climate and infrastructure, fast-growing middle class and market demand, coupled with preferential trading schemes to international markets. As of January 2016, monthly minimum wage in the CLMV ranged from USD83 to USD154, relatively low compared to other countries in Asia (Figure D4). China's continued minimum wage hike as well as its policies to move up the industrial value chain and shift to a consumption-led economy have enabled the CLMV to benefit from China's factory relocation. In addition, China's One Belt One Road initiative is expected to benefit the ASEAN economies, including the CLMV, in the form of trade and infrastructure investment. More importantly, the four nations are among the developing countries granted preferential trading schemes to EU – Everything But Arms and Free-Trade Agreement.

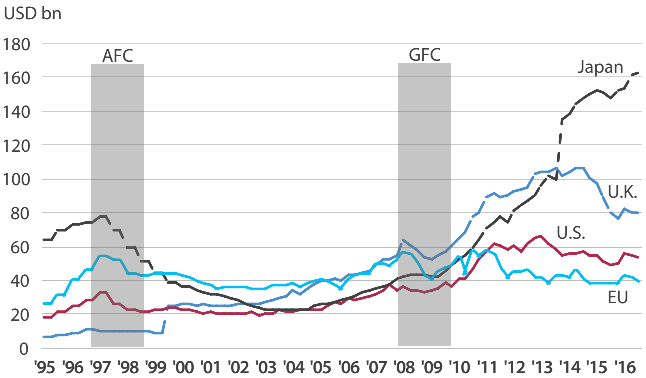
Notwithstanding the rise in intra-regional investment activities, the CLMV economies' dependence on the region, especially China, does entail some risks. China's rebalancing, for instance, may impact the region through various channels. Export is the primary channel through which the impact of China's slowdown can be transmitted. The CLMV, particularly Lao PDR and Myanmar, which heavily depend on China for their raw material exports are highly exposed to the slowdown. Another potential channel is FDI as China is one of the top investors in the CLMV. If China's economy slows much more sharply than expected, FDI inflows from China to the CLMV may be negatively impacted. The financial repercussions of China's slowdown may also impact domestic financial markets in the region, which may complicate macro-financial management. However, given their limited financial links with China, the CLMV's exposure to the spillovers from China's financial market fluctuations also remains limited.

Regional Financial Integration and Global Spillovers

36 Regional financial flows have also increased, with Japan continuing its role as a major lender and investor in the ASEAN+3 region. Japanese banks' cross-border lending and investment have been given a boost amid low interest rates in Japan, as indicated in the first part of this Report. With compression of net interest margins at home and the need to support the construction of global value chain by Japanese corporations, Japanese banks have significantly expanded their overseas lending. Japanese banks' overseas loans continued to see relatively high growth.[46] Figure 2.10 shows that after the GFC, Japanese banks have substantially increased their lending to Asia, filling the void left by Europe and the U.S. Similarly, in terms of portfolio investment, Japanese investors have reallocated their investments overseas in search of yields (Figure 2.11).

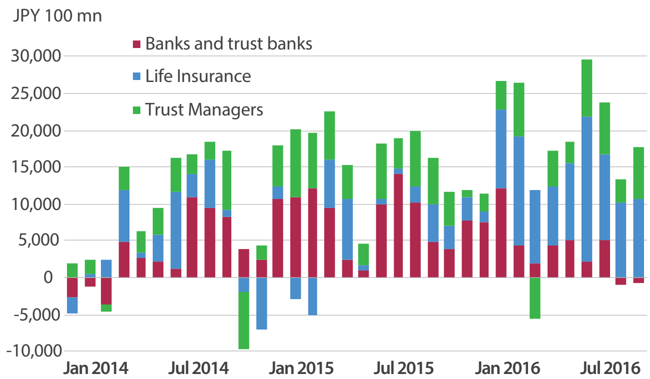
37 The positive structural trend of both Japan's outward investment and lending is likely to be sustained, and major Japanese banks have significantly increased their presence in the ASEAN region, including through mergers and acquisitions. High-profile acquisitions include the purchase by a major Japanese bank of a majority stake in the Bank of Ayudhya in Thailand, and purchase by the Japanese bank of a strategic stake in Security Bank in the Philippines, and in the Vietnam Joint Stock Commercial Bank for Industry and Trade (VietinBank) in Vietnam. All three major Japanese banks have also been granted banking licenses in Myanmar as part of Myanmar's first phase of banking liberalization. These significant investments suggest a long-term strategy of continued lending to the region, with Japanese banks' lending to the region rising steadily over the years.

Figure 2.10 Cross-border lending of Japan vs E.U. and U.S. bank lending to ASEAN (ex-Singapore)



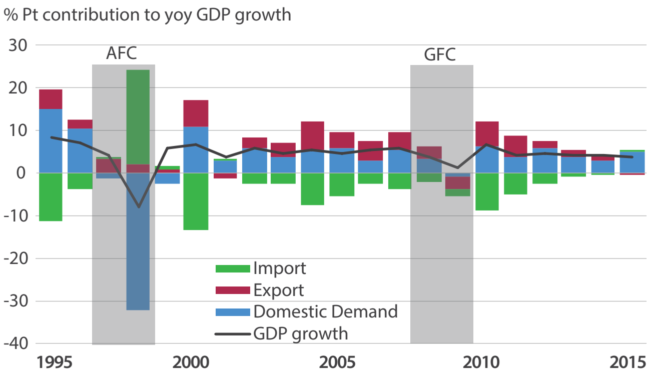
Note: Data based on BIS Consolidated Statistics which capture the worldwide consolidated positions of banks headquartered in BIS reporting countries, including positions of their foreign affiliates but excluding intragroup positions.
Source: BIS Consolidated Banking Statistics

Figure 2.11 Net Transactions of Foreign Securities in Asia by Japanese institutional investors



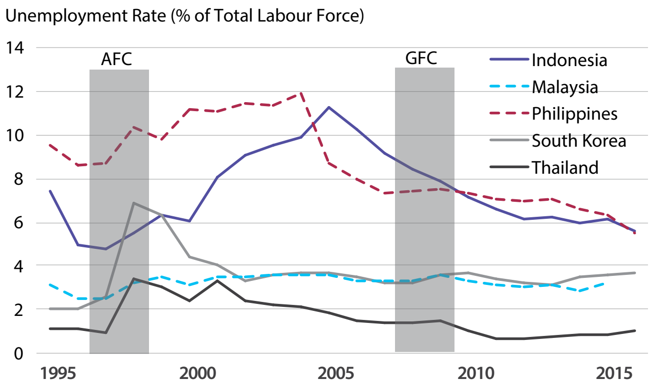
Sources: National Authorities, BIS, AMRO staff estimates

Figure 2.12 Growth contribution from exports has tapered after the GFC while that from domestic demand remains supportive



Note: For simplicity, changes in stock and statistical discrepancies are omitted.
Source: World Bank

Figure 2.13 Better labor market conditions in ASEAN-4 and Korea during the GFC have supported domestic demand-led growth after the crisis.



Source: National Authorities

[46] Bank of Japan, "Financial System Report", October 2016.

38 Intra-regional financial flows have increased in the context of massive monetary policy stimulus by the U.S. and the Eurozone, and the resulting prolonged period of low global interest rates have eased the ASEAN+3 region's adjustment to domestic-led demand (Figure 2.12). ASEAN+3 economies could shift from exports to domestic demand as a driver of growth, with investment and consumption facilitated by credit and low financing costs. Yield-seeking capital flows from advanced economies to emerging markets, including in the ASEAN+3 region, have expanded domestic liquidity and provided low-cost financing for corporates and households which has spurred domestic consumption and investment in real estate.

39 However, sustained capital inflows after the GFC, triggered by the combination of Unconventional Monetary Policies (UMP) and low interest rates in the advanced economies have, posed multiple challenges for ASEAN economies. First, large and sustained inflows create financial vulnerabilities in recipient economies through rapid credit expansion, asset price inflation, higher leverage and at times, currency and maturity mismatches. It amplifies the pro-cyclicality of the financial cycle and the higher the upturn, the sharper and more painful the downturn. Second, capital flow volatility creates and amplifies financial market volatility and this is exacerbated by the lack of depth and breadth of financial markets in ASEAN. In addition, the sudden reversal of capital flows is disruptive and the cost of disruption could be large if not managed properly, large exchange rate depreciations, financial instability and a severe downturn could be the result, as seen during the AFC.

40 Third, sustained capital inflows not only complicate the implementation of monetary policy, it undermines the efficacy of monetary management. For example, large capital inflows have resulted in exchange rate appreciations and excess liquidity in many ASEAN economies. ASEAN central banks have used sterilized intervention to manage the appreciation pressures while mopping up excess liquidity. And attempts to raise interest rates to tighten domestic conditions might be offset by the sheer size of inflows and attract even more inflows. Moreover, raising interest rate might be at odds with the domestic economic cycle. Thus, monetary policy is no longer "independent" as it is influenced by capital flow dynamics. It is in this sense that the global financial cycle transforms the trilemma into a "dilemma" – independent monetary policies are possible only if the capital account is managed. Thus, in many ASEAN economies, while monetary policy has focused on controlling inflation, active sterilized intervention of exchange rates in line with macroeconomic fundamentals is the norm and in the process, they have accumulated foreign exchange reserves as self-insurance against sudden stops.

Challenges to Policy Management

41 Heeding the lessons from the AFC, ASEAN economies have to judiciously manage the objectives of growth and financial stability when dealing with capital flows. Capital flows can increase the risk of asset price booms and if not managed properly could lead to negative spillovers affecting corporates, the household sectors and banks. In recent years, while ASEAN economies have reaped the benefits of capital flows, strong inflows have complicated monetary management, as domestic policy rates are only partly able to insulate business cycles. It has also raised concerns over increasing corporate and household leverage, as elaborated in the first section of this Report.

42 Policymakers in ASEAN+3 have been among the most active in the world in deploying macroprudential measures to manage financial stability risks while reaping the benefits from capital inflows. Policymakers have judiciously used a mix of monetary policy and macroprudential policies to achieve price and financial stability. This requires strong inter-agency coordination and clear communication to the public about the objectives and targets of the policy mix. Table 2.3 shows the main macroprudential measures deployed to manage financial stability risks. Among others, this macroprudential toolkit has included:

(a) Macroprudential policies such as loan-to-value ratios and debt servicing ratios as targeted responses to risks emerging in certain asset markets, in particular property markets;

(b) Capital flow management measures (CFMs) such as reserve requirements on foreign currency deposits, restrictions on bond holding period or withholding tax for foreigners (in Thailand and Indonesia) to manage risks from capital inflow surges

(c) Foreign exchange interventions have also been used to counter excessive currency volatility that might have a negative impact on balance sheets. At the same time, greater flexibility in exchange rates has allowed policymakers to manage the adjustment through a combination of foreign exchange interventions and exchange rate adjustments.

43 While the GFC affected the region relatively less as compared to the AFC, the contagion, capital outflows and USD liquidity crunch in some economies strengthened policymakers' resolve to build buffers and enhance regional financial arrangements. The decade saw a large build-up of foreign exchange reserves in the ASEAN+3 region, especially in China, as the first line of defense against external shocks. In addition, regional policymakers enhanced the CMI from a series of bilateral swap arrangements to a multilateral currency swap (CMIM) in March 2010, and doubled the size of CMIM from USD120.0 billion to USD240.0 billion in July 2014.

Table 2.3: Macroprudential Toolkit (Selected Economies)

China	Restrictions on property purchases in a number of cities and increases mortgage down payment in 2016.
Hong Kong	Ad valorem stamp duty raised for residential property transaction to a flat rate of 15.0 percent.
Singapore	Tiering of LTV ratios for borrowers with outstanding loans, introduction of loan tenure caps and total debt servicing ratio framework.
Indonesia	Raising of LTV ratios for house purchases and 5.0 percent reduction in down payment requirements.
Vietnam	Increasing risk weight assigned to real estate loans from 150.0 percent to 200.0 percent, effective January 2017 and lowering the ratio of short-term funding to medium- to long-term lending to 50.0 percent.
Cambodia	Large increases in the minimum capital requirements of banks in March 2016.
Korea	Tightening of existing regulations on banks' foreign currency liquidity.

Note: The table above shows recent measures taken by selected economies in 2016 and 2017.

3. 2017 — Regeneration and Growth in a Globalized Economy?

44 In 2017, 20 years after the AFC, that landmark event still offers valuable lessons to policymakers in the ASEAN+3 region. First, whereas the policy focus in the late 1980s to early 1990s was on risks from fiscal deficits and inflation, the AFC placed policy focus squarely on the risks arising from financial markets and capital outflows. Second, the AFC highlighted the speed and impact of contagion between economies that were perceived to be "similar" by investors, which caused a vicious cycle as economic fundamentals deteriorated with financial contagion. Third, the AFC highlighted the need for a more flexible and responsive policy framework domestically, and also greater financial cooperation within the region to deal with external shocks.

Challenges to Domestic Policy Frameworks

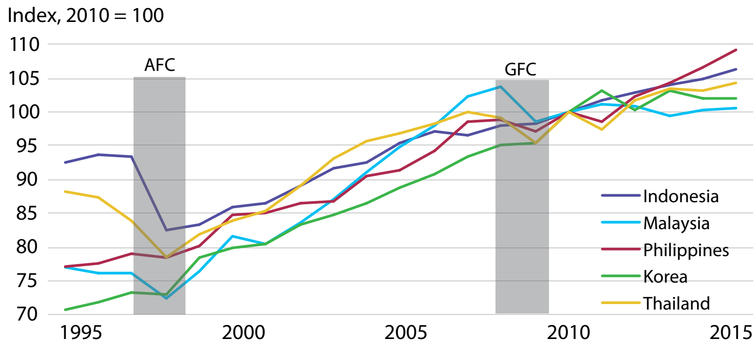
45 In terms of domestic policy frameworks, the first part of this report on Macroeconomic Prospects and Challenges highlighted the flexibility with which regional policymakers have responded to external shocks and spillovers, through exchange rate adjustments, fiscal stimulus where appropriate, and a robust and pragmatic use of macroprudential policies. The use of this enhanced policy toolkit is a testament to the policy institutions that the region has built up over the past 20 years. In monetary policy, for instance, this required building (or rebuilding) the credibility of the central banks and their communications framework, and monetary policy tools to ensure smooth transmission of policy rate adjustments to market interest rates. In fiscal policy, fiscal rules and consolidation have shored up the capacity of fiscal authorities to allocate fiscal resources in a more resource-efficient way. In both monetary and fiscal policy, the development of local bond markets has helped monetary policy transmission and also provided an additional source of financing for fiscal needs. In macroprudential policy, tools such as LTV ratios on property sectors required administrative capacity in monitoring and implementing these measures, as well as coordination with other government agencies.

46 The capital inflows into the region after the GFC have loosened the policy constraints on monetary and fiscal policy through lower financing costs globally, and these constraints have started to tighten again. Macroprudential policies, which were largely effective in a situation of capital inflows and an economic cycle upturn, are yet untested in a risk scenario of capital outflows coupled with an economic downturn. The current global policy uncertainty – which may include uncertainty from non-economic events – therefore requires policymakers to maintain policy discipline and to respond flexibly to the rapidly changing global environment, coordinating between different policy agencies of government, and ensuring policy intentions are well-communicated to the market.

47 Besides these near-term challenges to policy, the ASEAN+3 region also faces structural challenges to growth as it reaches a higher stage of economic development. Bottlenecks to growth, not only in physical infrastructure but also human capital, are becoming increasingly apparent in a slower-growth environment. Continuing the theme of lower investment from the AFC, total factor productivity has slowed in regional economies (Figure 3.1), and these structural issues may impede the continuing growth trajectory to catch up with advanced economies (Figures 3.2 and 3.3).

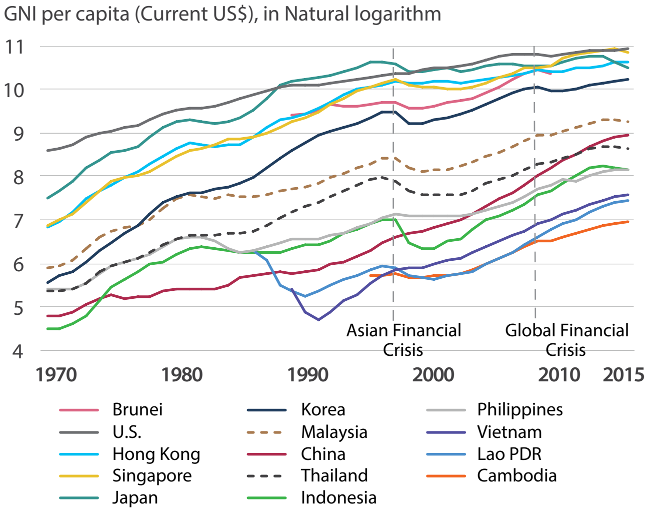
48 Faced with these near-term constraints and longer-term structural challenges, accelerating structural reform to address directly the inefficiencies in factor inputs and productivity has gained urgency. In this regard, policymakers in the region have been stepping up their structural reform agenda (Table 3.1). These reform measures will require continued policy focus and political will to push through and sustain, in order to reap the long-term benefits.

Figure 3.1 Post-GFC, total factor productivity growth slowed in Indonesia, Malaysia, Korea and Thailand



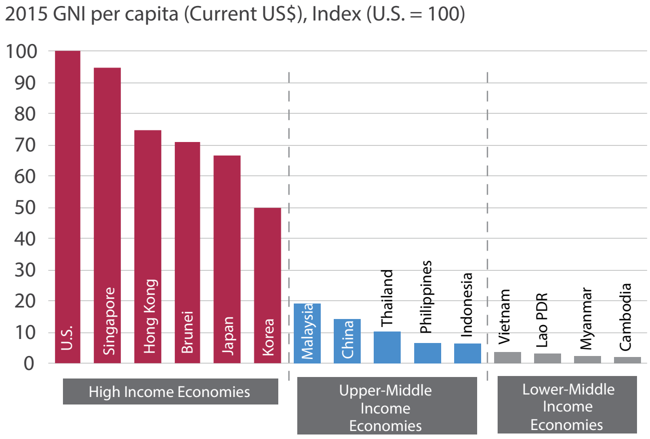
Notes: The Conference Board is a privately-run global, independent business membership and research association working in the public interest. It is also responsible for the widely followed benchmarks such as the index of Leading Indicators and the Consumer Confidence Index among others.
Sources: The Conference Board "Total Economy Database" , November 2016

Figure 3.2 GNI per capita by economy: Catching-up



Notes: GNI per capital is current USD, using the Atlas Method. Data for Brunei are available up to 2012, while time series data for Myanmar are not available.
Source: World Bank

Figure 3.3 Comparison of GNI per capita



Notes: GNI per capital is current USD, using the Atlas Method. Data for Brunei is as of 2012, while for Myanmar, data as of 2014. Classifications on high (GNI> USD 12,476), upper-middle (USD 4,036 <GNI< USD 12,475) and lower-middle income (USD 1,026 <GNI< USD 4,035) economies are based on World Bank's definitions.
Source: World Bank

(a) Addressing bottlenecks in infrastructure in the economy;

(b) Enhancing factor inputs through increasing labor force participation and labor force skills; and

(c) Mobilizing savings in the region to support investment needs, including developing local currency bond markets.

Challenges to Regional Financial Cooperation

49 The AFC marked the start of greater regional cooperation in dealing with external shocks and with the impact of contagion. The ASEAN+3 region has remained open to trade and investment flows, and with this come the risks of shocks from a globalized economy. In managing these risks collectively, the region has made remarkable progress over the past 20 years in the formation and enhancement of regional safety nets, such as the CMIM, to supplement global safety nets. This regional safety net supported by enhanced macroeconomic surveillance, together with their own strengthened domestic policy frameworks and buffers, will improve the ASEAN+3 economies' resilience against shocks and allow their economies to sustain relatively strong growth.

50 In the first part of this report on Macroeconomic Prospects and Challenges, while ASEAN+3 economies' FX buffers are high by conventional metrics of reserve adequacy (such as coverage of short-term external debt and coverage of months of imports), market expectations of FX reserve adequacy seem to have shifted. The markets appear to expect that current high levels of FX reserves are a "floor" and that reserves should not fall by much below that level. With shifting market expectations and rising global policy uncertainty, the role played by global and regional financial safety nets, such as the CMIM in augmenting an economy's buffers to deal with external shocks and contagion risks have become even more important.

51 More broadly, the global policy climate is at risk of a policy shift to a more bilateralist approach towards trade and potentially other economic relations, led by the U.S., challenging the modality of and benefits from multilateral economic cooperation. In the ASEAN+3 region, from a structural perspective, regional integration and capital flows post-GFC have given impetus to economic development and upgrading in the region. Growing regional trade, spurred by the rapid rise of the middle class, has increasingly offset weak global demand in advanced economies for the region's exports, while regional FDI and financial flows have financed investment and facilitated technology transfer. In the current global environment, policymakers' affirmation of their commitment to regional financial cooperation would help anchor market expectations and provide a solid policy basis for the region's continued growth and development.

Table 3.1: Structural Reform Agenda (Selected Economies)

Real Sector	
China	Pursuing "supply-side" reforms and SOE reforms. Streamlining government administration and allowing the market to play a more decisive role.
Indonesia	Increased streamlining of processing and reducing of red tape and regulations have been done for various sectors and industries to improve business environment.
Singapore	Corporate tax rebates and various business grants to provide more opportunities for SMEs to play a more prominent role in the economy.
Thailand	Adopting the Cluster Development Policy to strengthen industrial value chains by introducing investment incentives and promoting use of advanced technology. The government has also reinforced initiatives on digital economy development, such as the implementation of the National e-Payment Master Plan.
Myanmar	Among ongoing efforts to improve business environment and streamline business processes, implementation of the new Investment Law covering domestic and foreign investment to improve prospects for increased investments.
Vietnam	The Ministry of Planning and Investment has been assigned to lead the monitoring of indices in overall measures to improve the business environment and enhance competitiveness.
Fiscal Sector	
China	Implementing fiscal and tax reforms, including the replacement of business tax with VAT.
Indonesia	Reducing tax rates for certain industries for further promotion and development.
Myanmar	Continuing efforts to strengthen public financial management and practicing fiscal prudence. Also, efforts to expand tax revenue base are bolstered by providing more resources and modernize the Internal Revenue Department.
Lao PDR	Practicing more fiscal prudence while increasing efforts to improve administration in tax revenue collection.
Hong Kong	Established a Working Group on Long-term Fiscal Planning in 2013 to study ways to ensure fiscal sustainability amid population aging. Based on the WG's recommendation a Future Fund was set up in 2016, with a view to securing higher investment returns for fiscal reserves.
Financial Sector	
China	Improving macroprudential framework, improving regulation and curbing leverage.
Indonesia	Relaxation of eligibility criteria for micro-loan subsidies and simplification of regulatory and licensing procedures for Islamic financial products.
Myanmar	Implementation of the cash reserve requirement in April 2015 with full compliance by all banks in October 2016 and ongoing improvement of access to credit for SMEs and agriculture-related enterprises.
Vietnam	According to the economic restructuring plan 2016-2020, aims for the financial sector includes restructuring of credit institutions, reducing systemic risks and promoting operation efficiency.
Lao PDR	Made efforts to restructure and recapitalize three state owned banks.
Hong Kong	Placed the financial sector as an important growth driver and taken series of initiatives, including establishment of the two Stock Connects with the mainland and launch of the Infrastructure Financing Facilitation Office (IFFO) and Fintech Facilitation Office (FFO).
Labour and Productivity	
Singapore	Ongoing efforts to upgrade skills and productivity of local workforce through various schemes and investment in education infrastructure; gradually reducing the dependence on foreign workers.

Note: The table above shows selected measures recently taken by selected economies.