

**KEYNOTE ADDRESS BY
YAB DATO' SERI ABDULLAH AHMAD BADAWI
AT THE OPENING DINNER OF THE 2ND ASIA ECONOMIC SUMMIT
AT NIKKO HOTEL, KUALA LUMPUR
9 AUGUST 2004**

*"THE RISE OF A NEW ASIA – SHAPING ASIA'S RESPONSE TO GLOBAL
ECONOMIC CHALLENGES"*

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DISTINGUISHED GUESTS

LADIES AND GENTLEMEN

1. IT IS A PLEASURE FOR ME TO PARTICIPATE IN THIS IMPORTANT CONFERENCE AND TO BID YOU A WARM WELCOME TO KUALA LUMPUR. I WOULD LIKE TO CONGRATULATE THE NEW STRAITS TIME PRESS AND THE ASIAN STRATEGY & LEADERSHIP INSTITUTE (ASLI) FOR THEIR WORK IN BRINGING PEOPLE TOGETHER TO STRENGTHEN COOPERATION IN THE REGION. TONIGHT, I WOULD LIKE TO TALK ABOUT A NEW ASIA, FOCUSING MAINLY ON CHALLENGES THE REGION NEEDS TO MEET IN ORDER TO FULFIL ITS ENORMOUS POTENTIAL. ALTHOUGH THE FOCUS OF MY REMARKS IS ON ASIA'S FUTURE, A BRIEF LOOK AT ITS RECENT PERFORMANCE IS NECESSARY TO SET THE STAGE.

2. ASIA SHOWED CONSIDERABLE RESILIENCE LAST YEAR. THE S.A.R.S. OUTBREAK AND GEOPOLITICAL UNCERTAINTIES SLOWED THE MOMENTUM IN MOST ECONOMIES, BUT ONLY TEMPORARILY. SUPPORTIVE MACROECONOMIC POLICIES AND THE RECOVERY OF THE GLOBAL ECONOMY HELPED THE REGION TO BOUNCE BACK IN THE SECOND HALF OF THE YEAR. PROPELLED BY A RESURGENCE OF DOMESTIC DEMAND AND THE HIGHEST EXPORT GROWTH IN NEARLY THREE YEARS, ASIA EX JAPAN WAS—ONCE AGAIN—THE FASTEST GROWING REGION IN THE WORLD.

3. THERE ARE FOUR FEATURES OF THE REGION'S ECONOMIC PERFORMANCE THAT SHOULD BE KEPT IN MIND IN ASSESSING THE NEAR-TERM OUTLOOK FOR ASIA:

- FIRST, CHINA AND THE REST OF THE REGION ARE BECOMING INCREASINGLY INTERDEPENDENT. WHILE CHINA'S IMPORTS FROM ALL REGIONS HAVE BEEN GROWING, THOSE FROM ASIA HAVE BEEN EXPANDING PARTICULARLY RAPIDLY. THIS MAINLY REFLECTS CHINA'S RISING ROLE AS A PROCESSING HUB FOR EXPORTS FROM THE REGION. HOWEVER, A SIGNIFICANT PART OF THE INCREASE IN CHINA'S IMPORTS HAS ALSO GONE TO MEET GROWING DOMESTIC DEMAND FOR CONSUMPTION AND

INVESTMENT GOODS. THUS, ECONOMIC PERFORMANCE IN CHINA NOW HAS SIGNIFICANT SPILL OVER EFFECTS ON THE REST OF THE REGION.

- SECOND, IN SPITE OF SURGING INTRA-REGIONAL TRADE, ASIA CONTINUES TO DEPEND HEAVILY ON ECONOMIC DEVELOPMENTS IN THE REST OF THE WORLD. EXPORTS BETWEEN COUNTRIES IN THE REGION HAVE RISEN STEADILY FROM ABOUT 20 PERCENT OF TOTAL EXPORTS IN THE LATE 1970'S TO ABOUT 40 PERCENT IN 2002. HOWEVER, PERHAPS ONLY ABOUT HALF OF THIS TRADE IS GOING TO MEET INTRA-REGIONAL FINAL DEMAND. THUS, THE BULK OF THE EXPORTS OF ASIAN COUNTRIES IS STILL LINKED TO ECONOMIC ACTIVITY OUTSIDE THE REGION.
- THIRD, THE CENTRAL ROLE OF EXTERNAL DEMAND HAS BEEN REFLECTED IN A SUSTAINED CURRENT ACCOUNT SURPLUS FOR THE REGION. THIS SURPLUS STOOD AT ABOUT 4 PERCENT OF ASIA'S G.D.P. IN 2003, OR ABOUT US\$145 BILLION. IN TERMS OF CAPITAL INFLOWS, OFFICIAL RESERVES IN ASIA HAVE SURGED TO ABOUT US\$1.2 TRILLION, WITH AN INCREASE OF US\$270 BILLION IN 2003 ALONE. THE MAGNITUDE OF THESE DEVELOPMENTS RAISES QUESTIONS ABOUT BOTH THEIR GLOBAL IMPLICATIONS AND DOMESTIC SUSTAINABILITY.
- FOURTH, THE CYCLICAL UPSWING IN ASIA HAS SO FAR NOT BEEN ACCOMPANIED BY STRONG DOMESTIC INVESTMENT, WITH CHINA A NOTABLE EXCEPTION. THIS IS, OF COURSE, THE MIRROR IMAGE OF THE STRONG CURRENT ACCOUNTS. SUBDUED INVESTMENT HAS REFLECTED THE NECESSARY ADJUSTMENT TO THE UNSUSTAINABLE BOOM OF THE MID 1990S, AS WELL AS UNCERTAINTIES ASSOCIATED WITH THE ONGOING RESTRUCTURING OF PRODUCTION WITHIN THE REGION. BUT IT HAS ALSO REFLECTED LINGERING STRUCTURAL WEAKNESSES AND—AS SUCH—HAS IMPLICATIONS FOR THE UNFINISHED REFORM AGENDA.

4. IN TERMS OF ECONOMIC OUTLOOK, THE NEAR-TERM PROSPECTS FOR THE REGION APPEAR BRIGHT. THE RECOVERY IN THE GLOBAL ECONOMY, ALTHOUGH STILL UNEVEN, IS STRENGTHENING AND BROADENING. IN PARTICULAR, GROWTH IS RAPID IN THE UNITED STATES; IT IS PICKING UP IN JAPAN, LED BY INVESTMENT AND EXPORTS; AND, ALTHOUGH STILL LAGGING, IT SHOWS SIGNS OF REVIVAL IN THE EURO AREA AS WELL.

5. AGAINST THIS GENERAL BACKGROUND, GROWTH FOR ASIA IS EXPECTED TO BE OVER 7 PERCENT IN 2004, BROADLY THE SAME AS LAST YEAR. THIS INCORPORATES A MODEST SLOWDOWN IN GROWTH IN CHINA, TO PERHAPS AROUND 8½ PERCENT, AS A TIGHTER MONETARY STANCE COOLS INVESTMENT ACTIVITY. SIGNIFICANT PICKUPS IN GROWTH ARE FORESEEN FOR MOST OTHER COUNTRIES IN THE REGION ON THE BACK OF STRONG EXPORT EXPANSION. MOREOVER, THE BALANCE OF NEAR-TERM RISKS MAY EVEN BE ON THE UPSIDE, WITH THE UNITED STATES ECONOMY REBOUNDED, GLOBAL TRADE RISING SHARPLY, AND THE STRONG RECOVERY IN THE ELECTRONICS SECTOR.

6. WHILE THERE ARE REASONS TO BE OPTIMISTIC OF THE FUTURE, IMPORTANT CHALLENGES AND RISKS ARE PRESENT. 2005 IS EXPECTED TO SEE GROWTH IN THE GLOBAL ECONOMY AND IN ASIA SLOWING marginally. THERE ARE ALSO CHALLENGES TO SUSTAINING WORLD GROWTH. THESE INCLUDE: MAKING PROGRESS IN THE RESOLUTION OF GLOBAL CURRENT ACCOUNT IMBALANCES;

MANAGING ISSUES AROUND HIGHER INTEREST RATES IN THE INDUSTRIAL COUNTRIES AND MORE EXPENSIVE EMERGING MARKET DEBT; AND ADDRESSING DIFFICULT FISCAL SITUATIONS IN MANY INDUSTRIAL COUNTRIES AND SOME EMERGING MARKET ONES, INCLUDING HERE IN ASIA. EACH OF THESE CHALLENGES—IF NOT ADDRESSED PROPERLY—CARRIES A RISK OF WEAKENING THE GLOBAL RECOVERY ON WHICH ASIA IS DEPENDENT.

7. GIVEN THE GROWING REGIONAL INTERDEPENDENCE, RISKS ALSO ARISE FROM THE POSSIBILITY OF A MUCH SHARPER SLOWDOWN IN CHINA THAN FORESEEN. OUR CENTRAL SCENARIO IS FOR A SOFT LANDING, BUT A MORE ABRUPT SLOWDOWN REMAINS POSSIBLE IF CHINA IS NOT SUCCESSFUL IN STRIKING THE RIGHT BALANCE BETWEEN PREVENTING OVERHEATING AND AVOIDING A LARGE DECLINE IN INVESTMENT.

8. BE THAT AS IT MAY, IT SHOULD NOT BE FORGOTTEN THAT ASIA'S ABILITY TO COPE WITH EXTERNAL SHOCKS HAS COME A LONG WAY SINCE THE ASIAN FINANCIAL CRISIS. SOME OBSERVERS HAVE EXPRESSED CONCERNS THAT THE REGION IS INCREASING ITS EXPOSURE TO AN ABRUPT REVERSAL OF CAPITAL FLOWS, DRAWING PARALLELS WITH THE EARLY 1990'S. HOWEVER, MOST COUNTRIES IN ASIA NOW HAVE FAR GREATER RESILIENCE THAN BEFORE. KEY STRENGTHS INCLUDE AMPLE, OR MORE THAN AMPLE, OFFICIAL RESERVES IN MANY COUNTRIES, MORE FLEXIBLE EXCHANGE RATES, AND STRONGER BANK AND CORPORATE BALANCE SHEETS. THIS SAID, ASIA IS NOT YET "BULLET PROOF", AND IMPORTANT POLICY WORK REMAINS, TO INCREASE ITS RESILIENCE.

LADIES AND GENTLEMEN

9. THERE ARE THREE AREAS I BELIEVE POLICYMAKERS NEED TO FOCUS ON, IN THE PERIOD AHEAD TO STRENGTHEN PROSPECTS FOR SUSTAINED GROWTH:

- FIRST, THE NEED FOR FURTHER PROGRESS WITH STRUCTURAL REFORMS;
- SECOND, ENSURING THAT PUBLIC DEBT LEVELS ARE REDUCED; AND
- THIRD, STRENGTHENING REGIONAL ECONOMIC COOPERATION.

10. BEFORE ELABORATING ON THESE ISSUES, LET ME NOTE THAT THERE IS NEVER AN EASY TIME TO STEP UP ON REFORM EFFORTS. THIS OFTEN INVOLVES TACKLING VESTED INTERESTS AND CAN BE POLITICALLY DIFFICULT. BUT THERE ARE MOMENTS WHEN DOING SO ARE SIGNIFICANTLY EASIER THAN OTHERS. THE WORLD ECONOMY IS NOW ON THE UPSWING, AND THE IMMEDIATE OUTLOOK FOR ASIA IS BRIGHTER THAN IT HAS BEEN FOR SOME TIME. ADVANTAGE SHOULD BE TAKEN OF THESE "GOOD TIMES" TO PREPARE FOR THE DAY WHEN THEY, AT LEAST TEMPORARILY, COME TO AN END, AS GOOD TIMES ALWAYS DO.

11. AN IMPORTANT CHALLENGE FOR MANY COUNTRIES IN ASIA IS TO PRESS AHEAD WITH FURTHER STRUCTURAL REFORMS, ESPECIALLY THOSE NEEDED TO BOLSTER DOMESTIC DEMAND. FINANCIAL AND CORPORATE RESTRUCTURING HAS BEEN UNEVEN ACROSS THE REGION. DESPITE THE PROGRESS MADE, MANY BANKS

AND CORPORATIONS REMAIN SADDLED BY WEAK BALANCE SHEETS. ALSO, LEGAL AND REGULATORY REFORMS IN MANY ASIAN COUNTRIES HAVE LAGGED. THE LIST OF UNFINISHED BUSINESS INCLUDES EFFECTIVE BANKRUPTCY LAWS, TIGHTER PRUDENTIAL OVERSIGHT, AND IMPROVED DISCLOSURE AND GOVERNANCE IN THE CAPITAL MARKETS.

12. INDEED, IN A FAST-CHANGING GLOBAL MARKETPLACE, REFORM IS BY NECESSITY A CONTINUOUS PROCESS. YOU HAVE TO RUN TO STAND STILL. AS PERHAPS JAPAN'S EXPERIENCE DURING THE 1990'S SHOWS, PIECEMEAL REFORMS MEAN LOSING GROUND IN THE QUEST FOR AN INCREASINGLY RESILIENT AND COMPETITIVE ECONOMY. ADDRESSING THE STRUCTURAL PRIORITIES THAT I HAVE HIGHLIGHTED WILL HELP IN REVIVING PRIVATE INVESTMENT ACTIVITY IN ASIA BY STRENGTHENING THE BUSINESS CLIMATE AND F.D.I. INFLOWS. IT WILL ALSO HELP COUNTRIES IN THE REGION TO BECOME MORE FLEXIBLE AND, IN PARTICULAR, ADAPT TO CHINA'S EMERGENCE IN THE GLOBAL ECONOMY. THIS IS ESPECIALLY IMPORTANT FOR THOSE COUNTRIES THAT COMPETE MOST DIRECTLY IN THE PRODUCTION OF LABOUR-INTENSIVE GOODS. IN CHINA ITSELF, STRUCTURAL REFORMS, PARTICULARLY IN THE STATE-OWNED ENTERPRISES AND IN THE BANKING SECTOR, ARE KEY TO MAINTAINING A STRONG PERFORMANCE BASED ON HIGH PRODUCTIVITY GROWTH.

13. A SECOND CHALLENGE FACING ASIA IS TO MAKE SURE THAT THE BURDEN OF PUBLIC DEBT REMAINS MANAGEABLE. EMERGING MARKET COUNTRIES AS A GROUP HAVE PUBLIC DEBT RATIOS THAT ARE NOW HIGHER THAN THE INDUSTRIAL COUNTRIES. THE GROWTH IN PUBLIC DEBT IN ASIA SINCE THE MID 1990'S HAS BEEN PARTICULARLY RAPID, WITH THE DEBT BURDEN RISING FROM SOME 40 PERCENT OF AGGREGATE G.D.P. IN 1996 TO ABOUT 65 PERCENT IN 2002. THIS INCREASE REFLECTS, OF COURSE, THE NEED TO RECAPITALISE BANKING SYSTEMS DURING THE FINANCIAL CRISIS IN THE REGION. AS A RESULT, ASIA NOW HAS A DEBT TO G.D.P. RATIO SIGNIFICANTLY LARGER THAN LATIN AMERICA OR THE GROUP OF TRANSITION ECONOMIES.

14. HEAVY DEBT BURDENS TEND TO KEEP BORROWING COSTS HIGH, DISCOURAGE PRIVATE INVESTMENT, AND CONSTRAIN THE FLEXIBILITY OF FISCAL POLICY TO RESPOND TO DOWNTURNS. HIGH AND RISING DEBT RATIOS CAN ALSO CARRY RISKS OF FISCAL CRISES DOWN THE ROAD. WHAT SEEMS A MANAGEABLE DEBT BURDEN IN GOOD TIMES CAN BECOME HARD TO BEAR WHEN THE ECONOMY WEAKENS, OR INTEREST COSTS RISE. ASIA MUST USE THE PRESENT PERIOD OF STRONG GROWTH TO REDUCE FURTHER FISCAL IMBALANCES, TO REDUCE THIS VULNERABILITY AND OPEN UP ROOM FOR FISCAL POLICY MANOEUVRE IN FUTURE.

LADIES AND GENTLEMEN

15. FINALLY, I WANT TO TOUCH UPON THE ISSUE OF REGIONAL ECONOMIC INTEGRATION AND COOPERATION IN ASIA. REGIONAL INITIATIVES ARE AFOOT TO IMPROVE FINANCIAL COOPERATION. THE CHIANG MAI NETWORK OF BILATERAL SWAP AGREEMENTS COULD PLAY A SIGNIFICANT ROLE IF A PARTICIPATING COUNTRY EVER GOT INTO FINANCIAL DIFFICULTIES. AND THE EFFORTS UNDERWAY

TO SPUR THE DEVELOPMENT OF REGIONAL BOND MARKETS, WHILE STILL AT AN EARLY STAGE, SHOULD HELP DIVERSIFY SOURCES OF FINANCE AWAY FROM THE BANKING SYSTEMS AND LIMIT RELIANCE ON FOREIGN CURRENCY DEBT. I HAVE FURTHER PROPOSED THAT THE REGION ESTABLISH AN ASIAN MONETARY INSTITUTION. I SEE THESE AND OTHER INITIATIVES AS REFLECTING A DESIRE TO ENHANCE POLICY COLLABORATION IN THE REGION.

16. MUCH HAS ALSO BEEN DONE TO PROMOTE REGIONAL TRADE INTEGRATION. BILATERAL INITIATIVES HAVE PROLIFERATED AND HAVE CONTRIBUTED TO STRONGER TRADE LINKAGES ACROSS THE REGION. AS WE SAW EARLIER, THIS HAS INCREASED THE COHESION OF THE REGIONAL ECONOMY AND SUPPORTED ITS RECOVERY. CARE NEEDS TO BE TAKEN TO AVOID CREATING VERY COMPLEX TARIFF SYSTEMS AND TO ENSURE THAT REGIONAL ARRANGEMENTS ARE NOT A SUBSTITUTE FOR MULTILATERAL TRADE LIBERALISATION. WHAT IS IMPORTANT IS TO MAKE SURE THAT REGIONAL AND BILATERAL TRADE INITIATIVES REMAIN CONSISTENT WITH BROAD PARTICIPATION IN THE GLOBAL ECONOMY, FROM WHICH ASIA HAS BENEFITED SO MUCH AND WHICH IS KEY TO ITS GROWTH PROSPECTS.

17. AS I SAID BEFORE, BEYOND FINANCE AND TRADE, WE MUST ALSO DEVELOP OUR COOPERATION IN THE REALM OF HEALTH, SCIENCE AND TECHNOLOGY, LABOUR AND THE ENVIRONMENT. WE SHOULD TAKE AGGRESSIVE STEPS TO DEVELOP REGIONAL TOURISM AND EDUCATION, BOTH IMPORTANT IN ENHANCING FRIENDSHIP AND PEOPLE-TO-PEOPLE CONTACT IN THE REGION.

18. TO CAP IT OFF, I HAVE PROPOSED THAT THE REGION ENHANCE ITS INTEGRATION AND COOPERATION IN THE FIELD OF POLITICS AND DIPLOMACY. THE ASEAN+3 PROCESS WILL BE ADVANCED TO BECOME A SUMMIT OF THE EAST ASIAN ECONOMIC COMMUNITY. THIS NEW ARRANGEMENT WILL PROVIDE LEADERS IN THE REGION WITH A GREATER SENSE OF INTEGRATION OF EAST ASIAN COUNTRIES AND AT THE SAME TIME, SECURE A VERY PRAGMATIC PLATFORM FOR REGIONAL COOPERATION IN THE SPHERE OF ECONOMICS, FINANCE, TRADE, POLITICS AND DIPLOMACY.

LADIES AND GENTLEMEN

19. ASIA IS THE MOST DYNAMIC REGION IN THE WORLD, AND IS SET TO CONTINUE TO GROW RAPIDLY THIS YEAR. THE OUTLOOK FOR THE FUTURE IS ALSO PROMISING, THOUGH THERE ARE IMPORTANT POLICY CHALLENGES THAT NEED TO BE ADDRESSED. LOOKING BACK AT THE TREMENDOUS PROGRESS THAT ASIA HAS MADE OVER THE LAST DECADES, I AM CONFIDENT THAT REFORMS IN THE REGION WILL CONTINUE IN THE RIGHT DIRECTION AND WILL HAVE THE DESIRED IMPACT.

20. WE ARE NOW MEETING UNDER DIFFERENT CIRCUMSTANCES. WE ARE WITNESSING A REVITALISED ASIA THAT IS NOT JUST ON THE ROAD TO RECOVERY BUT PROSPERING AS WELL. THROUGH COMPREHENSIVE REFORM, A NEW ASIA IS EMERGING—ONE WITH STRONGER ECONOMIC FUNDAMENTALS AND ONE WITH AN

EVEN STRONGER COMMITMENT TO ENGAGE ACTIVELY WITH THE WORLD. AND WE ARE OBSERVING AN ASIA THAT IS SPEAKING INCREASINGLY WITH ONE VOICE. OUR MESSAGE TO YOU TODAY IS THAT WE IN ASIA ARE HERE TO DO BUSINESS— WITH EUROPE, THE U.S. AND BEYOND.

21. THE ATTENTION OF MUCH OF ASIA IS UPON US. LET US SEIZE THIS OPPORTUNITY TO STRENGTHEN OUR CO-OPERATIVE ENDEAVOURS AS WELL AS TO TACKLE THE NEW CHALLENGES THAT HAVE EMERGED, THEREBY LIFTING OUR PARTNERSHIP TO NEW HEIGHTS. IF WE SUCCEED, WE WILL HAVE CREATED A MORE DYNAMIC AND MORE PRODUCTIVE PARTNERSHIP BETWEEN THE COUNTRIES OF ASIA THAT WILL BE BOTH ENDURING AND REWARDING FOR ALL OUR COMMUNITIES AND PEOPLES.

THANK YOU.