

DEVELOPMENTS IN THE FIRST QUARTER OF 2010

INTERNATIONAL ECONOMIC ENVIRONMENT

Continued rebound in the global economy but at varying pace

The global economy continued to expand in the first quarter of 2010. Most economies registered stronger growth, with the emerging economies in Asia leading the global recovery. The improvement in economic activity in these economies was attributed to better consumer and business sentiments, leading to increases in consumption and investment. Conditions in the international financial markets continued to improve following massive policy support by the authorities and higher investor tolerance of risk. Inflationary pressures across most economies had begun to emerge, albeit moderately, due primarily to higher energy and food prices.

In the **US**, real GDP grew by a slower annualised rate of 3.2% in the first quarter (4Q 09: 5.6%), marking the third consecutive quarter of positive growth. The expansion in economic activity was mainly contributed by stronger private consumption growth following the improvement in job prospects. Employment registered a gain of 283,000 jobs in the first quarter (4Q 09: -269,000). In addition, households have shown more willingness to consume by drawing down their personal savings. Growth was also supported by inventory restocking in response to growing demand. Fixed investment grew moderately, due to strong increases in business investment in equipment and software that offset the declines in residential and non-residential investment. Government spending contracted by 1.8% (4Q 09: -1.3%), reflecting the larger decline in state and local government spending despite the increase in federal spending. On the inflation front, headline CPI rose by 2.3% during the quarter (4Q 09: 1.4%), driven by higher energy and food prices.

The **Japanese** economy remained on its recovery path, supported by sustained improvement in trade and private consumption. Exports rebounded strongly by 43.2% in the first quarter (4Q 09: -5.8%), registering the fastest pace of expansion in more than 30 years, largely

due to robust demand from Asia, especially from PR China. On the domestic side, private consumption continued to recover, supported by various government transfers and subsidy schemes. This was further supported by better employment prospects as the unemployment rate declined to 4.9% (4Q 09: 5.2%). On the inflation front, deflationary pressures eased as core consumer prices (excluding fresh food) declined at a slower rate of 1.2% (4Q 09: -1.7%) due to higher energy prices.

The economic recovery in the **euro area** continued to be gradual, sustained by the pick-up in external demand. Major euro area economies such as Germany and France recorded strong improvements in exports. The rebound in exports, driven by both intra-regional demand and demand from China, has also supported the improvement in industrial production. On the other hand, private consumption growth remained moderate as the effect of fiscal stimulus began to wane. On the inflation front, consumer prices increased by 1.1% during the first quarter (4Q 09: 0.4%) due mainly to higher energy prices. Meanwhile, the **UK** economy recorded its second consecutive positive quarter-on-quarter growth of 0.2% in the first quarter (4Q 09: 0.4%). On an annual basis, the economy recorded a smaller contraction of 0.3% (4Q 09: -3.1%). The improvement in growth was broad-based across all sectors following firmer consumer spending as well as higher exports. Meanwhile, inflation rose to 3.3% in the first quarter (4Q 09: 2.1%), due to the reversal of the reduction in value added tax and higher energy prices.

In light of the normalisation in the international financial markets, central banks in most major advanced economies have begun to allow for the expiry of several quantitative easing programmes that were introduced during the crisis. In the **US**, while the federal funds rate was maintained at 0 - 0.25%, the **Federal Reserve** (Fed) raised the discount rate by 25 bps to 0.75% on 19 February in an effort to normalise lending facilities. Furthermore, the Fed ended the purchase programmes for

Industrial Countries: Real GDP Growth

	2009			2010	Key contributing factors for 1Q growth
	1Q	4Q	Year	1Q	
	Annual change (%)				
US ¹	-6.4	5.6	-2.4	3.2 ^a	Growth contributed by private consumption, investment in equipment and software and inventory restocking.
UK	-5.3	-3.1	-4.9	-0.3 ^p	Smaller contraction due to improvement in business services and manufacturing sectors.

¹ Annualised basis
^a Advance estimate
^p Preliminary

Source: National authorities

USD1.25 trillion agency mortgage-backed securities and USD175 billion agency debt at the end of the first quarter. In addition, the purchases of loans backed by all types of collaterals were also ended in March, except for new-issue commercial mortgage-backed securities under the Term Asset-Backed Securities Loan Facility, which will end on 30 June 2010. In the euro area, the **European Central Bank** (ECB) continued to gradually phase out its non-standard liquidity measures by ending the fixed rate offered for the 6-month loans in March and the 3-month loans in April 2010. The ECB also reiterated its stance on ending its purchases of €60 billion worth of covered bonds by June 2010. The **Bank of England** (BoE) kept the official Bank Rate at 0.5% and maintained the size of the asset purchase programme at £200 billion. In contrast, the persistent threat of deflation in Japan prompted the **Bank of Japan** (BoJ) to expand its quantitative easing measures on 17 March by doubling the size of its credit programme to ¥20 trillion from the original ¥10 trillion.

From late April to early May, the escalation of the sovereign debt problems in Greece has heightened the contagion risk on other European economies with similar weak fiscal position as the global financial markets came under intense pressure and volatility. In response, on 9 and 10 May 2010, in co-ordination with the €750 billion joint EU-IMF financial stabilisation mechanism, the ECB announced three measures to restore confidence in the financial markets. First, the ECB will intervene in the euro area public and private debt securities secondary markets to

restore the functioning of the affected markets. Second, the ECB will provide emergency liquidity to the banks in the form of unlimited funds for three- and six-month lending operations at a fixed rate. Third, the ECB reactivated the US dollar swap line with the Fed alongside the BoJ, BoE, Bank of Canada and Swiss National Bank to ease the shortage of US dollar in the markets.

In the first quarter, global **crude oil prices**² declined to a four-month low of USD71 per barrel on 5 February, weighed down by the expectation of weaker global growth prospects following China's credit tightening measures as well as a build-up in inventories. The trend reversed in the latter part of the quarter following investors' renewed optimism of a sustained recovery in global demand, with global crude oil prices reaching an 18-month high of USD82 per barrel by the end of the quarter. For the whole quarter, crude oil prices averaged USD79 per barrel (4Q 09: USD76 per barrel).

In the **Asian region**, all economies continued their robust expansion in the first quarter, driven by sustained domestic demand and strong export growth. Private consumption and investment activity in the region remained strong, supported by favourable labour market conditions and lending activities. The acceleration in export growth was due to continued expansion in intra-regional trade, a gradual improvement in demand from the advanced economies, the upturn in the global electronics cycle and the low base effect. **PR China's** economy expanded at a robust annual pace of 11.9% in the first quarter (4Q 09: 10.7%), supported by strong expansion in fixed

² Refers to West Texas Intermediate one-month futures on NYMEX.

Regional Countries: Real GDP Growth

	2009			2010	Key contributing factors for 1Q growth
	1Q	4Q	Year	1Q	
	Annual change (%)				
Singapore	-9.4	4.0	-2.0	13.1 ^a	Sharp rebound in the manufacturing sector, especially in electrical and electronics and pharmaceuticals sub-sectors, as well as improved performance in the services sector.
PR China	6.2	10.7	8.7	11.9	Strong expansion in fixed asset investment, driven by both infrastructure spending related to fiscal stimulus and real estate investment.
Korea	-4.3	6.0	0.2	7.8 ^a	Improvement in the manufacturing sector, especially in the production of electrical and electronic equipment.
Indonesia	4.5	5.4	4.5	5.7	Supported by private consumption, exports and investment activities.

^a Advance estimate

Source: National authorities

asset investment, driven by both infrastructure spending related to the fiscal stimulus and real estate investment. Similarly, **Singapore's** economy grew by 13.1% in the first quarter (4Q 09: 4.0%), due mainly to the sharp rebound in the manufacturing sector, particularly in the electrical and electronics and pharmaceutical sub-sectors, as well as the services sector. **Korea's** economy expanded by 7.8% in the first quarter (4Q 09: 6.0%) supported by improvement in the manufacturing sector, especially in the production of electrical and electronic equipment. In **Indonesia**, the economy grew by 5.7% in the first quarter (4Q 09: 5.4%) boosted by private consumption, exports and investment activity while government spending declined for the first time since the third quarter of 2005.

With inflationary pressures gradually increasing, emanating from higher food and commodity prices, coupled with strong growth prospects, several central banks in Asia have stepped up their efforts in normalising policy rates.

The **Reserve Bank of India** increased its repurchase rate to 5.25% by 25 basis points each time in March and April to contain rising inflation. Similarly, the **Monetary Authority of Singapore** re-centered the exchange rate policy band and shifted its policy stance towards a "modest and gradual appreciation" in April from the previous "zero percent appreciation" stance. While keeping its key policy rate unchanged, the

People's Bank of China tightened regulations on the loan-to-value ratio and increased reserve requirements on banks, in an attempt to slow the growth of bank lending. Similarly, **Bangko Sentral ng Pilipinas** raised the rate of its short-term lending facility under the rediscount window in February as its first step towards unwinding the liquidity-enhancing measures introduced during the crisis.

In the **foreign exchange market**, the euro and pound sterling weakened steadily against the dollar to a 10-month low, reflecting market concerns over the uncertainty surrounding the proposed financial aid to Greece by the other euro economies and the International Monetary Fund. The heightened investor risk aversion over sovereign debt problems benefited the yen, which strengthened against the US dollar, particularly in the first two months of the quarter. Most regional currencies continued to strengthen against the US dollar during the quarter following optimism over growth prospects of the Asian economies.

Going forward, considerable uncertainties remain due to the ongoing sovereign debt problems in Europe and the diminishing support from policy stimulus. Despite these developments and the potential destabilising effects on financial markets, the assessment is that it would generally have limited effects on emerging market economies.