

DEVELOPMENTS IN THE FOURTH QUARTER OF 2010

INTERNATIONAL ECONOMIC ENVIRONMENT

Uneven recovery in the global economy amid renewed sovereign debt crisis in the euro area

The global economic recovery continued to be uneven in the fourth quarter. Growth in the advanced economies remained moderate as these economies continued to face headwinds in terms of persistent high unemployment, sluggish lending activity and growing concerns over fiscal sustainability. Although its economic fundamentals remained weak, US growth strengthened in the fourth quarter due to better-than-expected private consumption. In Asia, growth remained strong, as resilient domestic demand continued to provide support to economic activity. The expansion, however, was at a more moderate pace compared to the strong performance in the first half of the year in part due to the slower pace of improvement in external demand. Conditions in the international financial markets deteriorated during the quarter, particularly in November, following uncertainty over Ireland's fiscal position. This eventually led to a €85 billion EU-IMF bailout package for Ireland on 28 November which was aimed at restructuring the Irish banking system and safeguarding its public finances. In view of the divergence between further accommodative monetary stance in the advanced economies and policy normalisation in the emerging economies, particularly Asia, capital flows into the Asian region continued to remain large. In response, authorities in several Asian countries further introduced wide-ranging measures to mitigate the impact of capital flows on macroeconomic and financial stability.

In the **US**, real GDP grew faster by 3.2% on an annualised basis, (3Q 10: 2.6%) due to a stronger expansion in private consumption towards the latter part of the quarter. Private consumption increased as households drew down their savings following a slower pace of deleveraging and the better prospects for a turnaround in the employment outlook as monthly job creation averaged 128,000 during the quarter (3Q 10: -30,000). However, consumer sentiment remained soft relative to

historical norms, reflecting concerns over the persistently high unemployment rate which had remain above 9% since May 2009. Growth was also contributed by net exports due to a sharp decrease in imports following a rapid deceleration in inventory restocking. Fixed investment, in particular for equipment and software, remained supportive of growth, albeit at lower rates compared to the earlier period of the economic recovery. On the inflation front, headline CPI rose by 1.3% during the quarter (3Q 10: 1.2%), due to higher energy prices. On 3 November, the **Federal Reserve** (Fed) introduced a second round of quantitative easing amounting to USD600 billion to support the fragile economic recovery and address concerns over rising deflationary pressures. The measures are aimed at bolstering private sector demand, particularly consumption of households, through the lowering of long-term yields for residential mortgage payments and higher wealth effect from rising equity prices. Households received a further boost from the unveiling of a USD858 billion tax relief package (5.9% of GDP) in December, which included the extension of Bush era tax cuts and unemployment benefits.

In the **euro area**, growth on a quarter-on-quarter basis was sustained at 0.3% in the fourth quarter (3Q 10: 0.3%). On an annual basis, the economy grew by 2% in the fourth quarter (3Q: 1.9%). Growth was supported by an improvement in both exports and domestic demand for the core economies, in particular in Germany, while economic activity remained weak in the peripheral economies. On the inflation front, consumer prices rose by 2% (3Q 10: 1.7%), due to higher energy and food prices. The Irish crisis eventually led to a €85 billion EU-IMF package for Ireland's banking restructuring and public sector finance restoration on 28 November. During the quarter, the **European Central Bank** (ECB) utilised the Securities Market Programme which was introduced earlier in May as it purchased government bonds of the affected euro area economies to stabilise their respective borrowing costs.

Advanced Economies: Real GDP Growth

	2009		2010			Key contributing factors for 4Q growth
	4Q	Year	3Q	4Q	Year	
	Annual change (%)					
US ¹	5.0	-2.6	2.6 ^r	3.2 ^a	2.9	Growth contributed by private consumption, net exports and investment in equipment and software.
Japan ¹	7.3	-6.3	3.3 ^r	-1.1 ^p	3.9	Contraction due to slower improvement in external demand and decline in private consumption following expiry of government subsidies.
Euro area	-2.0	-4.1	1.9	2.0 ^p	1.7	Growth supported by an improvement in both external and domestic demand in the core economies.
UK	-2.8	-4.9	2.7 ^r	1.7 ^p	1.4	Moderation due mainly to decline in the construction and services sectors.

¹ Annualised basis

^r Revised

^a Advance estimate

^p Preliminary

Source: National authorities

The **UK** economy experienced a quarter-on-quarter contraction of 0.5% (3Q 10: 0.7%) in the fourth quarter. On an annual basis, growth moderated to 1.7% (3Q 10: 2.7%). The unexpected weaker growth was attributed mainly to a decline in the construction and services sectors, as economic activity was significantly affected by bad weather conditions. The economy, however, continued to be supported by an improvement in both production and exports. On the domestic demand side, private consumption weakened as indicated by slower retail sales and continued decline in consumer confidence following the prospects of further fiscal austerity measures. Meanwhile, inflation grew at a faster rate of 3.3% during the quarter (3Q 10: 3.1%) driven mainly by higher commodity prices. In balancing the weaker growth prospects and the risk of stronger inflation, the Bank of England (BOE) decided to leave its policy rate unchanged at 0.5% and maintained the size of its asset purchase programme at £200 billion.

The **Japanese** economy contracted by 1.1% on an annualised basis (3Q 10: 3.3%) in the fourth quarter, due to slowing external demand and renewed weakness in domestic demand upon the expiry of government subsidies. On an annual basis, the economy grew at a slower rate of 2.2% (3Q 10: 4.9%). Exports moderated sharply to 10% y-o-y (3Q 10: 17.8%) due to weaker external demand and to some extent, the impact of strong yen. Meanwhile, household spending declined by 1.4% (3Q 10: 0.9%) upon the expiry of government stimulus while the unemployment rate remained elevated at 5% (3Q 10: 5.1%). Deflationary

pressures persisted as core consumer prices (excluding fresh food) continued to decline by 0.5% (3Q 10: -1.1%). In response to the weaker economy amid strong yen and deflation, the **Bank of Japan** (BoJ) reduced the overnight call rate to a range of 0 - 0.1% in October and further established a ¥5 trillion (USD60 billion) asset purchase programme to acquire government and corporate bonds.

In the **Asian** region, economic activities in most economies remained strong in the fourth quarter as growth continued to be supported by resilient domestic demand, particularly private consumption, in light of improving labour market conditions and a strong growth in bank lending. However, the rate of expansion moderated from the first half of the year, reflecting a more modest improvement in external demand and slower inventory restocking activity. Growth in **PR China** expanded by 9.8% due to robust domestic demand in spite of a series of tightening measures during the quarter. **Singapore's** economy recorded a strong growth of 12.0% (3Q 10: 10.5%), driven mainly by the volatile biomedical manufacturing cluster. In **Korea**, the economy grew by 4.8% (3Q 10: 4.4%), supported by strong exports activity while the **Philippines'** economy expanded by 7.1% (3Q 10: 6.3%), led by strong household consumption and accelerated investments, particularly in durable equipment investments. In **Indonesia**, the economy grew by 6.9% (3Q 10: 5.8%), supported by strong investment activities and public spending. Meanwhile, the **Chinese Taipei** economy expanded by 6.9% (3Q: 10.7%) due mainly to a moderation in exports.

Amid favourable growth and rising inflationary pressures associated with higher commodity and fuel prices, several central banks in the region continued to normalise their policy interest rates to a level consistent with the prevailing economic conditions. In response to rising inflationary pressures where inflation peaked at a 28-month high in November, the **People's Bank of China (PBOC)** raised its one-year deposit and lending rates twice by 25 basis points each to 2.75% and 5.81% in October and December, as well as increasing reserve requirement ratio three times during the quarter by 50 basis points each, to 18.5% for the major banks. In January 2011, the central bank further raised the reserve requirement ratio to 19%. The **Central Bank of the Republic of China (Taiwan)** increased its discount rate by 12.5 basis points to 1.625% in December while the **Bank of Thailand** and the **Bank of Korea** hiked their policy rates by 25 basis points to 2.25% and 2.75% respectively in January 2011. In addition, several monetary authorities in the region also took further steps to manage capital inflows by imposing levies or taxes on foreign inflows (Korea and Thailand) and utilising macroprudential measures in

limiting foreign currency exposure of the banking system (Chinese Taipei, Korea and Indonesia). Several authorities such as in Hong Kong, Singapore and Thailand also introduced administrative measures to discourage speculative activities in the domestic real estate sector.

Prices of **crude oil**¹ generally trended upwards in the fourth quarter, averaging USD85 per barrel (3Q: USD76 per barrel). Oil prices rose to USD88 per barrel on 11 November following the announcement of a second round of quantitative easing by the Fed. This trend subsequently reversed, with oil prices touching a low of USD80 per barrel on 17 November as market sentiments were tempered by anticipation of further policy tightening by PR China, the second largest oil consumer, and renewed concerns over the sovereign debt problem in the euro area. Nevertheless, oil prices resumed its upward trend in December ahead of rising winter demand and tighter inventory conditions in the US. At the end of the year, crude oil traded at USD91 per barrel, representing a 27-month high as well as an increase of 15% from the level at the end of 2009.

Regional Countries: Real GDP Growth

	2009		2010			Key contributing factors for 4Q growth
	4Q	Year	3Q	4Q	Year	
	Annual change (%)					
Singapore	4.6 ^r	-0.8 ^r	10.5 ^r	12.0	14.5	Underpinned by strong expansion in the manufacturing sector, led by the biomedical manufacturing cluster.
PR China	10.7	9.2	9.6	9.8	10.3	Supported largely by robust domestic demand.
Philippines	6.0	1.1	6.3	7.1	7.3	Growth led by strong household consumption and investment.
Indonesia	5.4	4.5	5.8	6.9	6.1	Supported by strong investment activities and public sector spending.
Chinese Taipei	9.2	-1.9	10.7	6.9 ^p	10.8	Due mainly to a moderation in export performance while domestic demand remained resilient.
Korea	6.0	0.2	4.4 ^r	4.8 ^p	6.1	Driven by stronger export performance and sustained expansion in private consumption.

^r Revised
^p Preliminary

Source: National authorities

¹ Refers to West Texas Intermediate one-month futures on NYMEX

In the **foreign exchange markets**, the US dollar weakened against most currencies but strengthened against the euro and the pound sterling. The US dollar broad weakness was largely attributable to the anticipation of further quantitative easing by the Fed in November. Both the euro and pound sterling weakened against the dollar following renewed sovereign debt concerns arising from the Irish debt crisis, further rating downgrades and concerns over the impact of fiscal austerity measures on the recovery process. On the other hand, the yen continued to strengthen against the US dollar, to reach a 15-year high of ¥80 in October, benefiting from its role as a safe haven currency amid heightened investor risk aversion in the global financial market. Most regional currencies also strengthened against the US dollar in the fourth quarter following continued capital flows into the region amid optimism over the region's favourable growth prospects. On 4 November,

the Singapore dollar traded at a record high of S\$1.2824 per US dollar but weakened subsequently during the month due to rising geopolitical tension in the Korean peninsula and the escalation of sovereign debt crisis in Ireland. The Chinese yuan ended the quarter at a 17-year high of 6.5897 per US dollar.

Going forward, the global economic recovery is expected to remain uneven across the different regions. While short-term prospects for the advanced economies have improved recently, uncertainties remain over weak fiscal positions, high unemployment and constrained lending conditions. In contrast, the growth outlook for Asia remains favourable, supported by robust domestic demand. The regional economies are, however confronted with the challenges of both rising inflationary pressures, particularly from high commodity and fuel prices, and the large and volatile capital flows.