

## DEVELOPMENTS IN THE FIRST QUARTER OF 2008

### INTERNATIONAL ECONOMIC ENVIRONMENT

#### *Sustained growth in most major regions despite weak growth in US*

Global growth performance in the first quarter 2008 was mixed amidst weak growth in the US economy. Growth momentum was sustained in Asian economies and supported by firm growth in the euro area and Japan. In the **US**, the first quarter advance estimate showed that real GDP growth weakened significantly to 0.6% (4Q 2007: 0.6%), supported largely by a build up in inventories, which contributed 0.8 percentage points to growth. Consumption increased modestly by 1% (4Q 2007: 2.3%), with spending on services offsetting the decline in expenditure on goods. Net exports remained supportive. Meanwhile, housing investment fell for the ninth consecutive quarter while business investment declined on weaker spending on non-residential structures, and equipment and software. On inflation, prices increased by 4.2% in the quarter (4Q 2007: 4.0%), the highest since 1991, on higher energy and food prices.

In **Japan**, first quarter real GDP expanded by an annualised 3.3% (4Q 2007: 2.6%), driven by net exports which benefited from strong exports to Asia and emerging markets. On the inflation front, prices rose by 1% (4Q 2007: 0.5%), with core prices reaching positive

territory for the first time in nearly 10 years. This was attributed to price increases in energy- and food-related items.

A better-than-expected 2.2% growth was recorded in the **euro area** in the first quarter. Resilience in the region was mainly due to stronger growth in Germany and a rebound in France. Germany expanded by 2.6% (4Q 2007: 1.8%), due to investment and consumer spending; while growth in France was supported by a recovery in exports. Growth in these two large countries helped compensate for the slower growth in Spain (2.7%) and other smaller euro area countries. Meanwhile in the **UK**, economic growth in the first quarter slowed to its weakest rate in three years as the services sector lost momentum due mainly to moderation in business services and finance activity. Slower activity is also evident in industrial production and construction.

In the **US**, the **Federal Open Market Committee** (FOMC) lowered interest rates aggressively on concerns of weak growth amidst continued financial market turbulence. In the first quarter of 2008, the FOMC reduced interest rates by 200 basis points. From September 2007, when the federal funds rate easing began, to end-April 2008, interest rates have been reduced by a cumulative 325 basis points to 2%.

#### Industrial Countries: Real GDP Growth

	2007			2008	Key contributing factors for 1Q growth
	1Q	4Q	Year	1Q	
	Annual change (%)				
US <sup>1</sup>	0.6	0.6	2.2	0.6 <sup>a</sup>	Supported by a modest expansion in consumption and government spending, inventory accumulation and a positive contribution from net exports, while housing and business investment declined.
UK	3.1	2.9	3.1	2.5	Slower growth in services sector, especially business services and finance.
Euro area	3.2	2.2	2.7	2.2 <sup>a</sup>	Supported by strong growth in Germany and a rebound in France.
Japan <sup>1</sup>	4.6	2.6 <sup>r</sup>	2.1	3.3 <sup>p</sup>	Supported by exports and private consumption.

<sup>1</sup> Annualised basis  
<sup>a</sup> Advanced estimate  
<sup>r</sup> Revised  
<sup>p</sup> Preliminary

Source: National authorities

The Federal Reserve Board (Fed) also undertook several measures to address market liquidity strains since the end of 2007. These include an expansion of the Term Auction Facility (TAF), increasing the currency swap lines with the European Central Bank and Swiss National Bank, and creating new facilities (Term Securities Lending Facility and the Primary Dealer Credit Facility) for primary dealers to have access to funds and more liquid securities. The Fed also facilitated the purchase of a US investment bank, by extending USD29 billion of financing at the discount rate.

In other industrial economies, the **Bank of Japan** kept interest rates at 0.5% despite a gradual rise in consumer prices as weaker external demand conditions raised the risks to economic growth. The **European Central Bank** (ECB) continued to maintain policy rates due to concern over inflation despite increasing risk of economic slowdown in the wake of credit market turbulence. Inflation data for March rose to 3.6%, more than a percentage point above the ECB's 2% target. The **Bank of England**, however, cut interest rates by 25 basis points in the first quarter of 2008 and again at its April meeting amidst signs of a slowing economy and weakening financial sector.

Prices of several **commodities** have reached new record highs this year due to sustained firm demand, supply concerns, weaker US dollar and to some extent, speculation in the

commodity markets. In the first quarter of 2008, crude oil prices averaged USD98 per barrel (2007 average: USD72). More recently, rice, the world's second-biggest food grain crop, recorded a new high. Rice prices have hit successive peaks due to worries over supply shortages, and been associated with social concerns and export restrictions in several countries.

In the **Asian region**, first quarter growth remained supported by domestic demand and strong export performance. Despite slowing demand from the US, export activity was sustained by demand from other non-US markets, high commodity prices, and increased intra-regional trade. Regional growth continued to be led by China which posted 10.6% growth in first quarter. Notwithstanding the resilience in economic growth seen so far, inflation remains a concern across the Asian region due mainly to rising food and energy prices. Amidst these developments, most regional central banks maintained interest rates due to concerns over slowing economic activity, despite rising inflationary pressures.

In the **foreign exchange market**, the US dollar ended the quarter weaker against major currencies. Dollar performance was mainly influenced by prospects of a greater slowdown of the US economy and rate cuts by the Fed. The US dollar, however, recorded a first monthly gain this year in April against the euro and yen as the Fed was seen to be approaching a pause

#### Regional Countries: Real GDP Growth

	2007			2008	Key contributing factors for 1Q growth
	1Q	4Q	Year	1Q	
	Annual change (%)				
PR China	11.7	11.2	11.9	10.6	Economic activity was sustained by higher fixed asset investment, retail sales and industrial production.
Hong Kong SAR	5.5	6.9	6.4	7.1	Sustained by robust investment and resilient exports.
Singapore	7.0	5.4	7.7	6.7	Driven by biomedical manufacturing, construction and financial services.
Indonesia	6.0	6.3	6.3	6.3	Supported by strong exports and investment.
Korea	4.0	5.7	5.0	5.7 <sup>a</sup>	Supported mainly by the manufacturing sector. Resilient export performance offset the moderation in domestic demand.
Thailand	4.3	5.7	4.8	6.0	Supported by private consumption and investment.

<sup>a</sup> Advanced estimate

Source: National authorities

in its policy cycle. Most regional currencies also strengthened in the quarter against the US dollar due to continued strong trade-related and portfolio inflows.

Going forward, global growth is expected to moderate due to slowing growth in the major industrial economies and continued uncertainties in the global financial markets.

The ongoing slowdown in the US economy remains a risk to global growth, while economic activity could also be affected by increasing inflationary pressures from rising food and energy prices. Growth in the Asian region, however, is expected to remain supported by firm domestic demand amidst a cautious outlook on export performance. Meanwhile, high fuel and food prices remain a concern in the Asian region.