

DEVELOPMENTS IN THE FIRST QUARTER OF 2007

INTERNATIONAL ECONOMIC ENVIRONMENT

Sustained growth in most major regions despite moderation in US

Global economic growth continued on a positive growth momentum, supported by continued recovery in Japan and euro area as well as sustained expansion in the Asian region, despite further moderation in the US economy.

The **US** economy expanded at its slowest pace in four years in the first quarter of 2007, growing by 1.3%, amid continued weakness in the residential property and automotive sectors. Residential property investment continued to be a major impediment to growth, falling for the sixth consecutive quarter. The weakness in the housing market is evidenced from the continued decline in home sales and rising home inventories. In addition, the merchandise trade deficit widened as exports growth recorded its first decline since the second quarter of 2003. Nevertheless, consumer spending remained resilient, supported by job creation, low unemployment and rising wages.

In **Japan**, the economy remained on a recovery trend in 1Q, growing by 2.4%. The continued expansion was driven by healthy private consumption and robust external demand. Household spending grew in the first three months of 2007 supported by consumption expenditure on transportation and communication services, despite some weakness in retail sales. In addition, export activity continued to underpin economic growth against the background of sustained demand from abroad, especially from PR China. The latest Tankan survey released in April indicated that businesses remained optimistic with plans to increase capital spending in the near future. Meanwhile, the

euro area sustained its growth momentum in the 1Q. Consumer sentiment continued to improve in the euro area with most sentiment indicators trending upwards. A rebound in retail sales indicated resilient private consumption activity. Improvement in labour market conditions and expansion in capital investment lent support to growth. Growth in the **UK** economy was sustained at 2.8% in the 1Q. Growth was supported by the buoyant services sector, led by the business services and finance sub-sectors. Moderation in manufacturing output was offset by increased output in both mining and quarrying sectors and energy supply. The Confederation of

Industrial countries: Real GDP Growth

	2006			2007	Key contributing factors for 1Q growth
	1Q	4Q	Year	1Q	
	Annual change (%)				
US ¹	5.6	2.5	3.3	1.3 ^a	Slower-than-expected growth due largely to declines in residential property investment and exports. Nevertheless, consumer spending was sustained.
UK	2.4	3	2.8	2.8 ^p	Services sector, especially business services and finance, continued to be the driver of growth.
Euro zone	2.2	3.3	2.8	3.1 ^p	Supported by business investments and net trade.
Japan ¹	3.1	5.0 ^r	2.2	2.4 ^p	Supported by healthy private consumption and robust export activity.

¹ Annualised basis
^a Advance estimates
^r Revised
^p Preliminary

Source: National authorities

British Industry's (CBI) retail survey for April indicated that consumers were still spending, despite the higher cost of living and rising borrowing costs.

Most central banks maintained their tightening bias in terms of **monetary policy** stance. In the **US**, the **Federal Open Market Committee** (FOMC) maintained interest rates at 5.25% at its meeting on 21 March

and 9 May 2007. Inflation continued to be a concern. Both core consumer price index and personal consumption expenditure index had edged downwards in March, but remained above the Fed's comfort zone of 1-2%. The **European Central Bank** kept interest rates unchanged at 3.75% in April, after raising by 25 basis points in March amid concerns over inflationary pressure arising from rapid money and credit growth. The **Bank of England** (BoE) raised its policy rate in January and May by 25 basis points each time to 5.5%, due to concerns over inflation. Inflation data for March recorded an increase of 3.1%, more than a percentage point above the BoE's 2% target. The **Bank of Japan** maintained interest rates at 0.5% on 27 April, due to concerns over the declining inflationary trend after two months of falling consumer prices.

Global **crude oil prices** edged up towards the end of first quarter, closing at USD65.87 per barrel on 30 March, the highest level in two months, amid concerns over supplies in Nigeria and continued tension between Iran and the US. On 29 May, oil prices closed at USD63.15.

In the first quarter, PR China recorded a stronger expansion supported by continued expansion in exports and investment. Sustained domestic demand provided support to growth in other economies in the region as growth in exports, particularly electrical and electronic products, moderated.

Most regional countries experienced lower inflationary pressures, in response to generally lower oil prices compared to the previous quarter. The lower inflation prompted Indonesia and Thailand to reduce their policy rates to stimulate domestic demand. Meanwhile, PR China and India raised interest rates to contain strong credit growth.

In the **foreign exchange market**, the US dollar ended the quarter weaker against major currencies. While interest rate differentials remained the major factor influencing the US dollar performance, concerns over the strength of the US economy also affected the dollar performance. On 18 April, the US dollar hit a 26-year low against the pound sterling followed by a record low against the euro on 27 April. These developments reflected market expectations for a rate cut in the US and further rate hikes in Europe. Meanwhile, most regional currencies ended the quarter stronger compared to the fourth quarter of 2006, due to strong trade and investment inflows. In the equity markets, performance continued to be supported by strong inflows of foreign portfolio funds.

Regional Countries: Real GDP Growth

	2006			2007	Key contributing factors for 1Q growth
	1Q	4Q	Year	1Q	
	Annual change (%)				
PR China	10.4	10.4	10.7	11.1	Driven by exports and investment.
Singapore	10.1	6.6	7.9	6.1	Supported by construction and financial services.
Indonesia	4.8	6.1	5.5	6.0	Supported by investment and exports.
Hong Kong SAR	8.0	7.0	6.8	5.6	Supported by private consumption and exports.
Korea	6.3	4.0	5.0	4.0 ^a	Supported by exports, investment and private consumption.

^a Advance estimates

Source: National authorities