DEVELOPMENTS IN THE FIRST QUARTER OF 2014

INTERNATIONAL ECONOMIC ENVIRONMENT

Moderate economic expansion

Global economic activity expanded at a moderate pace in the first quarter. In the advanced economies, while the gradual recovery continued across most economies, the US experienced a slower growth, mainly due to adverse weather conditions. Several economies in Asia grew at a slower pace as domestic demand was affected by country-specific factors. Amid an environment of moderate growth and low inflation, global monetary policy remained highly accommodative.

Global financial market conditions were volatile during the quarter. Risk aversion increased, reflecting growth concerns and monetary policy developments in the US, as well as heightened geopolitical risks. Sentiments were weighed down by weaker-than-expected economic data in the US and the Fed's announcement of a further scale-back of its quantitative easing (QE) programme. In the emerging markets, the higher risk aversion was also due to unfavourable developments in several economies, such as the rising risk of a growth deceleration in PR China as well as political and social tensions in several countries, including Turkey and Argentina. Notwithstanding the adverse developments, most major global equity indices ended the quarter higher, as the weakness in economic activity in the US was perceived as temporary in nature. Of significance, the S&P 500 registered its fifth consecutive quarter of increase, with the benchmark equity index recording multiple all-time highs in March. In Japan and PR China, however, the equity indices ended the quarter lower. Japan's equity market was dampened by concerns over the potential impact of the consumption tax hike in April 2014. In PR China, sentiments were affected by rising downside risks to growth amid defaults in the financial sector.

The US economy moderated in the first quarter of 2014 (2.3%, 4Q 2013: 2.6%), attributable mainly to unusually adverse weather conditions. On a seasonally-adjusted annualised basis, growth slowed to 0.1% (4Q 2013: 2.6%). Inventory accumulation was lower while exports moderated. Similarly, the housing market recovery slowed, as the combination of higher mortgage rates and bad weather affected residential construction and home sales. Nevertheless, consumer and business sentiments continued to improve. Consumer spending rose, supported by higher healthcare spending following the implementation of the Affordable Care Act and increased utilities spending during the winter. Notwithstanding the weather-related weakness, labour market conditions were favourable with net job creation sustained at 569,000 (4Q 2013: 595,000). Headline inflation rose to 1.4% (4Q 2013: 1.2%), reflecting higher rent and food prices.

In the euro area, the recovery continued at a modest pace. Domestic demand improved, underpinned by accommodative monetary conditions and a slower pace of fiscal consolidation. Nevertheless, overall demand conditions remained sluggish due to tight financing conditions, high indebtedness and elevated unemployment rates. Inflation moderated to 0.7% (4Q 2013: 0.8%) due to weak energy and food prices.

Economic activity in the UK grew by 3.1% (4Q 2013: 2.7%). On a seasonally-adjusted basis, quarterly growth recorded an expansion of 0.8% (4Q 2013: 0.7%). The services sector remained the key contributor to growth, attributable mainly to the expansion of the business and financial services sub-sectors. The inflation rate moderated to 1.7% (4Q 2013: 2.1%) following lower increases in the prices of food and recreational services.

In Japan, the economy continued to benefit from an improvement in domestic demand. Private consumption rose, underpinned by higher retail spending, amid rushed demand ahead of the consumption tax hike on 1 April 2014. Investment was supported by an improvement in business sentiments, with the index from the

Tankan survey for large manufacturing enterprises rising to 17 (4Q 2013: 16). In the external sector, exports expanded at a slower pace due mainly to lower shipments to Asia, the US and Western Europe. Headline inflation (excluding fresh food) rose (1.3%; 4Q 2013: 1.1%) amid increases in the costs of household durable goods, utilities and recreation. Core inflation was at 0.7% (4Q 2013: 0.5%).

Advanced Economies: Real GDP Growth

	2013			2014
	1Q	4Q	Year	1Q
	Annual change (%)			
US[1]	1.1	2.6	1.9	0.1[a]
UK	0.5	2.7	1.7	3.1[p]

[1] Annualised basis
[a] Advance estimate
[p] Preliminary

Source: National authorities

Monetary policy in the advanced economies remained highly accommodative, even as divergence in policy bias began to emerge, reflecting the uneven pace of economic recovery. The Fed had signalled the possibility of monetary policy normalisation should economic activity continue to gain momentum, while the Bank of England (BoE) had indicated an increase in interest rate once it makes further progress in reducing economic slack. In contrast, the European Central Bank (ECB) and the Bank of Japan (BoJ) reaffirmed their commitments to maintain accommodative monetary policy stances amid low inflation and subdued economic recovery. The Fed continued to reduce the pace of its asset purchases by USD10 billion at each meeting, lowering the total purchases to USD45 billion beginning May 2014 (April 2014: USD55 billion; December 2013: USD85 billion). At the Federal Open Market Committee (FOMC) meeting in March, the Fed maintained its forward guidance for interest rates to remain low for a considerable period of time after the end of QE, but removed the numerical threshold of the unemployment rate of 6.5%. While growth projections were broadly unchanged, the Fed projected the unemployment rate to reach 6.1-6.3% and 5.6-5.9% by end-2014 and 2015, respectively (previous: 6.3-6.6% and 5.3-5.8%, respectively). Similarly, in February, the BoE re-focused its forward guidance from a primary emphasis on the unemployment rate threshold to an assessment of the medium-term equilibrium unemployment rate based on the economy's excess capacity. This followed the BoE's assessment that the 7% unemployment rate threshold will be reached earlier than initially expected. The ECB reiterated that its key interest rates will remain at present or lower levels for an extended period amid expectations of subdued inflation and broad-based economic weakness in the medium term.

Economic activity in some Asian economies moderated in the first quarter due to country-specific developments. In PR China, growth was slower at 7.4% (4Q 2013: 7.7%), reflecting mainly lower investment and a larger negative contribution from net exports. Growth in Indonesia moderated to 5.2% (4Q 2013: 5.7%) due mainly to lower net exports and government consumption amid fiscal consolidation. In Singapore, growth of the economy moderated to 5.1% (4Q 2013: 5.5%) as slower growth in the services sector more than offset continued expansion in the manufacturing and construction sectors. In Korea and Chinese Taipei, economic activity improved, supported by private consumption and net exports.

Regional Countries: Real GDP Growth

	2013			2014
	1Q	4Q	Year	1Q
	Annual change (%)			
PR China	7.7	7.7	7.7	7.4
Indonesia	6.0	5.7	5.8	5.2
Singapore	0.6	5.5[r]	4.1[r]	5.1[a]
Korea	2.1	3.7[r]	3.0[r]	3.9[a]
Chinese Taipei	1.4	2.9	2.1[r]	3.0[a]

[a] Advance estimate
[r] Revised

Source: National authorities

Headline inflation rose in several Asian economies (the Philippines, Chinese Taipei and Thailand) due mainly to the higher cost of food. In Korea, inflation increased at a faster pace as prices of utilities rose. In contrast, inflation in Singapore, Hong Kong SAR and Indonesia slowed, partly attributed to lower transportation costs. In Singapore and Indonesia, the moderation was also on account of slower growth in the prices of housing and food, respectively.

During the quarter, central banks in the region maintained an accommodative policy stance amid an environment of benign inflation and moderate expansion in economic activity. In March, the Bank of Thailand reduced its key policy rate by 25 basis points to 2.00% to support economic activity as downside risks to growth increased amid the prolonged political turmoil. The Reserve Bank of India (RBI), however, raised its policy repo rate by 25 basis points to 8.00% during the quarter to contain inflationary pressures. In April, the RBI increased the liquidity provided under the 7-day and 14-day term repos and reduced the liquidity provided under overnight repos to improve its policy rate transmission.

The price of Brent crude oil was sustained at an average of USD108 per barrel in the first quarter (4Q 2013: USD108 per barrel). Oil prices remained elevated as concerns increased over a potential disruption in supply from Russia, the world's largest oil producer, amidst heightened geopolitical tensions with Ukraine. The continued reduction in output from major OPEC producers placed upward pressure on oil prices, with prices peaking at USD110 per barrel in February. Further upside to oil prices was, however, limited by several factors. These included higher inventory levels of crude oil in major OECD countries, moderate oil demand growth in major oil consuming countries and the rise in shale oil production in the US. Towards the end of the quarter, oil prices moderated to USD108 per barrel.

Major currencies ended the quarter higher against the US dollar while most regional currencies ended the quarter lower. The euro and pound sterling appreciated on account of releases of favourable domestic economic data. Meanwhile, the yen strengthened following higher demand for its safe haven characteristics amid heightened geopolitical tensions. In Asia, regional currencies depreciated due to an increase in risk aversion, driven by concerns over growth and financial risks in PR China, vulnerabilities in several emerging economies such as Turkey and Argentina as well as rising geopolitical tensions in Ukraine. Towards the end of the quarter, however, positive sentiments over the increased possibility of an economic stimulus in PR China provided some support to Asian currencies. In PR China, the renminbi's depreciation during the quarter was driven in part by the widening of the exchange rate trading band to +/- 2% from +/- 1% by the People's Bank of China (PBoC) to increase the two-way flexibility of the currency. The Indonesian rupiah, however, appreciated on improved investors' sentiments following a more favourable political outlook.

Moving forward, recovery in the global economy is expected to continue. International trade activity will continue to benefit from the improving growth prospects in the advanced economies. In Asia, while domestic demand is expected to moderate, it will continue to underpin the overall performance of these economies, with additional support coming from the improving external conditions. Continued uncertainty over monetary policy in key advanced economies, economic developments in both the advanced and emerging economies, as well as geopolitical developments, are likely to generate continued volatility in the global financial markets.