DEVELOPMENTS IN THE FOURTH QUARTER OF 2014

INTERNATIONAL ECONOMIC ENVIRONMENT

Moderate global economic expansion

Global economic activity continued to expand at a moderate pace in the fourth quarter of 2014. Nevertheless, the growth has remained uneven across economies. While the US economy continued to show broader signs of improvement, economic activity in the euro area and Japan remained subdued. In Asia, growth has been driven by domestic demand and exports. Lower inflation was recorded in most economies with the decline in energy prices reinforcing this trend.

Financial markets continued to experience considerable volatility during the quarter, amid concerns over the growth prospects of the euro area and Japan, uncertainty around the magnitude and persistence of lower energy prices, and increasing concerns on the growth prospects of several emerging economies given the decline in energy prices. Nevertheless, most major and regional equity markets ended the quarter higher, with investor confidence lifted by the stronger-than-expected economic data in the US, and the additional monetary stimulus undertaken by the Bank of Japan (BoJ). In Asia, further targeted policy measures by the Chinese Government and the unexpected policy rate cut by the People's Bank of China (PBoC) also raised market sentiments.

In the US, economic activity continued to expand, although at a more moderate pace, in the fourth quarter (2.5%; 3Q 2014: 2.7%). On a seasonally adjusted basis, the economy grew by 2.6% (3Q 2014: 5.0%). The expansion in economic activity was driven mainly by private consumption, amid further improvements in labour market conditions and some support from lower fuel prices. Growth of fixed investment was underpinned by the continued expansion in non-residential capital expenditure and the rebound in residential investment. Headline inflation moderated to 1.3% (3Q 2014: 1.8%), amid lower energy prices.

Economic activity in the euro area remained subdued in the fourth quarter. Business sentiments remained weak amid continued geopolitical developments in Eastern Europe and increasing concerns on the risk of deflation given the decline in energy prices. Overall demand conditions also continued to be affected by high unemployment, ongoing balance sheet adjustments by both the private and public sectors, and low capacity utilisation. Inflation moderated further to 0.2% during the quarter (3Q 2014: 0.3%), due mainly to lower energy prices.

The UK economy expanded at a slightly faster pace of 2.7% in the fourth quarter (3Q 2014: 2.6%). Growth was driven mainly by the services sector, particularly the distribution, hotels and catering sub-sectors. Inflation rate moderated to 0.9% during the quarter (3Q 2014: 1.5%), amid lower prices of motor fuels.

In Japan, despite some tentative signs of improvement in the fourth quarter, overall economic activity remained weak following two quarters of contraction. Private consumption continued to be weighed down by the consumption tax increase in April 2014 and slower wage growth. Nevertheless, exports expanded at a faster pace (9.2%; 3Q 2014: 3.2%), supported by higher shipments to Asia and the US. Inflation (excluding fresh food) continued to moderate (2.7%; 3Q 2014: 3.1%), due mainly to lower utilities, transport and recreation costs. Core inflation (excluding food and energy) also moderated (2.1%; 3Q 2014: 2.3%).

Advanced Economies: Real GDP Growth

	2013		2014		
	4Q	Year	3Q	4Q	Year
	Annual Change (%)				
US	3.1	2.2	2.7	2.5[a]	2.4[a]
UK	2.4	1.7	2.6	2.7[p]	2.6[p]

[a] Advance estimate
[p] Preliminary

Source: National authorities

The monetary policy stance in the advanced economies remained highly accommodative in the fourth quarter, despite continued divergence in monetary policy direction across economies. In the US, the Federal Reserve (Fed) ended the asset purchase programme in October 2014 amid lower labour market underutilisation. Nevertheless, following the declining energy prices, the Fed lowered its median inflation forecast for 2015 to 1.1%-1.2% in December 2014 (September 2014 forecast: 1.7%-1.8%), and suggested that "it can be patient in beginning to normalise the stance of monetary policy". In contrast, the European Central Bank (ECB) introduced new purchase programmes for asset-backed securities and covered bonds in October 2014, to support economic growth and reduce the risk of deflation in the euro area. In January 2015, the asset purchase programme was expanded to EUR60 billion (approximately USD70.9 billion) per month between March 2015 until at least September 2016, to include the purchase of bonds issued by euro area central governments, agencies and European institutions. In Japan, the BoJ increased its annual asset purchases to JPY80 trillion (approximately USD669.8 billion) [previous target range: JPY60-70 trillion (approximately USD502.3-586.1 billion)], amid continued concerns on disinflation.

In PR China, economic growth was sustained at 7.3% in the fourth quarter. Growth was supported by improvements in the tertiary industry (which includes, among others, hotel and catering, wholesale and retail trade, and financial services), which offset the growth moderation in the primary (agriculture) and secondary industries (industry and construction). The acceleration of infrastructure investment by the Chinese Government and the policy rate cut by PBoC also provided some support to economic activity, particularly towards the latter half of the quarter. Inflation moderated to 1.5% (3Q 2014: 2.0%), amid lower transport and housing prices.

In Asia, growth continued to expand, albeit at a more moderate pace in several economies. In the Philippines, economic activity grew at a faster pace of 6.9% (3Q 2014: 5.3%), supported mainly by higher private and public consumption as well as exports. Growth in Indonesia was broadly sustained (5.0%; 3Q 2014: 4.9%), supported by the continued expansion in domestic demand. Nevertheless, the pace of economic expansion was more moderate in Chinese Taipei and Korea (3.2% and 2.7% respectively; 3Q 2014: 3.6% and 3.2% respectively), due mainly to lower growth of domestic demand. Chinese Taipei was also affected by slower export growth. In Singapore, growth also moderated (1.5%; 3Q 2014: 2.8%), amid slower economic activity in the manufacturing and construction sectors.

Regional Countries: Real GDP Growth

	2013		2014		
	4Q	Year	3Q	4Q	Year
	Annual Change (%)				
PR China	7.8	7.7	7.3	7.3	7.4
Philippines	6.3	7.2	5.3	6.9	6.1
Indonesia	5.6[r]	5.6[r]	4.9[r]	5.0	5.0
Singapore	4.9	3.9	2.8	1.5[a]	2.8[a]
Korea	3.7	3.0	3.2	2.7[a]	3.3[a]
Chinese Taipei	3.4	2.2	3.6	3.2[a]	3.5[a]

[r] Revised
[a] Advance estimate

Source: National authorities

Headline inflation moderated in most Asian economies, reflecting mainly lower fuel prices and its pass-through to lower food and transportation costs. However, inflation increased in Indonesia following the implementation of fuel subsidy rationalisation in November 2014.

Most regional central banks maintained an accommodative monetary policy stance in the fourth quarter. Of significance, PBoC reduced its interest rates in November 2014, the first time since July 2012, to support economic activity following some concerns on weakening growth momentum and lower inflationary pressures. In particular, the one-year lending rate was lowered by 40 basis points to 5.6%, and the one-year deposit rate was lowered by 25 basis points to 2.75%. In January 2015, the Reserve Bank of India (RBI) lowered the repo and the reverse repo rates by 25 basis points to 7.75% and 6.75% respectively, following easing of inflationary pressures. In contrast, Bank Indonesia (BI) increased its policy rate by 25 basis points to 7.75% in November 2014, to anchor inflation expectations following the implementation of fuel subsidy rationalisation.

Brent crude oil prices declined by approximately 25% to an average of USD77 per barrel in the fourth quarter (3Q 2014: USD103 per barrel), amid higher global supply and weaker-than-expected economic activity in several major economies. Of significance, crude oil prices declined rapidly when the Organisation of the Petroleum Exporting Countries (OPEC) announced its decision to maintain production levels despite prevailing oversupply on 27 November 2014. Market sentiments declined further amid the expectation for US shale oil production to be sustained in the first half of 2015. This resulted in crude oil prices reaching USD56 per barrel at the end of the quarter, and USD45 per barrel on 26 January 2015, the lowest level since April 2009.

Most major and regional currencies ended the quarter lower against the US dollar. The broad-based depreciation against the US dollar was attributed mainly to stronger-than-expected economic data in the US, which supported market expectations for an interest rate normalisation to begin in 2015. In the advanced economies, the depreciation of the euro and Japanese yen against the US dollar was also supported by the announcement of additional monetary stimulus by both the ECB and BoJ. Nevertheless, in Asia, the Philippine peso outperformed the other regional currencies due mainly to a seasonal increase in remittances.

Moving forward, the global economy is expected to remain on a moderate growth path, but with increasing divergence in the growth momentum among the major economies. The decline in energy prices is expected to provide some additional support to overall global growth, as higher disposable income and lower inflation will support consumer spending. Nevertheless, there remain considerable downside risks to global economic activity. This includes a prolonged weakness in demand and low inflation or the possibility of deflation in several major economies, uncertainty over monetary policy adjustments in key advanced economies, and rising concerns on the growth prospects of several net commodity-exporting emerging economies amid declining energy prices.