DEVELOPMENTS IN THE FIRST QUARTER OF 2013

INTERNATIONAL ECONOMIC ENVIRONMENT

Modest expansion in global economic activity

The global economy expanded at a modest pace in the first quarter of 2013, with the growth momentum remaining uneven between and within regions. In the advanced economies, growth in the US remained slow, while most European economies experienced weak or negative economic performance. In Asia, economic expansion continued albeit at a slower pace. Given the modest economic performance and low inflation, monetary authorities continued to maintain accommodative policies to support the recovery process.

Financial market conditions generally improved during the quarter, as favourable economic and policy developments resulted in lower market perception of tail risks. At the beginning of the first quarter, global equity markets improved, underpinned by the successful aversion of the fiscal cliff, temporary suspension of the statutory debt limit, and positive economic data releases in the US. The commitment by major central banks to maintain an accommodative policy stance further reinforced investor optimism. In particular, market expectations in Japan were lifted by the introduction of an "open-ended monetary easing" stance and the adoption of a 2% inflation target. However, market volatility increased in February and March, following the re-emergence of uncertainty in the euro area. Inconclusive election results in Italy and domestic political tensions in Spain led to concerns over the indebted nations' ability to implement economic reforms. In addition, the initial proposal to impose a deposit levy as a condition for the Cyprus bailout raised uncertainty over the progress towards achieving a European banking union. Despite these developments, global equity markets ended the quarter at higher levels.

The US economy continued to expand at a modest pace in the first quarter of 2013 (1.8%; 4Q 2012: 1.7%). On a seasonally adjusted annualised basis, growth increased by 2.5% (4Q 2012: 0.4%), supported by an increase in private consumption expenditure and private inventory investment. The recovery in private sector economic activity was led by gradual improvements in the housing and labour markets. Residential investment recorded an expansion of 13% (4Q 2012: 14.9%), supported by continued growth in residential construction and sales amid declining mortgage rates and relatively low inventories. Similarly, non-farm employment registered a gain of 618,000 jobs during the quarter (4Q 2012: 626,000 jobs). While the unemployment rate declined to 7.7% (4Q 2012: 7.8%), this was, however, attributable in part to a lower labour participation rate, underscoring the uneven recovery in the labour market. Government spending continued to be a drag on growth (-2.1%; 4Q 2012: -1.8%) following reduced defence spending, and was further compounded by the sequester cuts amounting to USD85 billion that took effect beginning March. Headline inflation was lower at 1.7% (4Q 2012: 1.9%), as relatively subdued growth in food and gasoline inflation offset higher shelter prices.

In the euro area, economic performance remained weak. Domestic demand was adversely affected by weak private sector sentiments amidst the austerity measures and ongoing sovereign debt crisis. In particular, economic activity in the crisis-affected economies continued to deteriorate, attributable to the anaemic labour market, weak earnings and tight financing conditions. Of significance, the unemployment rate rose to a record high of 12.1%, with Greece and Spain recording the highest unemployment rates of 27% and 26.7% respectively. Meanwhile, exports expanded marginally, supported by the modest growth in global demand. Inflation moderated slightly to 1.9% (4Q 2012: 2.3%), due to lower energy prices.

The UK economy expanded by 0.6% in the first quarter (4Q 2012: 0.2%). On a seasonally adjusted basis, quarterly growth turned around to register 0.3% (4Q 2012: -0.3%), driven mainly by the services sector. The expansion was broad-based across all services sub-sectors, contributing 0.5 percentage points to quarterly growth. Production also increased, due largely to the turnaround in mining and quarrying activities, as operations in the North Sea resumed following an extended period of maintenance. In addition, the production of energy supplies increased, due to the unusually cold weather. However, construction activity continued to contract during the quarter. The pace of inflation remained steady at 2.8% (4Q 2012: 2.7%).

In Japan, economic activity in the first quarter benefitted from a modest recovery in external demand and continued reconstruction efforts. Exports improved during the quarter (1.2%; 4Q 2012: -5.5%), mainly on account of higher shipments to the US. However, domestic demand activity remained weighed down by weakness in underlying economic fundamentals. Consumption activity moderated, as wage growth remained weak while retail sales continued to decline (-1.2%; 4Q 2012: 0%). Similarly, industrial production contracted (-7.9%; 4Q 2012: -5.9%), due to lower demand for general machinery, electronics and transport equipment. Nevertheless, consumer and business sentiments began to improve towards the end of the quarter, in anticipation of the policy stimulus measures to spur growth by the newly-elected government and the Bank of Japan (BoJ), which included the announcement of more aggressive monetary easing, an inflation target of 2%, and a fiscal stimulus package amounting to ¥10.3 trillion. Of significance, the consumer confidence index improved to a 5-year high of 44.8 in March. Headline inflation (excluding fresh food) remained weak at -0.3% (4Q 2012: -0.1%), as recreation prices declined.

Monetary policy in the advanced economies remained very accommodative during the quarter. In the US, the Federal Open Market Committee (FOMC) maintained the federal funds rate at 0–0.25%, and continued its asset purchase program. In the euro area, the European Central Bank (ECB) lowered the interest rate on main refinancing operations by 25 basis points to 0.5% in May 2013. Amid persistently weak economic sentiments, the cut in interest rate is expected to support prospects for a recovery later in the year. The ECB also announced that its monetary policy stance will remain accommodative for "as long as needed". The Bank of England (BoE) maintained both its key policy rate at 0.5% and its asset purchase programme of £375 billion. The BoE and HM Treasury also expanded the Funding for Lending Scheme. The availability of the scheme was extended until end-2015, incentives for banks to lend to small- and medium-sized companies were increased, and, for the first time, non-bank providers of credit were included in the scheme. In Japan, the BoJ announced a comprehensive overhaul of its monetary policy framework, with the introduction of "Qualitative and Quantitative Monetary Easing". The new framework integrated and replaced the previous asset purchase programmes, with the aim to achieve the price stability target of 2% within 2 years. The main policy target is now the monetary base, with a target of ¥200 trillion by end-2013 and ¥270 trillion by end-2014 (end-2012: ¥138 trillion, 29% of GDP). These would be achieved by doubling the central bank's holding of Japanese government bonds, doubling the average maturities of the bonds purchased, and increasing private asset purchases. Meanwhile, the Reserve Bank of Australia (RBA) lowered its cash rate by 25 basis points to 2.75% in May 2013, due to indications of below trend GDP growth amid contained inflationary pressures since the second half of 2012.

Advanced Economies: Real GDP Growth

	2012			2013
	1Q	4Q	Year	1Q
	Annual change (%)			
US[1]	2.0	0.4	2.2	2.5[a]
UK	0.5	0.2	0.3	0.6[p]

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

Source: National authorities

Regional Countries: Real GDP Growth

	2012			2013
	1Q	4Q	Year	1Q
	Annual change (%)			
PR China	8.1	7.9	7.8	7.7[p]
Indonesia	6.3	6.1	6.2	6.0
Hong Kong SAR	0.7	2.8	1.5	2.8
Korea	2.8	1.5	2.0	1.5[a]
Chinese Taipei	0.6	3.7	1.3	1.5[a]
Singapore	1.5	1.5	1.3	-0.6[a]

[p] Preliminary
[a] Advance estimate

Source: National authorities

Most economies in Asia continued to expand, albeit at a slower pace, in the first quarter. Domestic demand remained the key contributor to growth, underpinned by favourable labour market conditions, continued access to financing and rising income levels. In several regional economies, overall investment activity continued to be supported by government spending, in particular for infrastructure projects. Intra-regional trade also provided some support to growth, but this was offset in part by weak demand from the US and Europe. In Korea, Hong Kong SAR and Indonesia, growth was sustained (1.5%, 2.8% and 6%; 4Q 2012: 1.5%, 2.8% and 6.1% respectively), as the improvement in net exports offset weaker investment. Resilient consumption also supported economic activity in Indonesia and Hong Kong SAR. In PR China, economic expansion moderated to 7.7% (4Q 2012: 7.9%), following slower industrial activity. Growth in Chinese Taipei moderated to 1.5% (4Q 2012: 3.7%), amid subdued private consumption and lower export growth. In Singapore, growth contracted by 0.6% (4Q 2012: 1.5%), as the manufacturing sector declined at a faster pace, due mainly to the contraction in the biomedical manufacturing cluster.

Headline inflation rose at a slightly faster pace in several Asian economies, driven by a variety of factors. In PR China and Indonesia, food costs increased amid lower supply conditions. In the Philippines, the rise in inflation was attributable largely to increases in the prices of alcohol and tobacco due to higher taxes. Meanwhile, in Singapore, private transportation costs rose. Price increases in India, however, decelerated due mainly to lower costs of manufactured products.

As inflationary pressures generally remained moderate, most regional central banks kept their key policy rates unchanged during the quarter to provide support to economic activity. Nevertheless, the Bank of Korea and the Reserve Bank of India cut their benchmark interest rates by 25 basis points to 2.50% and 7.25% respectively in May 2013, following concerns over weak economic activity amid high downside risks from the global environment. The State Bank of Vietnam also reduced its discount, refinancing and overnight rates by 100 basis points to 5%, 7% and 8% respectively to increase lending to businesses and support the economy. In addition, Bangko Sentral ng Pilipinas, in April 2013, reduced the interest rates on the Special Deposit Account (SDA) facility by 50 basis points to 2% across all tenures, to further enhance the efficiency of its operations in absorbing liquidity through the SDA facility.

Moreover, amid continued concerns over property price inflation in several economies, the monetary authorities also undertook further macroprudential measures aimed at the property sector during the quarter. In Singapore, policy measures included additional stamp duties on the first purchase of residential property by permanent residents and the second purchase of residential property by Singaporeans, and lower loan-to-value ratios for the second mortgage and above. Similarly, in PR China, to curb speculative demand for properties, the government imposed higher down-payment requirements and mortgage rates, and strengthened the ban on the purchase of second homes in several cities.

In the first quarter, global crude oil prices[1] averaged higher at USD112.57 per barrel (4Q 2012: USD110.11). The rise in oil prices was driven by lower production in Saudi Arabia, higher demand for heating following the unusually cold weather in the US and parts of Europe, and stronger-than-expected demand from PR China as refineries increased production ahead of the Lunar New Year. While crude oil traded at a 9-month high of USD118.72 in mid-February, the upward trend in oil prices reversed during the second half of the quarter amid pessimism following heightened uncertainties in the euro area and rising inventories in the US.

Most major currencies ended the quarter lower against the US dollar. The euro began the quarter on an upward trend, as successful Portuguese and Spanish bond auctions supported market optimism that the crisis-affected nations are on a sustainable debt

[1] Refers to Brent one-month futures on the Intercontinental Exchange (ICE).

reduction path. However, the appreciating trend reversed in February, weighed down by weaker economic assessment of the euro area and political uncertainty in Italy. This was further exacerbated by concerns over financial stability in the monetary union following uncertainty in the terms of the Cyprus bailout. In the UK, the pound sterling depreciated by 6.5% against the US dollar, following the downgrade of the nation's credit rating and weaker economic data releases. Similarly, the Japanese yen weakened by 7.9% against the US dollar, driven by market anticipation of Japan's more aggressive policy stimulus. Most Asian currencies also depreciated against the US dollar, as modest economic data releases in several economies dampened optimism over the growth prospects in Asia. The decline was further affected by the onset of greater market volatility in the euro area. The Chinese renminbi, however, reversed its depreciating trend at the start of February to end the quarter stronger, amid the release of several favourable economic data. In contrast to the regional trend, the Thai baht appreciated, partly supported by the nation's more favourable growth prospects. Demand for the currency was further bolstered by the USD2.1 billion listing of a Thai infrastructure fund this year.

Going forward, the global economy is expected to continue its moderate expansion. Downside risks to growth, however, remain. While there has been progress made in the major advanced economies to address the fiscal and financial issues, the sustainability of the economic recovery remains vulnerable to continued policy uncertainties and the risk of contagion. The divergent policies across regions are also resulting in spillover effects on global financial conditions, as reflected by the large capital flows into the emerging economies. Nevertheless, in Asia, growth will continue to be sustained by domestic demand, underpinned by income growth and healthy labour market conditions, and supported by continued policy flexibility.