DEVELOPMENTS IN THE FOURTH QUARTER OF 2013

INTERNATIONAL ECONOMIC ENVIRONMENT

Continued economic expansion

Global economic activity improved in the fourth quarter. In the advanced economies, recovery remained intact, albeit at a gradual pace. Some economies in Asia benefitted from the improvements in external demand. However, growth was weighed down by domestic factors, which offset the better export performance. Amid an environment of modest growth and low inflation, global monetary policy remained highly accommodative.

Movements in the global financial markets were defined primarily by policy uncertainties in the US. At the beginning of the quarter, equity markets fell following the US government shutdown. Nevertheless, the trend reversed when the government resumed operations on 17 October after the funding issues were resolved. Of significance, the S&P and Dow Jones reached record high levels following better US economic data releases and improved growth prospects as well as indications that the Fed would maintain its policy of low interest rates. With the improvements in the US, investors took the opportunity to reduce their holdings of assets in Asia which had previously experienced sharp price increases due to strong demand. Such volatility is part of the behaviour of financial markets in an environment of surplus global liquidity. In addition, there were country–specific factors that led to the outflows. Investor sentiments in Thailand and the Philippines were dampened by political unrest and the severe impact of Typhoon Haiyan, respectively. In Indonesia, continued concerns over the health of the economy led to a decline in the financial market conditions. In PR China, heightened money market rates fuelled concerns over market liquidity, amid lingering concerns over the pace of growth of the economy. Towards the end of the quarter, the Federal Reserve's (Fed) decision to begin scaling back quantitative easing (QE) resulted in further weakening in some Asian financial markets.

The US economy posted a stronger expansion in the final quarter of 2013 (2.7%, 3Q 2013: 2.0%). On a seasonally adjusted annualised basis, growth was slightly lower at 3.2% (3Q 2013: 4.1%). Growth was driven primarily by stronger consumption and private inventory accumulation. While the government shutdown and debt ceiling debate temporarily affected consumer and business sentiments in October, consumption and investment registered further improvements in the remaining months, suggesting underlying strength in the private sector. On the labour market front, net job creation improved to 586,000 (3Q 2013: 515,000) amid stronger hiring in the manufacturing and retail sectors. However, the housing market recovery momentum moderated during the quarter, as the rise in mortgage rates affected the pace of residential construction and home sales. Headline CPI moderated to 1.2% (3Q 2013: 1.6%) following persistent weakness in energy prices.

In the euro area, indicators generally pointed towards a continued recovery in economic activity, albeit at a gradual pace. The overall economic performance was supported by a modest improvement in exports. Nevertheless, structural and fiscal concerns continued to weigh down on domestic demand amid the ongoing balance sheet adjustments in the public and private sectors. Inflation moderated to 0.8% (3Q 2013: 1.3%) due to weak energy and food prices.

The UK economy grew by 2.8% (3Q 2013: 1.9%). On a seasonally adjusted basis, quarterly growth recorded an expansion of 0.7% (3Q 2013: 0.8%). The services sector was the key contributor to growth, attributable mainly to the expansion in the business services and finance sector. The inflation rate decreased to 2.1% (3Q 2013: 2.7%) following slower increases in the prices of food as well as recreational goods and services.

In Japan, economic activity benefitted from an improvement in domestic demand. Consumption increased, driven by higher household spending on durable goods and earnings. Investments rose as business sentiments continued to improve with the Tankan survey for large

Advanced Economies: Real GDP Growth

	2012		2013		
	4Q	Year	3Q	4Q	Year
	Annual change (%)				
US[1]	0.1	2.8	4.1	3.2[a]	1.9[a]
UK	0.2	0.2	1.9	2.8[p]	1.9[p]

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

Source: National authorities

manufacturing enterprises increasing to 16 (3Q 2013: 12). On the external demand front, exports recorded a positive growth of 17.4% (3Q 2013: 12.7%) due mainly to higher shipments to Asia, the US and Western Europe. Headline inflation (excluding fresh food) rose (1.1%; 3Q 2013: 0.7%) amid increases in the cost of education and recreation. Core inflation turned positive (0.5%; 3Q 2013: 0.0%).

The stance of monetary policy in the advanced economies remained highly accommodative but a shift in bias has emerged, reflecting the different pace of economic recovery. Following cumulative improvements in labour market conditions, the Fed announced that it would reduce its asset purchases by USD10 billion to USD75 billion in December 2013 and subsequently, in January 2014 to USD65 billion per month. In the December FOMC meeting minutes, many FOMC members indicated that further reductions in asset purchases would be undertaken in measured steps. However, the Fed stressed that the pace of asset purchase reduction was not a preset course. It remained contingent upon labour market conditions and inflation developments. While growth projections were broadly unchanged, projections for the unemployment rate improved to 6.3-6.6% in 2014 and 5.8-6.1% in 2015 (Previous: 6.4-6.8% and 5.9-6.2%, respectively). In addition, the Fed also enhanced the existing forward guidance, noting that it will maintain the current federal funds rate even after the unemployment rate has declined beyond the 6.5% threshold. In the euro area, the European Central Bank (ECB) lowered interest rates to 0.25% in November. The decision was premised upon latest indications pointing to a prolonged period of low inflation below the 2% target. The ECB also reaffirmed the forward guidance for monetary policy to remain accommodative for

Regional Countries: Real GDP Growth

	2012		2013		
	4Q	Year	3Q	4Q	Year
	Annual change (%)				
PR China	7.9	7.7	7.8	7.7	7.7
Philippines	7.1	6.8	6.9[r]	6.5	7.2
Indonesia	6.2[r]	6.3[r]	5.6	5.7	5.8
Singapore	1.5	1.3	5.9[r]	4.4[a]	3.7[a]
Korea	1.5	2.0	3.3	3.9[a]	2.8[a]
Chinese Taipei	3.9	1.5	1.7	2.9[a]	2.2[a]

[p] Preliminary
[a] Advance estimate
[r] Revised

Source: National authorities

as long as necessary. Meanwhile, the Bank of England and the Bank of Japan maintained their accommodative monetary policy stance.

Notwithstanding the improvement in external demand, domestic economic activity in several Asian economies moderated in the fourth quarter due to country-specific factors. In PR China, growth was slightly lower at 7.7% (3Q 2013: 7.8%), attributable mainly to slower investment and net exports amid tighter credit conditions. Growth in the Philippines moderated to 6.5% (3Q 2013: 6.9%) as economic activity was adversely affected by Typhoon Haiyan in November. Singapore's economy also grew at a slower pace of 4.4% (3Q 2013: 5.9%) due to a broad-based moderation in economic activity. In Indonesia, economic activity grew by 5.7% (3Q 2013: 5.6%) on account of improved exports, which more-than-offset the moderation in domestic demand which was affected by high inflation and tighter monetary policy. The economies of Korea and Chinese Taipei expanded at a faster pace of 3.9% and 2.9%, respectively (3Q 2013: 3.3% and 1.7%, respectively), underpinned by better domestic demand and exports.

Headline inflation rose in several Asian economies (PR China, Singapore, Chinese Taipei and the Philippines) due mainly to the higher cost of food. In the Philippines, inflation was driven by the increases in the cost of food and utilities in the aftermath of Typhoon Haiyan. Prices rose marginally in Thailand as the higher cost of food was to some extent offset by the moderation in transport, housing and energy prices. Meanwhile, in Indonesia, inflation remained high but moderated slightly, on account of slower growth in the prices of food, clothing and education.

Most regional central banks maintained an accommodative monetary policy stance to support growth. In November, the Bank of Thailand (BOT) lowered its key policy rate by 25 basis points (bps) to 2.25% to mitigate downside risks to growth arising from the benign inflation outlook and moderating household credit growth. In contrast, Bank Indonesia hiked its benchmark rate by 25 bps to 7.50% to narrow the current account deficit. In January 2014, the Reserve Bank of India (RBI) raised its policy repo rate by 25 bps to 8.0% as core inflation remained elevated. The cash reserve ratio (CRR) was maintained at 4.0%.

Prices of crude oil moderated to an average of USD109 per barrel (3Q 2013: USD110 per barrel). Oil prices trended lower in the beginning of the quarter due to a number of factors. Prices declined following reduced geopolitical uncertainties in Syria. The sharp rise in US oil inventories thereafter exacerbated the decline in prices to a 3-month low at USD103 per barrel in early-November. This was followed later by optimism over the partial removal of Iranian sanctions, which led to an expectation of higher oil supply. Nevertheless, the trend was subsequently reversed following concerns over disruptions in the supply of oil in Libya, as well as higher demand for heating following the harsh winter in North America. By year-end, oil prices closed at USD111 per barrel.

With the exception of the Japanese yen, most major currencies ended the quarter higher against the US dollar. At the beginning of the quarter, improved investor sentiments following the temporary resolution of the US fiscal issues supported the appreciation of most major currencies against the US dollar. The euro and sterling also benefitted from better-than-expected economic data releases. However, the euro depreciated against the US dollar in the middle of the quarter due mainly to the downgrade in France's sovereign rating and the ECB's reduction of its policy rate. The downward trend reversed in the second half of the quarter, underpinned by an improved outlook for the euro area's economy and the ECB's statement that interest rates will remain low. Meanwhile, the Japanese yen generally depreciated against the US dollar throughout the quarter on account of lower demand for the yen as a safe haven currency. In Asia, most currencies also ended the quarter lower against the US dollar, attributable mainly to the uncertainty surrounding the Fed's QE scale-back. The declines in the ASEAN currencies were exacerbated by country-specific factors, namely concerns over the current account position in Indonesia, political unrest in Thailand and adverse economic impact of Typhoon Haiyan in the Philippines. Nevertheless, the Korean won outperformed the regional currencies and ended the quarter higher against the US dollar, underpinned by investors' confidence of the country's economic outlook and large current account surplus.

Moving forward, the global economy is expected to continue to experience a moderate recovery. Sustained improvements in the advanced economies will benefit international trade. However, uncertainties surrounding monetary and fiscal policy adjustments in the advanced economies are likely to persist. Growth of the Asian economies is expected to be supported by improving external conditions amid moderating domestic demand.