International Economic Environment

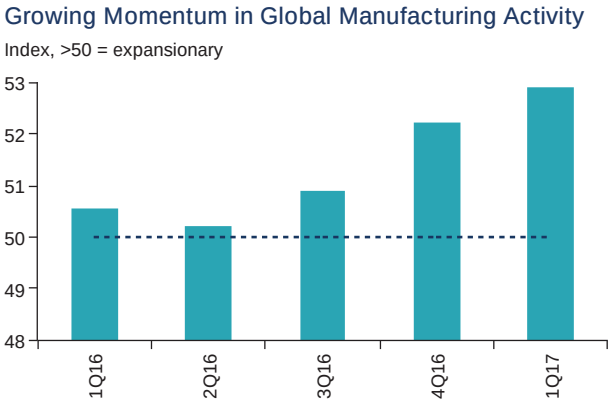
HIGHLIGHTS

- **Broad-based improvements in global growth, supported by stronger investment activity in major advanced economies.**
- **Rise in headline inflation following increase in crude oil prices.**
- **Less volatile financial markets, despite several major developments.**

Global growth expanded further

In the first quarter of 2017, global economic activity expanded further with growth becoming more synchronised across countries. Indicators such as the manufacturing purchasing managers' index (PMI) and trade growth showed a significant pick-up in economic activity. In particular, the manufacturing PMI recorded the fastest rate of expansion in six years. Manufacturing activity was supported by better performance across the consumer, intermediate and investment goods sectors, suggesting a broad-based expansion in demand from consumers and businesses. Trade for the Asian economies, including Korea, Chinese Taipei and Singapore, recorded double-digit growth for the first time since 2011, supported mainly by the electrical & electronics (E&E) and commodities sectors.

Chart 1 Global Manufacturing PMI

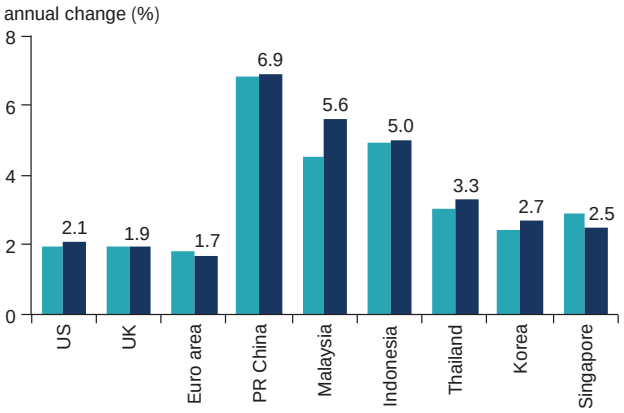


Source: J.P. Morgan, IHS Markit, Bloomberg

The improvement in growth was observed across both the advanced and emerging market economies. First quarter GDP releases showed higher growth in several economies in Asia and sustained performance in the advanced economies. Looking at the growth components, while the expansion in consumption was sustained, investment activity rose in the advanced economies. This was an important development given the weakness seen in investment particularly in the US since 2Q 2016. More importantly, improvements in investment play a bigger role in driving global trade (Constantinescu et al., 2015). Continued strength in domestic demand in PR China lent further support to global demand, as shown by the double-digit growth in PR China's imports during the quarter. The rise in demand was generated by both the demand for intermediate goods meant for re-exports and domestic consumption. Asia benefitted from the recovery in global demand amid sustained strength in domestic demand, supported by favourable labour market conditions and infrastructure spending.

Chart 2: GDP Growth of Selected Economies

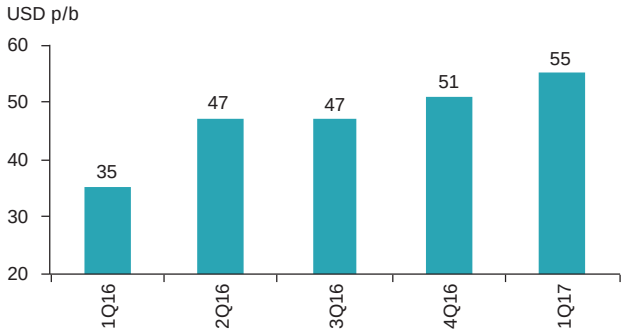
Further Global Economic Expansion in 1Q 2017



Source: National authorities

Chart 3: Brent Crude Oil Price

Higher Crude Oil Prices in 1Q 2017



Source: Bloomberg

Chart 4: Inflation Rates of Selected Economies

Headline Inflation Rose Across Major Advanced and Asian Economies



*Data refers to personal consumption expenditures price index

Source: National authorities

Higher headline inflation following increase in oil prices

Headline inflation in many economies rose during the quarter arising mainly from increased oil prices. Brent crude oil price averaged USD55 per barrel (4Q 2016: USD51 per barrel), supported by investors' optimism following strong compliance by OPEC members for the oil output cut initiative.

This price increase drove up transportation costs across the major advanced and emerging economies. The UK's headline inflation rose to 2.1%, above the Bank of England's inflation target of 2%, the highest since 4Q 2013. Similarly, in the euro area, headline inflation recorded its fastest reading since 1Q 2013. However, the pace of inflation differed across euro member states. Germany and Spain recorded inflation rates of 2.0% and 2.8%, respectively, while Finland and Greece registered inflation rates of 0.9% and 1.3%, respectively. Rising inflation was also observed across Asian economies, including Indonesia, the Philippines, Korea, Thailand and Singapore where the transportation subcomponent constituted between 8% (Philippines) to 19% (Thailand) of the consumer price index (CPI) basket. Nonetheless, underlying price pressures remained modest, as reflected by the low growth in core inflation. The only major exception was the US, where core inflation (as measured by the personal consumption expenditures price index) rose due to a sustained expansion of private consumption, particularly of services.

Less volatile financial markets

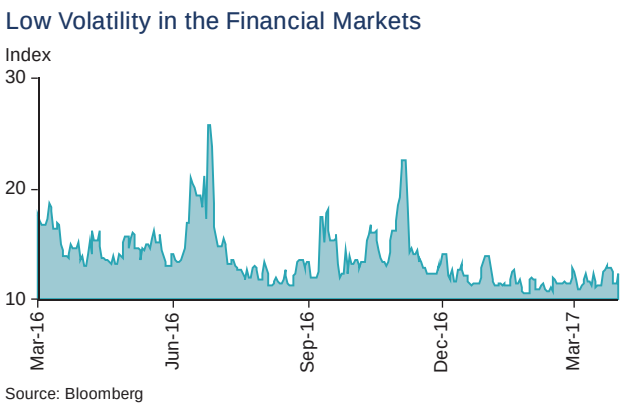
Volatility in the global financial markets declined, as major developments and events were largely anticipated by market participants.

A key policy event was Federal Reserve's decision to raise the federal funds rate for the second time since December 2015. The normalisation was a widely anticipated move. The Federal Reserve had earlier indicated that an interest rate hike would be appropriate amid continued improvements in employment and inflation data. Most other major central banks remained committed to maintaining an accommodative monetary policy stance until stronger signs of rising inflation emerged while allowing the current phase of economic expansion to be more entrenched. Beyond monetary policy, the much awaited triggering of the Article 50[1] by the UK government also had limited impact on volatility in the financial markets.

[1] Article 50 of the Treaty on European Union is the part of European Union law that sets out the process by which member states may withdraw from the European Union.

Markets were nevertheless affected, albeit marginally, by the attempt by the Trump administration to repeal the Affordable Care Act, as evidenced by an increase in the VIX reading on 23 March. Concerns surrounding the Trump administration's ability to execute the pro-growth policies rose, resulting in a depreciation of the US dollar against major and regional currencies, towards the end of the quarter.

Chart 5: Chicago Board Options Exchange (CBOE) Volatility Index (VIX)



Source: Bloomberg