DEVELOPMENTS IN THE FOURTH QUARTER OF 2016

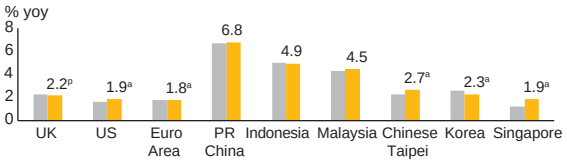
INTERNATIONAL ECONOMIC ENVIRONMENT

Global economic activity continued to expand in the fourth quarter of 2016. The advanced economies experienced divergent growth trends, in part, driven by differences in the strength of private consumption amid cyclical and structural weaknesses. In Asia, economic activity was supported mainly by domestic demand. Of importance, the external sector provided a small lift to growth in several economies, following consecutive quarters of negative growth. Financial market volatility increased following concerns over major issues in the advanced economies, such as the policy and political uncertainties in the US and the UK, arising from the outcome of the presidential election in the US and the UK's vote to exit the EU. Overall, global monetary conditions remained very accommodative, against a backdrop of continued growth concerns with rising, but still low inflation.

Continued expansion in the global economy

The advanced economies experienced a divergence in growth performance, with improvement in the US and sustained growth in the UK and euro area. The US economy expanded at a faster pace in 4Q 2016, mainly reflecting a turnaround in fixed investment growth. Of significance, higher capital spending by the public sector on highways, education and recreation-related constructions supported investment activity. Growth in the UK was broadly sustained, being anchored primarily by private consumption. Firms remained cautious regarding the prospects of the economy amid lingering uncertainties surrounding the new framework of UK-EU relations. In the euro area, growth was mainly driven by domestic demand. However, labour market conditions remained subdued with weak wage growth and high unemployment rates. In addition, business conditions continued to be weighed down by uncertainties from upcoming national elections in some key economies and a potentially lengthy UK-EU exit negotiation process, especially with rising euroscepticism across the region.

Global Real GDP Growth (Annual Change, %)



a Advance
p Preliminary

Source: National authorities

Economic activity was sustained in emerging Asia against a backdrop of gradual improvement in external demand. The Chinese economy registered a marginal improvement in economic growth. While the primary and secondary industries expanded at a slower pace, this was more than offset by higher growth in the services industry (8.2%, 3Q 2016: 7.5%), in particular, in consumer services such as media, education, scientific research, and social services. In the ASEAN economies, growth continued to be underpinned by domestic demand amid some policy support.

Global financial market volatility increased during the quarter

In the second half of the quarter, global financial conditions were more volatile, dominated by shifts in sentiments surrounding events in the advanced economies. In the US, equity markets and the US dollar rose after the presidential election outcome on expectations of pro-growth policies under the new administration and a faster pace of monetary policy normalisation by the Federal Reserve. Financial markets in most other advanced economies improved, supported by tentative signs of strength from PR China, and an extension of the ECB's bond-buying programme. The weakening of the yen against the US dollar also contributed to the rally in Japanese markets, as prospects for exports improved. In contrast, most regional equity and bond markets were adversely affected by concerns that these events could accelerate capital outflows from emerging markets. As a

result, currencies in the region declined broadly from early-November, and ended the quarter lower against the US dollar.

The Brent crude oil prices trended higher, averaging USD51 per barrel (3Q 2016: USD47). During most of the quarter, expectations for an OPEC oil output cut agreement supported a marked improvement in market sentiments. The upward trend was disrupted in the middle of the quarter on account of post-US election uncertainties. The decline was exacerbated by a re-emergence of oversupply concerns as oil inventories in the US increased and uncertainty rose over OPEC's ability to finalise its agreement. Subsequently, however, the eventual agreement among OPEC and non-OPEC countries to reduce oil output resulted in an increase in Brent crude oil price to the highest level since mid-2015, ending the year at USD57 per barrel.

Marginally higher inflation in the advanced and Asian economies

Headline inflation in the advanced economies increased during the quarter, albeit still remaining below central bank targets in most economies. Of significance, the uptrend in headline inflation partly reflected the increase in crude oil prices in the fourth quarter of the year, contributing towards higher fuel and heating oil prices, consequently reducing the drag from energy prices on domestic price pressures. Core inflation was relatively stable in the advanced economies.

Similarly, inflation rose in most Asian economies. Food prices in the region continued to grow at a faster pace due to supply shortages caused by adverse weather conditions. Additionally, the increase in oil prices had eased downward price pressures across the region. Of significance, following a period of negative inflation since 4Q 2014, Singapore recorded its first quarterly increase in inflation, as the modest recovery in global oil prices reduced the drag from transportation costs. However, Hong Kong SAR experienced a moderation in inflation, as government measures to curb escalating private housing prices began to take effect.

Continued accommodative global monetary policy stance

The monetary policy stance in the advanced economies remained highly accommodative. Most central banks maintained their key policy rates except the US Federal Reserve (Fed). The Fed raised the federal funds rate for the first time since December 2015 by 25 basis points to 0.50 – 0.75%. The Fed assessed that the US economic recovery has been expanding at a moderate pace, with significant improvements in the labour market. Of significance, the FOMC expected a faster pace of monetary policy normalisation in 2017. In the euro area, the European Central Bank (ECB) decided to maintain its key policy rate and continue the asset purchase programme (APP) at a rate of EUR80 billion per month until the end of March 2017 and subsequently reduce it to EUR60 billion until December 2017, or beyond, dependent upon the adjustment in the path of inflation. Other central banks in the advanced economies such as the Bank of Japan, Bank of England and the Reserve Bank of Australia kept their key policy rates unchanged over the last quarter.

In Asia, a few central banks reduced their key policy rates during the quarter. Bank Indonesia (BI) cut its key policy rate, the seven-day reverse repo rate, from 5.00% to 4.75% in October as domestic inflationary pressures eased. Subsequently, BI maintained its key interest rates, indicating its caution in response to increasingly uncertain global financial markets. The Reserve Bank of India also reduced its key policy rate from 6.50% to 6.25% in October, citing a marked slowdown in global growth. This was the first decision by the recently appointed monetary policy committee, which pushed policy rates to a five-year low. All other central banks across the region maintained their key policy rates.

Global growth prospects continue to be surrounded by uncertainties

Going forward, the global economy is expected to improve but remain on a moderate growth path. While there are indications of more sustained growth in the major economies in 2017, downside risks to global growth continue to prevail, arising from the volatility in commodity prices, policy uncertainties and growth prospects of the major developed economies, heightened risk aversions in the global financial markets as well as geopolitical developments.