DEVELOPMENTS IN THE FIRST QUARTER OF 2016

INTERNATIONAL ECONOMIC ENVIRONMENT

Moderate global growth

In the first quarter of 2016, the global economy expanded moderately against a backdrop of high financial market volatility. The advanced economies continued to register modest improvements, as the pace of growth remained constrained by crisis-related legacies, including high indebtedness and labour market slack. In Asia, economic activity expanded at a more moderate pace due in part to the weakness in exports. Amid these developments, several economies adopted more stimulus to support growth.

Global financial conditions were volatile during the quarter, particularly at the start of the year, from a confluence of factors. The unexpected adjustments in PR China's currency and equities, amid weaker Chinese economic data, led to heightened concerns over the health of the Chinese economy and the potential spillovers to the rest of the world. Additionally, the decline of the Brent crude oil prices to a 12-year low (USD28 per barrel) also dampened investor sentiments. In the euro area, financial markets were affected by concerns that the introduction of negative interest rates and weak global growth would undermine the health of Europe's banking sector. The adoption of negative interest rates policy by the Bank of Japan also contributed to an increase in market volatility. As a result, credit spreads widened and equity markets fell across major and regional financial markets. Nevertheless, equity markets in the major and regional economies rose in the second half of the quarter, which offset earlier declines in several economies. The improvement was supported by a modest rebound in oil prices and Chinese policymakers' comments on more accommodative policy and exchange rate stability. The Federal Reserve's announcement of more gradual monetary policy adjustments on 16 March 2016 also contributed to the improvement in market sentiments. Against this backdrop, most major and regional currencies ended the quarter higher against the US dollar.

Brent crude oil prices declined to an average of USD35 per barrel in the first quarter of 2016 (4Q 2015: USD45 per barrel) as excess supply and elevated inventory build-up continued. In January, sentiments in the markets were weighed down by worsening oversupply in the oil market following the lifting of international sanctions on Iran on 16 January 2016. Financial market volatility in PR China was also a key factor in causing prices to hit a 12-year low of USD 28 per barrel on 20 January 2016. However, the oil market recovered slightly towards the end of the quarter due to improved sentiments following the news of an agreement by OPEC and Russia to meet in Doha, Qatar on 17 April 2016 to discuss a plan to freeze oil output from both parties. In addition, the continued fall in oil rig count in the US and news of project deferments and job cuts in the US shale oil industry reinforced expectations of lower US oil production that could support prices in the coming months. Brent crude oil prices reached a 4-month high of USD42 per barrel on 22 March 2016, eventually ending the quarter at USD 40 per barrel.

In the US, economic activity was sustained at 2.0% in the first quarter, supported by private consumption and government spending. However, on a seasonally adjusted annualised basis, the overall growth momentum slowed to 0.5% (4Q 2015: 1.4%). The moderation in growth was observed in all major components of growth except government spending. While private consumption remained a key contributor to growth, demand was weighed down by durable goods, which turned negative due mainly to motor vehicles and parts. The slower momentum in fixed investment was attributable mainly to weaker capital spending in structures and equipment. Net exports were a larger drag on growth as exports recorded negative growth for the second consecutive quarter (-2.6%) while imports grew by 0.2%. During the quarter, headline inflation moved closer to the target rate of 2.0% with a 1.1% increase (4Q 2015: 0.5%), due mainly to the rise in the cost of medical care and transportation services.

The euro area economy expanded by 1.6%, according to preliminary estimates. On a seasonally-adjusted quarter-on-quarter basis, growth improved to 0.6%, from 0.3% in the

fourth quarter 2015. Economic activity was underpinned by growth in household consumption and gradual improvements in the labour market. Overall business sentiments were weaker but remained positive, with the manufacturing PMI declining slightly to 51.8 (4Q 2015: 52.8). On the external front, exports contracted marginally (Jan. - Feb. 2016 average: -0.4%, 4Q 2015: 3.4%), following lower shipments of raw materials and manufactured products. Deflationary pressures increased during the quarter as headline inflation declined to 0% (4Q 2015: 0.2%) while core inflation remained low at 1.0%. following a broad-based moderation across industries.

The UK economy expanded at a sustained pace of 2.1% in the first quarter. The services sector continued to be the key contributor to growth, particularly the business services and finance sub-sectors. Labour market conditions remained favourable, as employment continued to grow at a strong pace, while the unemployment rate remained low. Headline inflation rose slightly to 0.3% (4Q 2015: 0.1%), as a result of higher prices for housing and household expenditures.

Meanwhile, overall economic activity in Japan remained weak. Business sentiments were weaker, as indicated by the Tankan survey index for large manufacturers (6.0%, 4Q 2015: 12.0%) while industrial production declined (-3.3%, 4Q 2015: -1.1%). In terms of external demand, exports contracted further, mainly due to slower demand growth in most of its key trading partners. Nevertheless, consumer spending experienced a slight improvement as real wages recorded a positive growth of 1.6% in the first quarter, after a contraction in 2015. Headline inflation (excluding fresh food) declined slightly to -0.1% (4Q 2015: 0%) while core inflation (excluding food and energy) was sustained at 0.7%.

Advanced Economies: Real GDP Growth

	2015			2016
	1Q	4Q	Year	1Q
UK	2.6	2.1	2.3	2.1[p]
US	2.9	2.0	2.4	2.0[a]
Euro area	1.3	1.6[r]	1.6[r]	1.6[p]

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

Source: National authorities

Monetary policy in the advanced economies remained highly accommodative during the quarter, with most central banks in the advanced economies conducting further easing. The European Central Bank (ECB) lowered interest rates on the main refinancing operations and the marginal lending facility by 5 basis points to 0.00% and 0.25% respectively. The ECB also further reduced the deposit rate by 10 basis points to -0.4% and started increasing asset purchases by EUR20 billion to EUR80 billion per month as well as extending the period of the asset purchases to at least March 2017. A new series of four targeted long-term loans to banks (TLTRO II) was also announced. Additionally, beginning June 2016, the ECB will start the corporate sector purchase programme (CSPP), an expansion to the type of assets purchased under its current programme. Under the CSPP, the ECB will purchase investment-grade euro-denominated bonds issued by euro area's non-bank corporations. It is intended to further strengthen the effectiveness of its asset purchases programme. Meanwhile, in an unanticipated move, the Bank of Japan (BOJ) introduced "Quantitative and Qualitative Monetary Easing (QQE) with a Negative Interest Rate" on 29 January 2016. Of significance, the interest rate on deposits that financial institutions hold at the BOJ was reduced from 0.1% to -0.1%. Likewise, the Swedish Riksbank and Reserve Bank of New Zealand lowered their key policy rates by 15 basis points to -0.5% (official cash rate) and by 25 basis points to 2.25% (main repo rate), respectively. In the other advanced economies, central banks in the US, Australia and Canada reiterated their commitment to maintain accommodative monetary conditions and kept their policy rates unchanged during the quarter. In particular, the Federal Reserve in March projected a more gradual pace of normalisation, with an estimated 50 basis points increase in the interest rate by the end of the year (Dec. 2015: 100 basis points).

The Chinese economy grew at a moderate pace of 6.7% in the first quarter (4Q 2015: 6.8%). Economic activity continued to be affected by the unwinding of excess capacity in key industries and the weakness in external demand. In view of rising downside risks to growth, the Chinese Government implemented

a series of wide-ranging policy measures. These included the easing of house purchase restrictions and higher infrastructure investment. The People's Bank of China (PBOC) also eased monetary policy through liquidity injections into the interbank market and lowered the reserve requirement ratio to support liquidity conditions. Meanwhile, inflation increased to 2.1% (4Q 2015: 1.5%) due to higher prices in the food and healthcare sub-sectors.

In several other Asian economies, economic activity moderated amid continued weakness in external demand. In Indonesia, growth was slightly lower at 4.9% (4Q 2015: 5.0%) due to more moderate investment activity. The Korean economy expanded at a slower pace of 2.7% (4Q 2015: 3.1%), as growth was weighed down by a moderation in private consumption, investment and exports. Growth in Singapore remained modest at 1.8% (4Q 2015: 1.8%). An improvement in construction activity was offset by a moderation in growth in the manufacturing and services sectors. Meanwhile, growth in Chinese Taipei recorded a sharper contraction of 0.8% (4Q 2015: -0.5%), as investment and exports declined at a faster pace, offsetting the improvement in private consumption.

Regional Countries: Real GDP Growth

	2015			2016
	1Q	4Q	Year	1Q
	Annual change (%)			
PR China	7.0	6.8	6.9	6.7
Indonesia	4.7	5.0	4.8	4.9
Korea	2.4	3.1	2.6	2.7[a]
Singapore	2.7	1.8	2.0	1.8[a]
Chinese Taipei	4.0	-0.5	0.7	-0.8[a]

[a] Advance estimate

Source: National authorities

Inflation increased in several Asian economies. Food prices grew at a faster pace due to lower supply caused by colder weather conditions and higher seasonal demand during the Lunar New Year festival period. In addition, inflation rose in Chinese Taipei as the effect from the electricity rate refund plan which was implemented for households in 2015 diminished, leading to higher growth in the cost of utilities. However, Singapore and Thailand remained in deflation, reflecting mainly the lower cost of housing and transportation.

In this environment, the monetary policy stance remained accommodative across the regional economies, with a few central banks lowering their key policy rates during the quarter. Bank Indonesia lowered its key policy rate by a cumulative 75 basis points from 7.50% to 6.75% to support economic activity, as domestic inflationary pressures eased. In March, the Central Bank of the Republic of China (Taiwan) lowered its key policy rate by 12.5 basis points to 1.50% from 1.625%, noting that the modest economic recovery faced headwinds from the external environment. In contrast, to deter offshore speculation of the renminbi, the People's Bank of China tightened offshore renminbi liquidity by implementing a reserve requirement ratio of 17.5% on banks' offshore renminbi deposits.

Overall, downside risks to the global economy remain elevated. Cyclical and structural economic weaknesses continue to weigh on growth in the major economies, in addition to volatility of energy prices and rising geopolitical risks. Looking ahead, although the global economy is projected to improve, the pace of expansion is expected to be moderate and uneven. In most of Asia, domestic demand will continue to drive growth amid policy support.