DEVELOPMENTS IN THE FIRST QUARTER OF 2009

INTERNATIONAL ECONOMIC ENVIRONMENT

Further deterioration in global economic conditions

The global economy deteriorated further in the first quarter of 2009, while conditions in the international financial system began to stabilise towards the latter part of the quarter. Major advanced economies are still facing a deepening economic contraction following compression in private sector demand. Regional economies experienced a sharp economic slowdown in the first quarter following further deterioration in both exports and production. Amidst worsening economic growth and diminishing inflationary pressures, authorities in the advanced economies continued to adopt aggressive monetary and financial measures to stabilise the financial system.

In the **US**, real GDP contracted at an annualised rate of 6.1% in the first quarter (4Q 08: -6.3%), its third consecutive quarter of decline, marking the longest contraction since 1975. While there was a quarter-on-quarter increase in consumer spending, the decline in overall GDP was due to larger declines in private fixed investment and government spending as well as significant inventory drawdown. Private fixed investment activities registered a larger contraction of 37.9% (4Q 08: -21.7%), reflecting a broad-based decline in residential and non-residential sectors. Private inventory drawdown accounted for nearly half of the GDP decline in the first quarter, as businesses continued to reduce inventories amidst weak demand prospects. Meanwhile, headline inflation declined by 0.2% in the quarter (4Q 08: 1.5%) due mainly to lower energy prices and transportation cost.

In **Japan**, real GDP contracted by an annualised rate of -15.2% (4Q 08: -14.4%), its worst decline in the postwar period, driven mainly by the sharp fall of 46.9% in exports during the quarter (4Q 08: -23.2%). The broad-based decline in exports, especially in automobiles to the US and Europe and electronics to the Asian region, had been accompanied by a sharp contraction of 34.5% in industrial production (4Q 08: -14.6%). Meanwhile, private consumption remained under stress as unemployment reached a 5-year high of 4.8% in March. On the inflation front, prices as measured by core consumer prices (excluding fresh food) recorded flat growth in the quarter (4Q 08: 1%), reflecting lower commodity prices and sluggish demand conditions.

The **euro area** experienced a decline in real GDP of 4.6% in the first quarter (4Q 08: -1.5%), recording the largest contraction since its formation in 1999. Germany, the largest member country, contracted by 6.9% (4Q 08: -1.6%), its steepest decline in 30 years driven by deterioration in net exports and investment. Domestic demand in several economies such as Ireland and Spain were affected by the ongoing correction in the housing market. The financial turmoil has also resulted in tighter credit conditions for households and businesses in the euro area, with the economic sentiment indicator reaching a record low of 64.6 points in March. Meanwhile, in the **UK**, real GDP declined by 4.1% in the first quarter (4Q 08: -2.0%), its largest contraction since 1980. This was attributed to larger contractions in both the manufacturing and services sectors. On the inflation front, consumer prices continued to trend downwards to 3.0% in the first quarter (4Q 08: 3.9%).

Industrial countries: Real GDP Growth

	2008			2009	Key contributing factors for 1Q growth
	1Q	4Q	Year	1Q	
	Annual change (%)				
U.S[1]	0.9	-6.3	1.1	-6.1[a]	Large declines in private investment and government spending as well as inventory drawdown.
UK	2.6	-2.0	0.7	-4.1	Bigger contraction in both the manufacturing and services sectors.
Euro area	2.1	-1.5	0.8	-4.6[p]	A combination of external-driven slowdown in Germany and weak domestic conditions in other euro economies.
Japan[1]	3.4	-14.4[r]	-0.7[r]	-15.2[p]	Deterioration in exports and production

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

Source: National authorities

While the global financial system has showed some tentative signs of stabilisation, central banks in the advanced economies continued to adopt quantitative easing measures and introduced further measures to strengthen the fragile financial institutions and markets. In the **US**, as the federal funds rate was already at near zero, the **Federal Reserve** (Fed) decided to inject liquidity into the financial system and support the housing market by purchasing long-term US Treasury securities of as much as USD300 billion and mortgage-backed securities of up to USD750 billion on 18 March. The Fed also utilised the *Term Asset-Backed Securities Loan Facility* (TALF) to support business and consumer lending through the secondary markets. Of significance, the US authorities unveiled a new plan called the *Public-Private Investment Program for Legacy Assets* to remove toxic assets up to USD1 trillion from the balance sheets of banking institutions. As part of its recapitalisation plan, the US authorities conducted stress tests on the 19 largest US banks to determine whether further capital injections were needed before the banks could normalise their lending activities. The stress tests revealed that 10 out of 19 banks have to increase their capital by a total of USD75 billion. Meanwhile, the **European Central Bank** (ECB) reduced its overnight rate by 50 basis points to 1.5% in March, and by another 25 basis points to 1.25% in April. In May, the ECB announced that it will purchase €60 billion euro-denominated covered bonds to improve bank lending and market liquidity. The **Bank of England** (BoE) also cut its base lending rate by 50 basis points to a record low of 0.5% in March and announced a £75 billion asset purchase programme to increase the money supply over a 3-month horizon. Similarly, the **Bank of Japan** also announced a plan to increase by nearly 30 percent its monthly purchases of government bonds from the banking institutions as part of its strategy to inject liquidity into the system.

In the first quarter, global **crude oil prices**[1] initially declined to a two-month low of USD33.98 per barrel in mid-February due to a combination of weak global demand conditions as well as a build-up in inventories. However, oil prices strengthened to close at USD49.66 per barrel at the end of the quarter on investor optimism that the global economy may have bottomed out.

In the **Asian region**, the more open economies including Singapore, Chinese Taipei, Korea and Hong Kong SAR experienced deeper recessions following the broad weakness in external demand while growth of other regional economies decelerated sharply during the first quarter. Growth in some economies was further affected by inventory drawdown as companies continued to cut production by a larger magnitude relative to exports. Following a weaker export performance, growth in PR China moderated to 6.1% in the first quarter (4Q 08: 6.8%). However, economic indicators in March showed that there were some signs of a pick-up in economic activity in PR China arising from the implementation of the fiscal stimulus. In response to the worsening global economic prospects amidst subsiding inflationary pressures, central banks across Asia have reduced interest rates by between 75 and 175 basis points.

[1] Refers to WTI one-month futures on NYMEX

Regional Countries: Real GDP Growth

	2008			2009	Key contributing factors for 1Q growth
	1Q	4Q	Year	1Q	
	Annual change (%)				
PR China	10.6	6.8	9.0	6.1	Growth moderated due to weakening external demand but remain supported by resilient domestic demand
Indonesia	6.3	5.2	6.1	4.4	Supported by strong domestic demand
Korea	5.5	-3.4	2.2	-4.3[a]	Downturn in private consumption, investment and exports.
Thailand	6.0	-4.2	2.6	-7.1	Contraction led by manufacturing sector
Hong Kong SAR	7.3	-2.6	2.4	-7.8	Contraction in growth due to weaker external and domestic demand
Singapore	6.7	-4.2	1.1	-10.1	Declines in both manufacturing and services sectors
Chinese Taipei	6.3	-8.6	0.1	-10.2[p]	Contraction due to sharp falls in exports and private investments

[a] Advance estimate
[p] Preliminary

Source: National authorities

In the foreign exchange market, most major currencies depreciated against the US dollar during the period January-February as there was increased risk aversion among investors amidst increasing signs of deterioration in the growth prospects of the advanced economies. To some extent, the euro was also affected by concerns of the impact of emerging Eastern European financial crisis on the European financial sector. However, most major currencies began to stabilise or have strengthened against the US dollar since March as there was improved risk appetite among investors amidst the rally in the global equities markets. Similarly, regional currencies also initially depreciated against the US dollar, as there was growing concern over the impact of sharp declines in exports and industrial production on the growth prospects in the region. Of significance, the Korean won reached an 11-year low in early March due to concerns on the ability of Korean private sector to service its external debt. However, as global equities strengthened from March onwards, the regional currencies strengthened risk appetite among investors improved.

Going forward, while some segments of the financial markets have showed improvement, global growth prospects are expected to remain weak despite some tentative signs of stabilisation in a number of economic indicators in several economies. Nonetheless, the implementation of large stimulus measures, as well as the ongoing measures to restore the health of the financial sector have increased the prospects for global economic conditions to stabilise in the second half of the year.