# DEVELOPMENTS IN THE FOURTH QUARTER OF 2009

## INTERNATIONAL ECONOMIC ENVIRONMENT

### Broad-based but uneven global economic recovery

The recovery in the global economy improved further in the fourth quarter of 2009. While the recovery was evident in most economies, the speed of the recovery differed across regions. The advanced economies experienced gradual pick-up in growth, while the recovery in the regional economies has been relatively stronger as domestic demand was reinforced by the rebound in intra-regional trade. Conditions in the international financial markets continued to improve as the combination of the accommodative monetary policy and the search for yield encouraged investors to return to the markets. To some extent, this led to larger capital inflows into the Asian region, placing challenges to the conduct of monetary policy should it contribute to asset price inflation.

In the **US**, real GDP expanded for the second consecutive quarter by an annualised rate of 5.7% in the fourth quarter (3Q 09: 2.2%), its biggest quarterly growth in six years. More than half of the growth in GDP was attributed to the smaller drawdown in private inventory, while the rest of the growth came from revival in non-residential fixed investment and net exports. Non-residential fixed investment registered strong growth, led by the double-digit increase of 13.3% (3Q 09: 1.5%) in business investment in equipment and software. Net exports' contribution came mainly from the moderation in imports growth to 10.5% (3Q 09: 21.3%). Meanwhile, real personal consumption expenditure increased at a slower pace of 2% (3Q 09: 2.8%) due to lower purchases of motor vehicles as consumers frontloaded these purchases during the cash-for-clunkers programme in the third quarter. On the inflation front, headline CPI turned around to record a positive growth of 1.4% during the quarter (3Q 09: -1.6%), driven by higher energy prices.

In **Japan**, real GDP grew at a faster annualised rate of 4.6% in the fourth quarter (3Q 09: 0%), due to continued improvements in private consumption and net exports. Exports recorded a reduced contraction of 5.8% (3Q 09: -34.4%), supported by stronger demand from Asia, in particular PR China. This development was also reflected in a slower rate of decline of 4.7% in industrial production (3Q 09: -20%), due mainly to improvements in transport equipment and general machinery. Private consumption continued to improve, supported by policy measures. Although unemployment rates eased in the fourth quarter to 5.1% (3Q 09: 5.5%), sentiment remained weak as consumers continued to be concerned about falling incomes and job security. On the inflation front, deflationary pressures subsided as core consumer prices (excluding fresh food) declined at a slower rate of 1.7% (3Q 09: -2.3%), due to higher energy prices.

The **euro area** expanded marginally by 0.1% quarter-on-quarter in the fourth quarter (3Q 09: 0.4%) due largely to the government stimulus measures and the pick-up in external demand. France led the improvements in the region, recording a growth of 0.6%, while economic activity in Germany was flat for the quarter. On an annual basis, the euro area recorded a smaller contraction of 2.1% during the quarter. Benefiting from the fiscal support for consumption especially in automobiles, production indicators for the euro area showed improvements. These were further reinforced by the recovery in exports, especially in the intra-EU trade as well as demand from Asia. On the inflation front, consumer prices turned around to record a positive growth of 0.4% in the fourth quarter (3Q 09: -0.4%), due mainly to higher energy prices.

The **UK** economy was among the last major economies to emerge from recession with real GDP recorded its first quarter-on-quarter growth of 0.1% in the fourth quarter (3Q 09: -0.2%). On an annual basis, the economy recorded a smaller contraction of 3.2% (3Q 09: -5.1%). The improvement in growth came from the manufacturing sector as well as the services sectors, in particular *hotel & restaurant* and *government & other services*. Meanwhile, inflation trended upwards to 2.1% in the fourth quarter (3Q 09: 1.4%) due mainly to the base effect from the very low energy prices in late 2008.

**Industrial Countries: Real GDP Growth**

| | 2008 | | 2009 | | | Key contributing factors for 4Q growth |
|---|---|---|---|---|---|---|
| | 4Q | Year | 3Q | 4Q | Year | |
| | Annual change (%) | | | | | |
| US[1] | -5.4 | 0.4 | 2.2 | 5.7[a] | -2.4 | Growth supported by smaller drawdown in inventory, slower growth of imports and an upturn in nonresidential fixed investment. |
| Japan[1] | -11.4 | -1.2 | 0.0[r] | 4.6[p] | -5.0 | Supported by improvements in private consumption and net exports. |
| Euro area | -1.8 | 0.6 | -4.0 | -2.1[p] | -4.0 | Smaller contraction in most euro area economies. |
| UK | -2.1 | 0.5 | -5.1[r] | -3.2[p] | -4.8 | Growth supported by both production and services sectors. |

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

Source: National authorities

Against the backdrop of improved conditions in the financial markets amid the gradual economic recovery, more central banks in the major advanced economies have begun to announce plans to unwind the quantitative support measures introduced during the crisis. In the **US**, while the federal funds rate was maintained at 0 – 0.25%, the **Fed** reiterated its stance that was made in June 2009 on ending some of its financial measures beginning 1 February 2010. These include the Commercial Paper Funding Facility, Primary Dealer Credit Facility and Term Securities Lending Facility. In addition, the temporary liquidity swap arrangements between the Federal Reserve and other central banks expired on 1 February 2010. On 19 February, the Fed increased the discount rate by 25bps to 0.75% in their effort to normalise lending facilities. Furthermore, the Fed also planned to complete its purchases of USD1.25 trillion agency mortgage-backed securities and USD175 billion of agency debt by the end of first quarter of 2010. Meanwhile the expiration date for the Term Asset-Backed Securities Loan Facility will remain on 31 March 2010 for loans backed by all types of collaterals except for new-issue commercial mortgage-backed securities, which will expire on 30 June 2010. In the euro area, the **European Central Bank** had announced details of the withdrawal of its liquidity provisions. The fixed rate offered for the 12-month unlimited loans to commercial banks was ended on 16 December, while the 6-month loans will be discontinued on 31 March 2010. In addition, the purchases of €60 billion worth covered bonds are expected to expire on June 2010. There, however, continued to be downside risks in the UK and Japan. The **Bank of England** expanded the purchase of asset and corporate bonds for the third time in November by another £25 billion to a total of £200 billion. However, the central bank halted the program in early February 2010 to monitor the impact of previous purchases on the economy. Meanwhile, the **Bank of Japan** introduced a ¥10 trillion credit program in December to deepen commercial banks' liquidity and to ease deflationary pressure.

In the fourth quarter, prices of **crude oil**[2] rose to USD80 per barrel, the highest level in 12 months, following a sharp increase of almost USD10 in the first three weeks of October. The increase in crude oil prices was mainly due to optimism about a sustained recovery in global demand. During the quarter, crude oil prices averaged around USD76 per barrel (3Q 09: USD68 per barrel). At the end of the year, crude oil traded at USD79 per barrel, an increase of 78% (2008: -54%) from the level at the end of 2008. Meanwhile, oil prices continued to trend upward at the beginning of 2010, reaching a 15-month high of USD83 per barrel on 6 January 2010.

[2] Refers to West Texas Intermediate one-month futures on NYMEX.

**Regional Countries: Real GDP Growth**

| | 2008 | | 2009 | | | Key contributing factors for 4Q growth |
|---|---|---|---|---|---|---|
| | 4Q | Year | 3Q | 4Q | Year | |
| | Annual change (%) | | | | | |
| PR China | 6.8 | 9.6 | 9.1[r] | 10.7 | 8.7 | Supported by ongoing fiscal stimulus programmes. |
| Chinese Taipei | -7.1 | 0.7[r] | -1.0[r] | 9.2 | -1.9 | Supported by exports and private consumption. |
| Korea | -3.4 | 2.2 | 0.9 | 6.0[p] | 0.2 | Supported by stronger growth in private consumption and exports as well as a rebound in investment activity. |
| Thailand | -4.2 | 2.5 | -2.7 | 5.8 | -2.3 | Supported by stronger growth in exports, private consumption and government spending. |
| Indonesia | 5.2 | 6.1 | 4.2 | 5.4 | 4.5 | Supported by both private consumption and government spending. |
| Singapore | -4.2 | 1.4 | 0.6[r] | 4.0 | -2.0 | Supported by continued expansion in the services sector. |
| Philippines | 2.9 | 3.8 | 0.4[r] | 1.8 | 0.9 | Supported by both private consumption and government spending. |

[r] Revised
[p] Preliminary

Source: National authorities

In the **Asian region**, the growth momentum from the third quarter continued into the fourth quarter, with most economies recording faster growth. While the main impetus emanated from a sustained rise in private consumption and a pick-up in investment activity, growth was further augmented by a rebound in exports from the intra-regional trade centred around PR China as well as a revival in demand from the advanced economies. Regional growth was led by PR China, which posted a double-digit growth rate of 10.7% (3Q 09: 9.1%), the fastest expansion since the first quarter of 2008, supported by the ongoing fiscal stimulus programmes. Meanwhile, Chinese Taipei, Korea, Thailand, Indonesia, Singapore and Philippines also continued to expand at a stronger pace in the fourth quarter. As the inflationary pressures remained benign, central banks in the region maintained an accommodative monetary policy stance to ensure a more sustainable economic recovery. However, for some economies facing sharp increases in asset prices, monetary authorities undertook measures to discourage the possible build-up of asset bubbles, either through imposing administrative measures to limit speculation in the property market or using restrictions on short-term capital flows.

In the **foreign exchange market**, most major currencies appreciated against the dollar during the first two months of the quarter following continued improvements in risk appetite and global financial market conditions. However, in December, the trend reversed as most major currencies weakened against the dollar following expectations of an early hike in the US interest rate following stronger-than-expected US data. In addition, the euro and pound sterling were also affected by concerns over government debt outlook and sovereign ratings in the UK and in some parts of Europe. Similarly, the Japanese yen weakened as investors reacted to the Bank of Japan's decision to inject ¥10 trillion of emergency loans into the financial system to fight deflation. In the region, most currencies strengthened in the quarter against the US dollar following optimism over growth prospects in the Asian economies.

Going forward, the recovery in the global economy is expected to continue into 2010 supported by the continued implementation of stimulus measures. However, the prospects for sustainable growth hinges critically on the recovery in private sector demand especially in the advanced economies facing several structural issues in terms of the high unemployment, fragile financial sectors and weaker fiscal positions. The emerging economies, especially Asia, are however expected to experience better growth prospects given the stronger domestic demand and more robust financial sectors.