

1 The International Economy

- The continued resilience of the global economy is evident from the latest high-frequency indicators in early-2024. The benign growth backdrop will add momentum to the nascent upturn in the global electronics cycle, supporting the EM Asia economies. Looking ahead, global growth is expected to remain steady in 2024, even as the impact of past monetary policy tightening and less supportive fiscal policy continues to exert a restraining effect.
 - Following significant progress last year, the pace of disinflation in Singapore's major trading partners, especially the AEs, has slowed. The road ahead is likely to be bumpy as the deflationary impulse from lower commodity and goods prices fade. Further, geopolitical risks or extreme weather events could result in supply-driven cost hikes. In the AEs, slower wage and strong productivity growth will be necessary to return inflation sustainably to their 2% targets.
 - Against this backdrop, the balance of risks appears to be still tilted towards persistent inflation. However, a delayed and slower pace of AE monetary easing could trigger latent financial vulnerabilities and consequently weigh on growth. For EM Asia, the combination of high AE bond yields, increased risk aversion, and USD appreciation would exacerbate the spillovers from weaker global growth and sentiment, imparting stresses on regional asset prices and those economies with substantial external financing needs.
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1.1 Global Economic Developments

The global economy is still showing notable resilience, despite slower growth

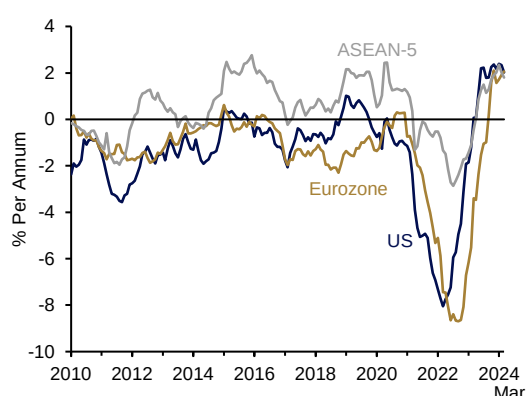
Global economic growth moderated in Q4 2023 as the outperformance of the US was offset by weaker growth across several ASEAN-5 economies. Still, at 3.3% for 2023 as a whole, the expansion showed considerable strength in the face of multi-decade high interest rates (**Charts 1.1 and 1.2**). Recent high-frequency data signal that the resilience has persisted into 2024, reflecting in part the revival in manufacturing activities. Outperforming economies continued to turn in strong growth, while tentative signs of recovery were also evident in several laggard economies.

In the US, growth momentum has remained robust, as employment and wages continued to expand above pre-pandemic trends, bolstering household spending. Investment in manufacturing structures has surged, in part due to incentives under the Inflation Reduction Act (IRA) and CHIPS and Science Act. There is emerging evidence that equipment investment is picking up as construction of factories reach completion. Meanwhile, investment in artificial intelligence (AI) continues to grow at a healthy clip. Encouragingly, several business surveys point to a long-awaited rebalancing between manufacturing and services, with the ISM manufacturing index marking an expansion in March for the first time in over a year.

Meanwhile, China's economy experienced renewed momentum in H2 2023 after the post-pandemic recovery initially lost steam in the earlier months. The pickup has carried over to 2024, especially in manufacturing, while overall exports has also firmed. Nonetheless, the property market remains in the doldrums with transaction volumes and prices continuing to deteriorate. Across the region, the upturn in manufacturing is showing tentative signs of broadening beyond semiconductors as evidenced by the expansion in the ASEAN-5's latest manufacturing PMI and new orders index. With the destocking of manufacturing inventories in 2023 largely completed, regional industrial production has picked up, following lacklustre growth last year.

Chart 1.1 Despite elevated real interest rates...

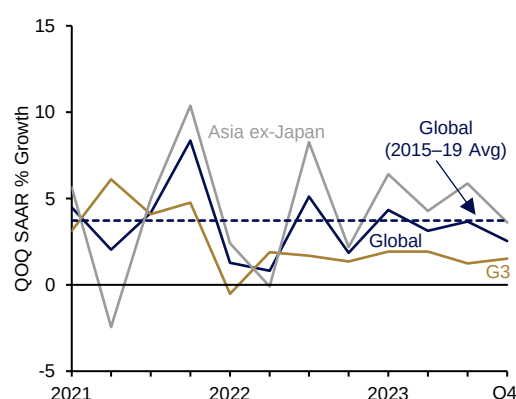
Real interest rates



Source: Haver Analytics and EPG, MAS estimates

Chart 1.2 ...the global economy, especially the US, expanded at a firm pace

GDP growth



Source: Haver Analytics and EPG, MAS estimates

1.2 Global Outlook

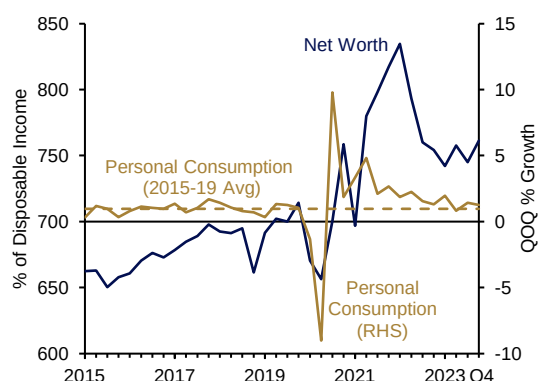
Global growth is poised for continued steady expansion over 2024

The resilience that the global economy has exhibited so far is set to continue for the rest of the year. Notably, the US economy is expected to turn in fairly robust growth. Excess savings built over the pandemic and increases in net wealth have created a virtuous cycle of strong household spending, improved corporate profitability and solid labour market conditions (**Chart 1.3**). Even as excess savings diminish, and real interest rates and fiscal policy turn more restrictive over 2024, the strength of private sector balance sheets and stronger real wage growth will continue to support around trend growth (**Chart 1.4**).

In contrast, economic momentum in the Eurozone and Japan is expected to remain relatively sluggish in the short term. However, activity should improve in H2 as inflation eases and real disposable incomes and financial conditions improve.

Chart 1.3 Net worth and personal consumption remain robust

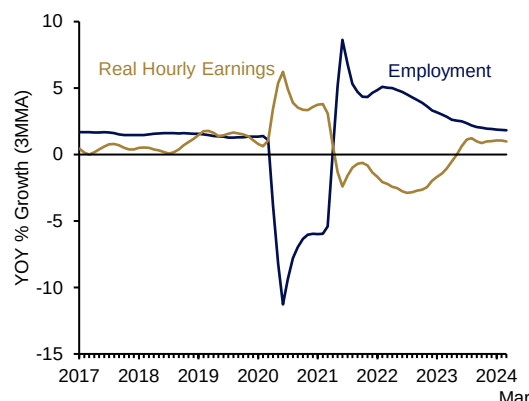
US personal consumption and net worth



Source: Haver Analytics and EPG, MAS estimates

Chart 1.4 While employment has trended down in recent months, real wages have held up

US nonfarm payroll employment and real wages



Source: Haver Analytics and EPG, MAS estimates

China's GDP growth is forecast to ease in 2024, even as the larger projected fiscal deficit this year imparts a positive impulse to the economy. In any event, the government retains sufficient policy headroom to step up support, should existing policy settings prove insufficient to offset the drag and negative spillovers from the property sector.

For the rest of EM Asia, growth is set to pick up across the ASEAN-5 and NEA-2 blocs amid a recovery in manufacturing and goods exports. However, the improvement in ASEAN goods exports is likely to lag that of the NEA, given the former's largely downstream position in the electronics supply chain. Nevertheless, domestic demand will remain supportive of growth in the ASEAN-5 given solid labour market conditions and public investment plans. Further, the ongoing recovery in tourism, especially the renewed inflows of Chinese tourists, will benefit the ASEAN-5. China was the world's largest consumer of travel services in 2019 in terms of both departure numbers and spending. Regaining some of these pre-pandemic levels of activity would provide a fillip to the region's growth.

All in, the global economy is expected to expand by 3.0% in 2024, slightly lower than the 3.3% recorded last year, as the impact of past policy tightening and less supportive fiscal policy in most economies continues to exert a restraining effect on growth (**Table 1.1**). Still, the global economy is likely to emerge unscathed in 2024 from the tightening of financial conditions, with economic growth set to become gradually more broad-based over the year. Overall, growth is set to improve to 3.3% in 2025 as central banks cautiously begin to normalise monetary policy.

Table 1.1 Global GDP growth, TiVA-Weighted

	QOQ SA (%)			Annual (%)		
	2023 Q4	2024 Q1*	2024 Q2*	2023	2024*	2025*
G3	0.3	0.3	0.3	1.7	1.3	1.6
Asia ex-Japan	0.9	1.1	1.2	4.7	4.6	4.6
ASEAN-5	0.4	1.4	1.0	4.3	4.6	5.3
Global	0.6	0.7	0.8	3.3	3.0	3.3

Source: OECD TiVA Database and EPG, MAS estimates

* EPG, MAS forecasts

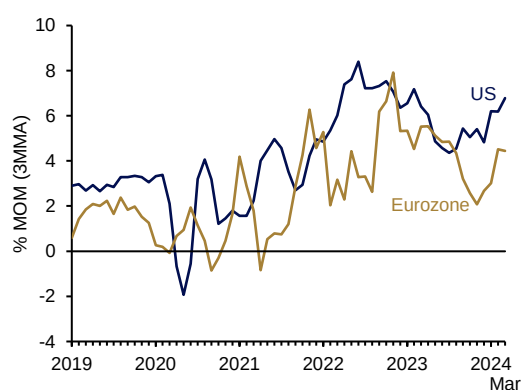
Note: The G3 refers to the Eurozone, Japan, and the US, while the ASEAN-5 comprises Indonesia, Malaysia, the Philippines, Thailand, and Vietnam. Asia ex-Japan comprises China, Hong Kong SAR, India, South Korea, Taiwan, and the ASEAN-5. All aggregates are weighted based on Singapore's value added by destination of final demand (using TiVA data).

Disinflation in the AEs appears to have faltered

Global headline inflation decelerated to 2.0% y-o-y in February, less than half the 5.0% recorded a year ago. Core inflation also abated further to 3.1%. Inflation rates across most EM Asian economies have returned to central banks' targets, with China and Thailand witnessing the largest decreases in inflation due to declining energy and food prices. In comparison, inflation appears to have gained momentum in the AEs recently due to a firm pace of services price increases (**Chart 1.5**). That said, AE inflation should remain well below its peak as monetary policy continues to exert a restraining effect on economic activities (**Chart 1.6**).

Chart 1.5 Disinflation in the AEs appears to be faltering as services inflation has picked up

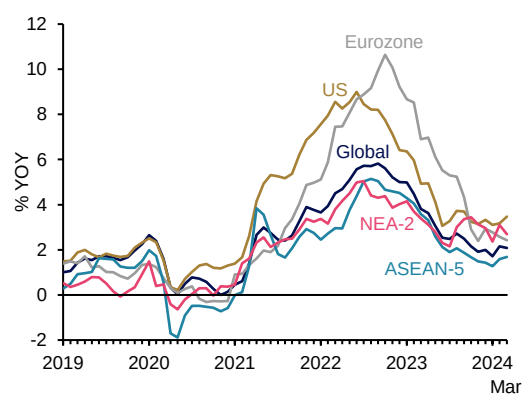
Annualised services inflation



Source: Oxford Economics and EPG, MAS estimates

Chart 1.6 However, on a year-ago basis, headline inflation is still significantly below its recent peak

Headline inflation



Source: Oxford Economics and EPG, MAS estimates

The last leg of the disinflation journey is likely to be bumpy

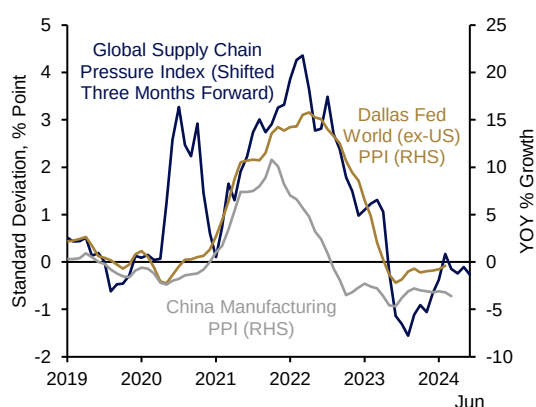
The key deflationary impulses from last year are set to fade. First, energy deflation will no longer be the main driver of disinflation this year. The fall in energy prices last year contributed to around one-fifth of the moderation in inflation across the G3. However, oil prices are expected to average higher this year.¹ Moreover, the global oil market is likely to experience spurts of volatility amid ongoing geopolitical tensions in the Middle East and the prolonged Russia-Ukraine War.

Second, core goods prices are unlikely to decline by the same extent as they did in 2023. The earlier unwinding of global supply chain dislocations has largely been completed, and in turn, Producer Price Indices (PPIs) have picked up recently (**Chart 1.7**). Meanwhile, the Red Sea disruptions to shipping now look likely to keep logistical costs elevated for at least the next few months. This is expected to result in slightly higher core goods prices this year, particularly in the Eurozone which has faced the largest surge in shipping costs.

Third, the global deflationary impulse from China could fade towards the end of the year. In the absence of further RMB depreciation, as well as the gradual recovery of the Chinese economy, China's PPI is expected to return to positive later this year.

Chart 1.7 Fading cost relief as supply chains normalise

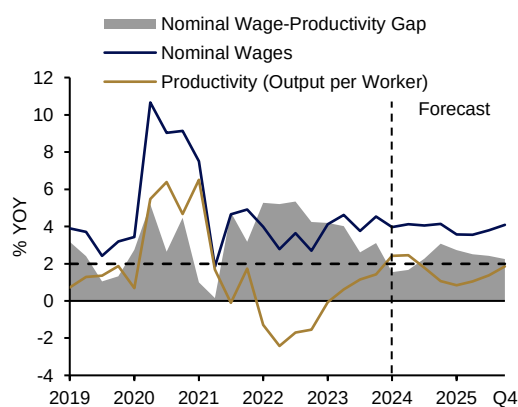
Global supply chain pressures and PPI



Source: Haver Analytics and the Dallas Federal Reserve

Chart 1.8 Nominal wage growth continues to exceed productivity gains

US wages and productivity



Source: Haver Analytics and EPG, MAS estimates

Consequently, the further easing of headline inflation will be a function of the services component, which in turn has been largely driven by effective wage costs. Broadly, services inflation has already normalised across most of EM Asia, given little evidence of AE-type labour supply distortions. Headline inflation is expected to remain around target in most regional economies, outside of changes to administrative price controls.

In AEs, a combination of slower wage growth and/or continued productivity gains is still necessary to bring inflation back to target. In the US, strong immigration growth and higher working age participation rates have contributed to a better rebalancing between labour

¹ US Energy Information Administration (EIA) projects oil prices to average US\$89 per barrel in 2024, from US\$83 last year.

demand and supply. This has helped to lower nominal wage growth to 4.3% in Q1 this year, a significant step down from the peak of 6% in early-2022.

Productivity has also picked up strongly in recent quarters in the US and is growing well above its historical average. However, with nominal wage growth still exceeding average productivity growth by 2% points, this is hindering the return of core inflation back towards targets (**Chart 1.8**). In the Eurozone, which is not benefiting from a rebound in productivity as seen in the US, and where negotiated wage outcomes remain high, hitting inflation targets will be a greater challenge.

Persistent inflation leading to a delay in policy rate cuts is a significant risk

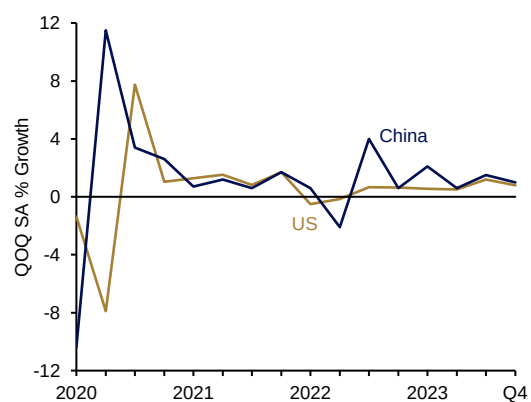
Against this backdrop, the balance of risks appears to be tilted towards higher inflation. Disappointing productivity growth, the re-emergence of supply-side disruptions due to an escalation in geopolitical tensions and/or extreme weather events, could cause the current upward inflation momentum in the AEs to be sustained. A significant widening of conflict in the Middle East could disrupt oil supply and commercial shipping along the Red Sea and the Strait of Hormuz, which together account for 30% of global container traffic and nearly 40% of global seaborne traded oil. Persistently elevated inflation implies interest rates remaining higher for longer, even as the prospect of a broadening conflict in the Middle East triggers financial market volatility and heightened risk aversion.

If real interest rates remain restrictive for a prolonged period, this may hasten the crystallisation of latent financial vulnerabilities, resulting in stagflationary-like conditions across AEs. Softer external demand and higher AE yields would leave several EM Asian economies, especially those with negative interest rate differentials with the US, vulnerable to swings in foreign investment and capital outflows. In turn, persistent exchange rate depreciation and increased volatility could warrant FX intervention, interest rate hikes, and even more concerted fiscal consolidation to instil greater confidence in EM assets.

The Chinese economic outlook is also not without risks, given the structural challenges facing the property sector and local government debt. A sharper-than-expected slowdown in China would compound the weakness in global economic growth, especially for Asian economies possessing strong trade linkages with China, via lower imports as well as weaker global commodity prices. A more bearish outlook for China would likely exacerbate capital outflows and depreciation pressures across the region. Serendipitously, since 2020, the episodes of weakness in the US or China, have been de-synchronised, such that one economy has helped cushion the impact of the other on global growth. (**Chart 1.9**). Consequently, a synchronised slowdown in the US and Chinese economies could be particularly detrimental to the regional outlook (**Chart 1.10**).

Chart 1.9 China and US growth has fortuitously offset one another

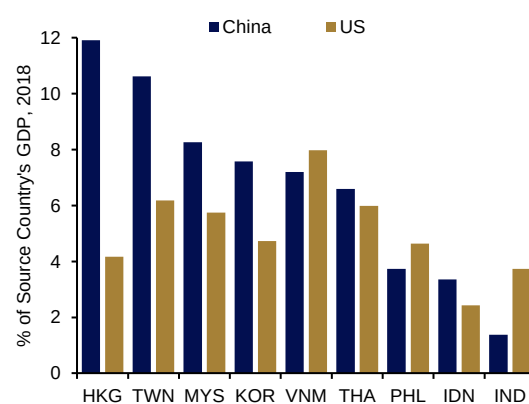
GDP growth



Source: Haver Analytics and EPG, MAS estimates

Chart 1.10 A synchronised slowdown in China and US would be consequential for EM Asia

China and the US final demand



Source: OECD and EPG, MAS estimates