1 The International Economy

Global Growth To Remain Subdued In 2016

The global economy slowed in Q4 2015, as growth decelerated in the advanced economies while remaining below trend in Asia ex-Japan. Economic activity in the US and Japan was dampened, in part, by weather-related factors, even as the Eurozone maintained a steady pace of growth. Meanwhile, China's ongoing restructuring has put its economy on a weakening growth trajectory, with a pullback in industrial output only partially compensated by a better-performing services sector. Elsewhere in the region, economic activity was weighed down by the turning of the financial, credit and commodity cycles. Nevertheless, generally resilient domestic demand has helped to support growth, with policy stimulus providing a further boost in some countries.

In 2016, the outlook is lacklustre growth and low inflation globally. The post-GFC years have been characterised by low nominal GDP growth in many advanced economies. Confronted with weak demand from these economies, as well as China, growth in the rest of emerging Asia is expected to stay tepid. Moreover, with the tightening of global financial conditions, domestic demand growth in the region will be impeded by rising debt service burdens. The softness in emerging Asia's growth will, in turn, spill back into activity in the advanced economies. Consequently, the prospects for the global economy have dimmed, as compared to the last Review. Growth is projected at 3.8% in 2016, slightly below the 3.9% recorded last year, before edging up marginally to 4.0% in 2017. (Table 1.1) Meanwhile, global inflation is likely to stay muted in 2016, but may rise further next year, alongside the mild pickup in economic activity.

Table 1.1
Global GDP Growth

(%)

	Q3 2015	Q4 2015	2015	2016F	2017F
	q-o-q SAAR		y-o-y		
Total*	**4.0**	**3.7**	**3.9**	**3.8**	**4.0**
G3*	**1.5**	**0.8**	**1.6**	**1.5**	**1.7**
US	2.0	1.4	2.4	2.0	2.4
Japan	1.4	−1.1	0.5	0.6	0.5
Eurozone	1.2	1.3	1.5	1.5	1.6
NEA-3*	**2.1**	**1.7**	**1.9**	**1.8**	**2.3**
Hong Kong	2.2	0.9	2.4	1.7	2.0
Korea	5.0	2.7	2.6	2.6	2.8
Taiwan	−0.2	2.2	0.7	1.4	2.3
	y-o-y				
ASEAN-4*	**4.5**	**4.6**	**4.6**	**4.4**	**4.7**
Indonesia	4.7	5.0	4.8	5.0	5.3
Malaysia	4.7	4.5	5.0	4.2	4.4
Philippines	6.1	6.3	5.8	6.0	5.9
Thailand	2.9	2.8	2.8	2.9	3.3
China	**6.9**	**6.8**	**6.9**	**6.5**	**6.3**
India**	**7.7**	**7.3**	**7.2**	**7.6**	**7.7**

Source: CEIC, Consensus Economics, Apr 2016 and EPG, MAS estimates

* Weighted by shares in Singapore's NODX.

** Figures are reported on a Financial Year basis; FY2017 refers to the period from April 2016 to March 2017.

1.1 G3 Economies

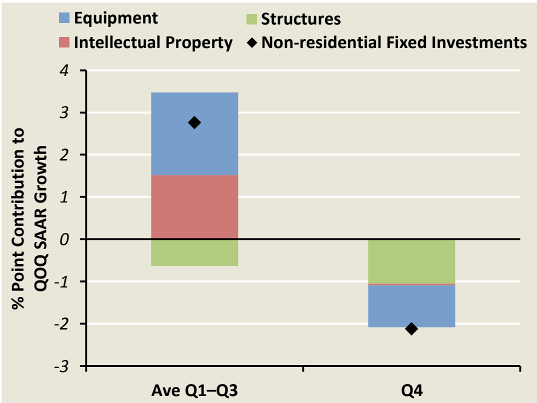
Low Inflation Amid Growth Underperformance

The G3 economies ended 2015 on a subdued note, with weaker-than-expected GDP outturns in Q4. This reflected, to some extent, the impact of one-off factors such as unusual weather, which held back spending on warm clothing and utilities in the US and Japan. Nonetheless, expectations are for the US to expand at a moderate pace this year, on the back of a strong labour market and modest income growth. Concerns over the strength of the recovery in Japan remain, given tentative signs that the pullback in economic activity has carried over into Q1 this year. In the Eurozone, domestic demand will be supported by additional monetary easing measures, but external demand will be adversely impacted by the slowdown in emerging markets. On the whole, GDP growth in the G3 is projected to come in at 1.5% in 2016 and tick up slightly to 1.7% in 2017. This sub-par expansion in output, coupled with below-target inflation, implies that nominal GDP growth in the G3 will stay low in the near term, thus necessitating concerted policy responses.

Growth in the US eased towards the end of 2015 …

US GDP growth slackened to 1.4% q-o-q SAAR in Q4 2015, from 2.0% in the preceding quarter. The slowdown in economic activity was broad-based, with a moderation in personal consumption expenditure growth, a sharper pullback in fixed investment spending, and weaker exports. Consumer spending, which had been the lynchpin of growth through most of 2015, rose by a softer 2.4% q-o-q SAAR in Q4, from 3.0% in the previous quarter. This was partly due to transitory factors, such as unusually warm weather, which lowered utilities spending. Meanwhile, non-residential fixed investment contracted for the first time since Q3 2012, by 2.1% q-o-q SAAR in Q4, as a pullback in oil drilling caused structures and equipment expenditure to decline sharply by 5.1% and 2.1%, respectively. (Chart 1.1) Moreover, the strength of the US dollar, alongside soft global demand, continued to weigh on net exports in Q4, which subtracted 0.1% point from GDP growth.

Chart 1.1
Decomposition of US Non-residential Fixed Investment Growth in 2015

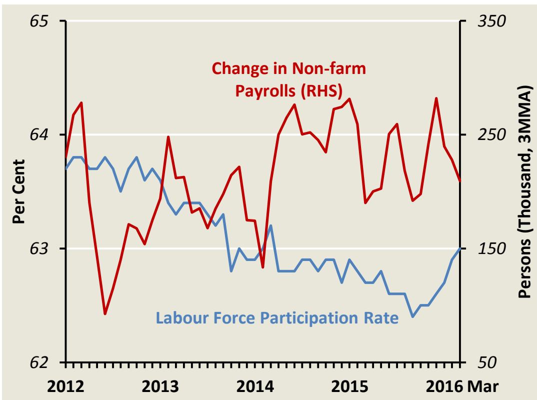


Source: Haver Analytics and EPG, MAS estimates

… but the core strengths of the economy should reassert themselves as the year progresses.

Economic indicators point to modest growth in Q1 2016, with a stronger pickup expected only later this year. There have been sustained improvements in the labour market in the early months of 2016, with employment growth averaging 209,000 jobs per month over Jan–Mar. This strength in hiring has, in turn, drawn more people back into the workforce, resulting in a rise in the labour force participation rate to 63.0% in March this year. (Chart 1.2) Indeed, the participation

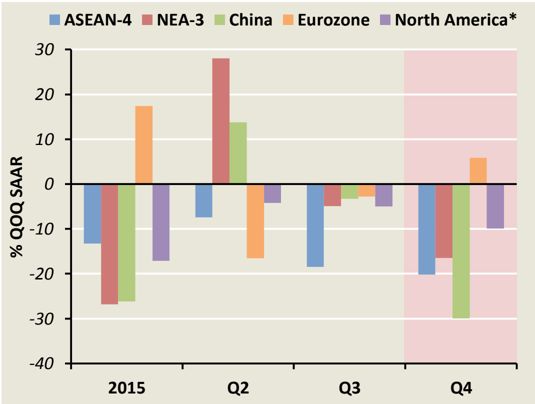
Chart 1.2
Change in US Non-farm Payrolls and Labour Force Participation Rate



Source: Haver Analytics and EPG, MAS estimates rate has been increasing steadily since September 2015, after being on a downtrend following the GFC. Nevertheless, wage growth has been relatively weak, indicating the presence of residual slack in the labour market.

On the whole, consumer spending is likely to maintain a moderate pace of expansion and provide the key support to GDP growth in 2016. In comparison, sectors of the US economy that are sensitive to external demand or energy prices will continue to weigh on growth. Net exports will likely be a drag on account of the substantial appreciation of the US dollar in real trade-weighted terms since mid-2014, accentuated by weak foreign demand. Notably, with the exception of the Eurozone, demand for US exports from all other regions, especially China and ASEAN-4, deteriorated further in Q4 2015. (Chart 1.3)

Chart 1.3
Growth in US Exports by Region



Source: Haver Analytics and EPG, MAS estimates
* North America refers to Canada and Mexico.

In December 2015, the US Federal Reserve raised the Federal funds rate, after maintaining it at near-zero for seven years. The median expectation among FOMC members at that time was for another four rate hikes, amounting to a cumulative 100 bps increase, over the course of 2016. However, at the latest policy meeting in March, the FOMC members slightly lowered their growth and inflation forecasts for 2016 and cut back on the projected number of rate hikes to just two this year. Although core inflation has picked up more recently, the strength of the US dollar is anticipated to help keep inflation in check and there appears to be room for further employment growth before marked increases in labour costs are triggered. All in, US GDP growth is expected to come in at 2.0% in 2016, before rising to 2.4% in 2017.

Eurozone growth was steady in Q4.

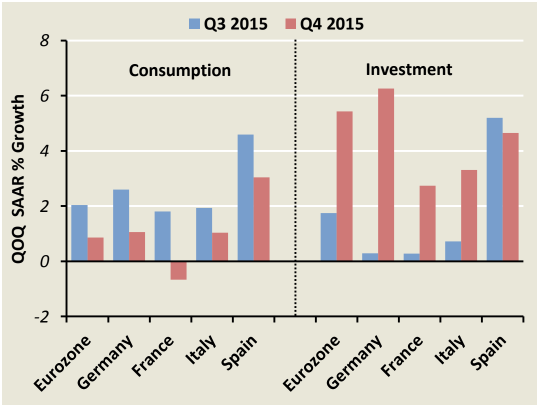
Eurozone GDP expanded by 1.3% q-o-q SAAR in Q4 2015, similar to the outturn in the previous quarter. Although this was marginally higher than the average of 1.2% since the recovery from the sovereign debt crisis in Q2 2013, growth momentum decelerated through the course of 2015, from an average of 1.9% in H1 to 1.2% in H2. In terms of expenditure, robust domestic demand continued to be offset by the negative effect from trade, although there was a discernible shift in the former's underlying composition. Private consumption growth—the main driver of the recovery thus far—eased across the four major Eurozone economies, in spite of a pickup in wage growth and lower oil prices. (Chart 1.4) Notably, consumer spending in France fell into outright contraction in the aftermath of the Paris terror attacks in November. In contrast, investment spending in the Eurozone, which has been subdued over the past two years, rebounded strongly (except in Spain), to 5.4% in Q4, from 1.7% in the previous quarter. This was due to a rise in construction-related activity, albeit from a low base, as well as a tentative pickup in machinery and equipment investment across the region as business confidence improved.

A challenging external environment will pose a drag on Eurozone growth.

The Eurozone economy should expand at a modest pace in 2016, with growth underpinned by private consumption and a slightly expansionary fiscal impulse. Notwithstanding the recent dent in consumer confidence caused by elevated financial volatility earlier this year, household spending should continue to be supported by moderate wage growth, low oil prices and steady employment gains. Moreover, the fiscal stance will be fairly accommodative, in view of refugee-related spending in Germany, alongside some easing of fiscal tightening measures in Italy and Spain.

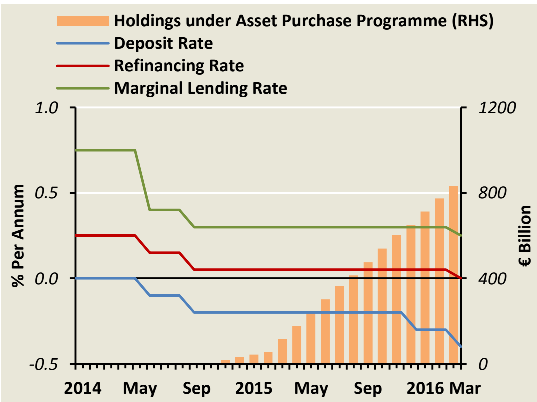
Nonetheless, the region faces a challenging external environment. Exports from the Eurozone to large emerging markets, such as China and Russia, as well as shipments to advanced economies such as the US, may continue to underperform. The ECB had noted that risks to growth are tilted to the downside, which could exacerbate deflationary pressures. In response, the ECB eased monetary policy further in March 2016: interest rates were lowered, including the rate on the deposit facility, which was cut by 10 bps to an unprecedented −0.4% (Chart 1.5); the asset purchase programme was expanded to €80 billion per month and will include purchases of investment-grade bonds issued by non-bank corporations; and a series of four targeted longer-term refinancing operations (TLTRO II) was launched. In order to spur economic activity and raise the inflation rate back to target, ECB President Draghi has committed to keep interest rates "very low, for a long period of time". On balance, growth projections for the Eurozone are 1.5% this year and 1.6% in 2017.

Chart 1.4
Eurozone Private Consumption and Investment



Source: Eurostat

Chart 1.5
Eurozone's Key Policy Rates and Asset Purchase Programme



Source: ECB

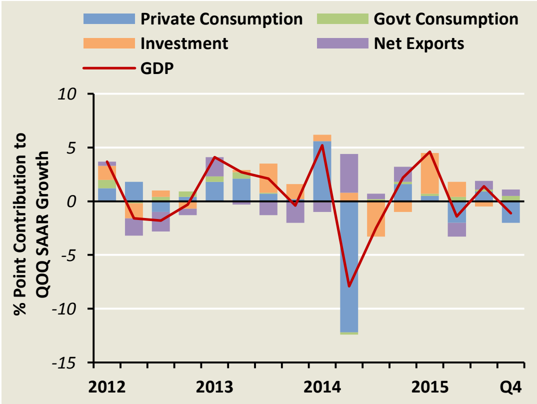
Growth prospects for Japan have been downgraded.

Following an expansion of 1.4% q-o-q SAAR in Q3 2015, Japan's economy contracted by 1.1% in Q4 due to a pullback in private consumption, with unusually warm weather dampening spending on winter goods and heating. (Charts 1.6 and 1.7) Meanwhile, aggregate investment spending increased by 0.8% q-o-q SAAR in Q4, supported mainly by the non-residential segment, while residential investment contracted by 4.7%, following three quarters of increase. Overall exports fell by 3.3%, as a decline in shipments to Asian markets more than offset a pickup in volumes to the advanced economies.

Private spending has been lacklustre in Japan, especially after the consumption tax hike in April 2014. Slower wage growth and higher food prices have also curtailed real household expenditure on non-food consumption items, as more spending was channelled to food expenses. (Chart 1.7) Against this backdrop of flagging domestic demand and lower-than-expected inflation outcomes, the Bank of Japan (BOJ) enhanced its Quantitative and Qualitative Monetary Easing (QQE) policy in October 2014 with higher asset purchases. This was followed by a further move in January 2016 to introduce a negative interest rate policy, which will apply to financial institutions' funds in excess of average outstanding balances at the central bank in 2015 and selected portions of reserves. Working in tandem with asset purchases, the policy aims to further reduce rates across the entire yield curve and spur spending by firms and households.

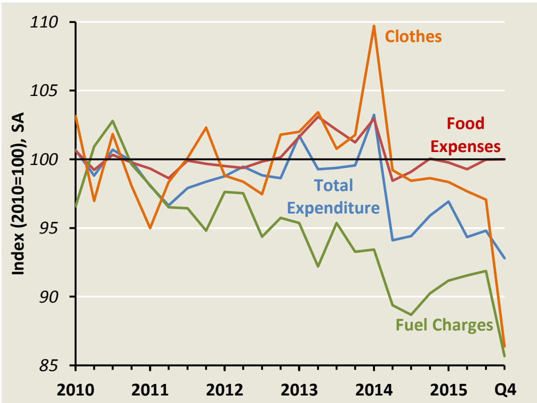
Looking ahead, domestic demand is projected to recover, albeit gradually, on the back of healthy corporate profits as well as a modest pickup in wage growth. The further loosening of financial conditions through negative interest rates is also expected to have some stimulative effects, especially on investment. However, risks to Japan's growth outlook include heightened uncertainty in the global economy and the recent appreciation of the yen, which could adversely affect firms' profits and hold back the pace of capital expenditure and wage increases. All in, the Japanese economy is projected to grow by 0.6% in 2016, before easing to 0.5% in 2017, mainly due to the effects of the planned consumption tax hike.

Chart 1.6
Contribution to Japan's GDP Growth



Source: CEIC

Chart 1.7
Real Household Expenditure in Japan



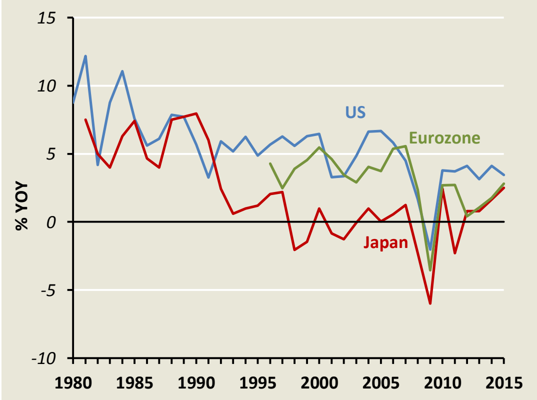
Source: CEIC

Slow growth and low inflation necessitate concerted policy responses by the advanced economies.

More than seven years after the collapse of Lehman Brothers, a strong recovery has yet to materialise in the advanced economies. In the aftermath of the GFC, debt overhang, sluggish investment and hysteresis effects associated with increases in long-term unemployment have contributed to a reduction in trend real GDP growth, as well as a notable decline in nominal GDP growth rates in the G3. (Chart 1.8) The deceleration in nominal growth, reflecting both low growth and muted inflation, is of particular concern given the elevated stock of private and public sector debt in these economies. (Chart 1.9) With nominal interest rates largely constrained by the zero lower bound, low (and at times negative) inflation implies that the real rate of interest remains too high. Apart from restraining current spending, high real interest rates also raise debt servicing and repayment obligations, especially with a slowdown in nominal GDP growth depressing corporate revenues.

Going forward, more needs to be done by the G3 economies on the policy front to raise growth prospects over the longer term. While monetary policy has shouldered most of the burden in supporting aggregate demand in the short term, there is insufficient progress on improving supply-side growth drivers, without which sustained long-term growth will not be achievable. A concerted and coordinated package of measures that includes monetary accommodation, fiscal stimulus and structural reforms, aimed at enhancing economic efficiency and removing impediments to growth (such as labour and product market rigidities), will have a better chance of lifting investment and economic growth.

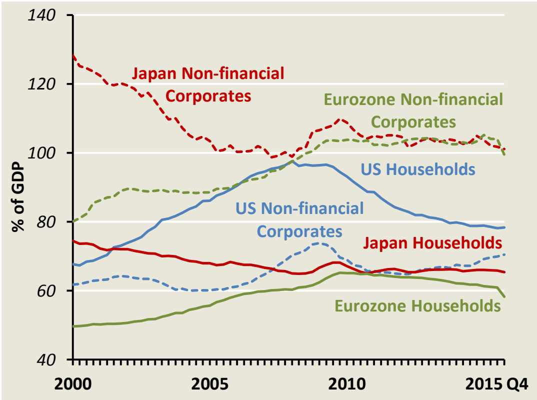
Chart 1.8
G3 Nominal GDP Growth



Source: CEIC and EPG, MAS estimates

Note: The slight uptick in nominal GDP growth in Japan in 2014 and 2015 was due, in large part, to the 3% points hike in the consumption tax to 8% in April 2014, which led to a one-off increase in the price level.

Chart 1.9
G3 Non-financial Private Sector Debt



Source: Institute of International Finance

1.2 Asia

Growth Outlook Dims With Rising Financial Headwinds

In Asia ex-Japan, growth was underpinned by relatively resilient domestic demand in Q4 2015, which provided some buffer against lacklustre export performance. Although further pump-priming measures should help to put a floor on China's growth in 2016, the economy's rebalancing continues to impact the region through lower import demand. In the coming quarters, Asia ex-Japan is expected to register tepid growth, given further moderation in the Chinese economy and muted imports of investment goods from the advanced economies. However, the weakness in the export sector will be partly offset by a revival of public investment in most ASEAN economies and India.

The outlook for private investment is much less sanguine. First, the turn in the global financial cycle, triggered by the US interest rate hike in December 2015, will raise the debt-servicing burden of corporates which had borrowed heavily during the upswing of the cycle amid low global interest rates. Second, credit growth has waned alongside intermittent capital outflows and tightening financial conditions. Third, the end of the commodity super-cycle has crimped corporate and fiscal revenues in a number of economies. This confluence of events has intensified the challenges facing the region, and growth in Asia ex-Japan is projected to slow to 4.6% in 2016 from 4.7% last year, before picking back up mildly to 4.7% in 2017.

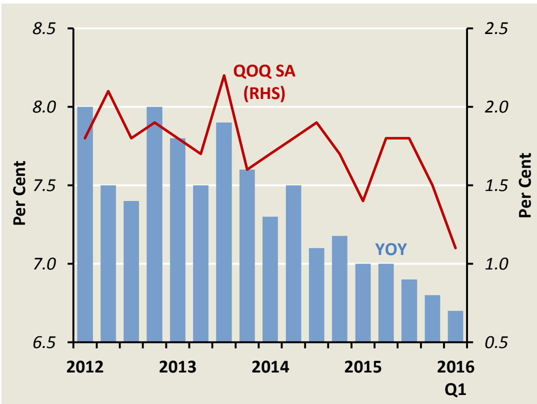
China's growth will be cushioned by policy easing.

The Chinese economy experienced a gradual slowdown over the course of 2015, as the divergence between its goods-producing and services industries widened. In Q4 2015, China's GDP decelerated to 6.8% on a y-o-y basis and to 1.5% on a q-o-q SA basis, from 6.9% and 1.8% in Q3, respectively. (Chart 1.10) For the year as a whole, the manufacturing and construction sectors grew on average by a tepid 6.0%, weighed down by excess industrial capacity and sluggish demand. In comparison, growth in the services sector came in at 8.3% y-o-y, spurred by capital market-driven activity in the financial services sector.

China's economy slowed further in Q1 2016 to 6.7% y-o-y, with sequential growth momentum easing to 1.1% q-o-q SA. Nonetheless, investment in fixed assets grew by 10.7% y-o-y in Q1, up from 10% in 2015, on the back of a property market recovery and faster infrastructure construction. Meanwhile, retail sales rose at a slightly slower pace of 10.3% y-o-y compared to 10.7% in 2015, alongside sluggish consumer confidence and a softer labour market. (Chart 1.11)

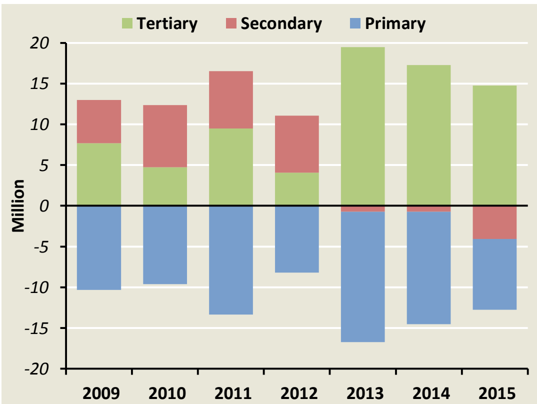
In the quarters ahead, the Chinese authorities are expected to continue to apply monetary and fiscal stimuli to the economy in a measured manner, to ease the adjustment costs arising from structural reforms and industrial layoffs. Besides successively lowering the

Chart 1.10
China's GDP Growth



Source: CEIC and EPG, MAS estimates

Chart 1.11
Change in Employment in China by Sector



Source: CEIC

benchmark lending rate and the reserve requirement ratio for banks over the past year, the central government recently announced a more expansionary fiscal stance for 2016 by targeting a budget deficit amounting to 3% of its GDP. In addition, direct fiscal spending will be complemented by off-budget measures, such as local government bond issuances, the proceeds from which can be used to fund infrastructure works.

Nonetheless, given weak domestic and external demand, the industrial sector faces continuing overcapacity in heavy industries and electronics. The hitherto robust expansion of the overall services sector will not be sufficient to offset the effects of sluggish exports and manufacturing output, as services are not fully insulated from the industrial weakness. Activities that move in sync with manufacturing, such as transportation and wholesale trade services, will be adversely affected. Increased layoffs in the heavy industries will also dampen wage growth and weigh on private consumption. Taking these factors into account, China's growth is expected to come in at 6.5% this year, before slowing further to 6.3% in 2017.

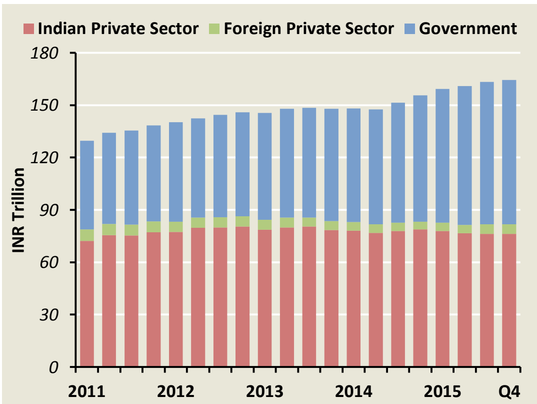
The deceleration in the Chinese economy has been a contributor to the weakness in global trade in the last few quarters, dampening the growth outcomes of key trading partners across the world. Box A highlights the differential impact of this development on various countries and regions.

India is the bright spot in the region.

India's GDP expanded at a firm 7.3% y-o-y in Q4 2015, though this was a slight moderation from the 7.7% in the previous quarter. Household expenditure growth rose to 6.4% y-o-y from 5.6% over the same period, as higher urban discretionary spending more than compensated for weak rural demand. However, the investment recovery seen earlier faltered somewhat, as gross fixed capital formation growth slipped to 2.8% y-o-y in Q4 2015 from 7.6% in the preceding quarter, largely on account of weak private investment. (Chart 1.12)

In the near term, the Indian economy will remain on a modest expansion path, despite a weak external environment. Economic activity will continue to be driven by private consumption, which has received a fillip from lower energy prices and higher real wages.

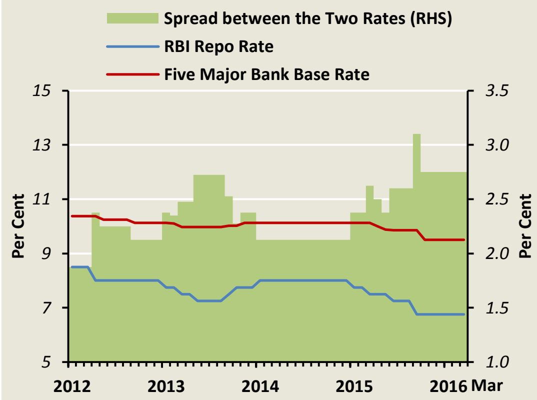
Chart 1.12
India's Outstanding Investment by Ownership



Source: Centre for Monitoring Indian Economy

Looking ahead, an increase in public infrastructure spending and official efforts to improve the business environment should gradually crowd in private investment. Encouragingly, foreign direct investment hit a record high of US$39 billion in 2015, a 37% surge from the previous year. Nonetheless, weakness in both corporate financial and public bank balance sheets will constrain a sharper pickup in growth. To date, Indian banks have passed on less than half of the Reserve Bank of India's (RBI) cumulative 150 bps reduction in the policy rate since the beginning of 2015, with median base lending rates having fallen by only 60 bps. (Chart 1.13) Notwithstanding a challenging global growth environment, GDP growth is projected to come in at a solid 7.6% in FY2016 and rise further to 7.7% in the following year.

Chart 1.13
India Interest Rates

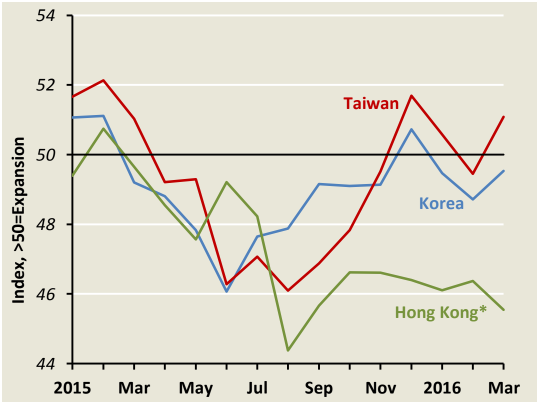


Source: CEIC and EPG, MAS estimates

Growth projections for the NEA-3 have been revised down sharply.

The NEA-3 region as a whole grew by 1.7% q-o-q SAAR in Q4 2015, down from a 2.1% expansion in the preceding quarter. Weak external demand was behind the slowdown. In Korea and Taiwan, the weakness in shipments of capital goods and heavy equipment has extended to electronics, as industrial upgrading in China's electronics industry reduced the mainland's reliance on imported Korean and Taiwanese components. As a result, Korea's growth decelerated to 2.7% q-o-q SAAR in Q4 from 5.0% in Q3. However, Taiwan's GDP expansion picked up to 2.2% q-o-q SAAR on the back of stimulus-driven private consumption expenditure. Hong Kong's growth eased to 0.9% q-o-q SAAR in Q4 from 2.2% in the previous quarter, owing to falling retail sales and shrinking tourist numbers, particularly from mainland China.

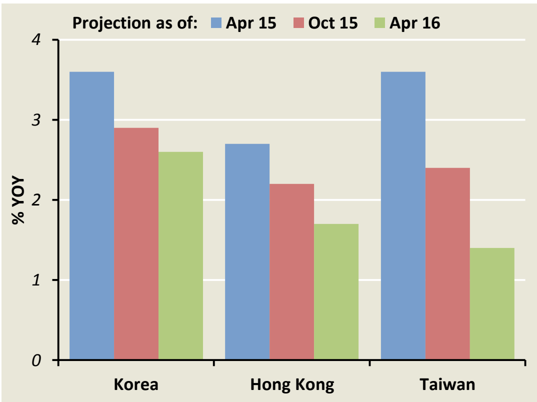
Chart 1.14
NEA-3 Manufacturing PMIs



Source: Markit
* Whole economy.

The persistently weak export performance of Korea and Taiwan is beginning to weigh on domestic economic activity, as shown by signs of softness in their manufacturing sectors and labour markets. Hong Kong, which has been a popular destination for mainland tourists and an important transhipment hub for China, is also likely to face challenges. The latest PMI reading for Hong Kong deteriorated further in March 2016, although those for Korea and Taiwan saw some improvement. (Chart 1.14) Overall, the short-term outlook for the NEA-3 has dimmed progressively, resulting in successive downgrades in growth projections for the region. (Chart 1.15) Accordingly, consensus growth forecasts for 2016 and 2017 have been lowered to 1.8% and 2.3%, respectively, from 2.2% and 2.5% in January.

Chart 1.15
NEA-3 GDP Growth Projections for 2016



Source: Consensus Economics

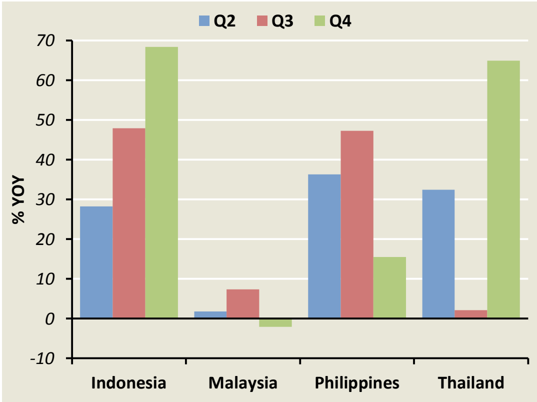
ASEAN-4 will deliver below-trend growth.

GDP growth in the ASEAN-4 held steady at 4.6% y-o-y in Q4 2015, as a pickup in domestic demand alleviated the negative impact of a slowdown in exports. Across the region, private consumption growth held firm or strengthened, supported by resilient labour markets and the boost to real incomes from a renewed decline in oil prices. In Malaysia and Thailand, household spending was also lifted by the frontloading of vehicle purchases ahead of tax revisions in 2016. Bolstered by robust growth in government development expenditure, investment surged in Indonesia and Thailand, and rose at a creditable pace in the Philippines. (Chart 1.16)

Trade performance, however, diverged across the region, largely reflecting variations in the composition of exports. Goods exports from Malaysia and the Philippines expanded in the past two quarters, supported by firmer demand for high-tech products. (Chart 1.17) In comparison, goods exports declined in Indonesia and Thailand, weighed down by falling shipments of mining and agricultural products, respectively, while exports of lower value-added manufactured goods stayed weak. The Philippines benefited from solid growth in services exports, due to higher tourism receipts and business services earnings. In comparison, the surge in Thailand's services exports faded in Q4 2015 as tourist arrivals slowed following the rebound in Q1–Q3.

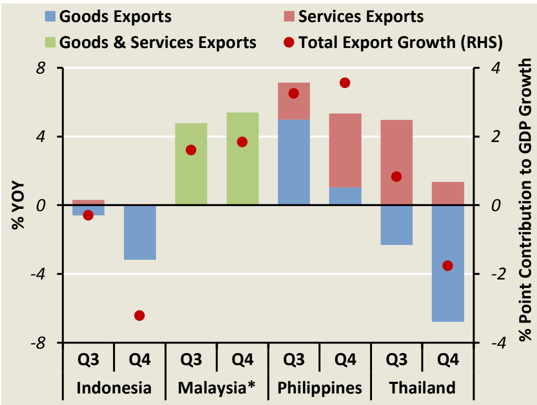
Economic growth in the ASEAN-4 region is expected to ease further this year, given the downbeat global outlook and slowing domestic demand in some economies. Increased government outlays on infrastructure, however, will provide some support in the near term. Malaysia and Thailand will be the most affected by continued softness in external demand, given their greater external orientation and exposure to China's slowing economy. Meanwhile, Indonesia and the Philippines face firmer growth prospects, with domestic demand underpinned by improving consumer and investor sentiments. In addition, the monetary easing undertaken by Indonesia early this year will provide support to economic activity, while growth in the Philippines will be bolstered by additional fiscal expenditures in the run-up to the presidential election in May. Overall, GDP growth in the ASEAN-4 is projected to slow from 4.6% last year to 4.4% in 2016, before rising to 4.7% in 2017.

Chart 1.16
Growth in ASEAN-4 Public Capital Expenditure in 2015



Source: CEIC and EPG, MAS estimates

Chart 1.17
Growth in ASEAN-4 Real Exports in 2015



Source: CEIC and EPG, MAS estimates

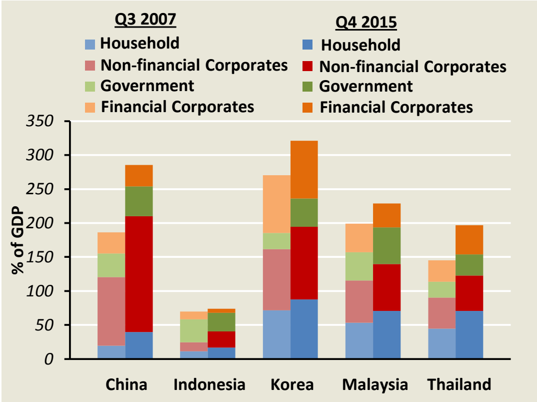
* Malaysia's national accounts data does not have a quarterly breakdown into goods and services exports.

Growth in Asia ex-Japan will be hampered by the sharp run-up in debt post-GFC.

The Asia ex-Japan region as a whole is presently adjusting to the turn in the global financial, credit and commodity cycles. For several years following the GFC, low interest rates in the advanced economies, accompanied by quantitative easing and large capital outflows, led to a rapid escalation in debt accumulation in parts of Asia. While the flood of global liquidity helped to fuel growth, the resultant debt build-up is now unravelling at a time when commodity prices have slumped and global interest rates are set to rise. This deleveraging process, combined with slowing activity, could result in a period of weak investment and consumption growth.

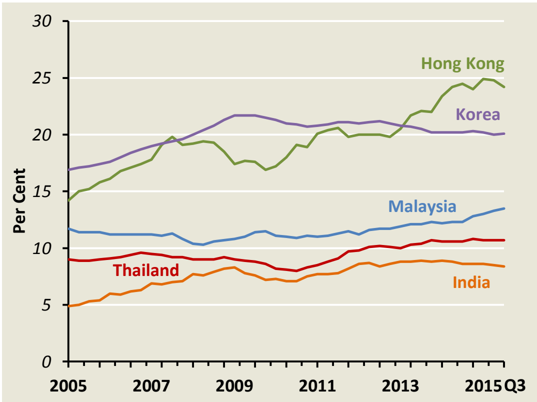
The increase in leverage is most pronounced in China, where debt rose largely because of a rapid build-up of non-financial corporate borrowing. This reflected, in part, the Chinese government's efforts to support growth in the aftermath of the GFC through monetary easing. (Chart 1.18) In Korea, Thailand, and Malaysia, household debt has also climbed significantly, to around 70–90% of GDP. In these, and some other Asia ex-Japan countries, debt service ratios in the private non-financial sectors have trended up over the past several years to above pre-GFC levels. (Chart 1.19) Further, countries with a significant proportion of US dollar-denominated debt may face some refinancing difficulties ahead, given the ongoing trend appreciation in the US dollar. (Chart 1.20) In sum, the tightening of global financial conditions in the aftermath of a credit boom in the region could pose a significant drag on growth, although the impact would vary across countries.

Chart 1.18
Asian Debt by Sector



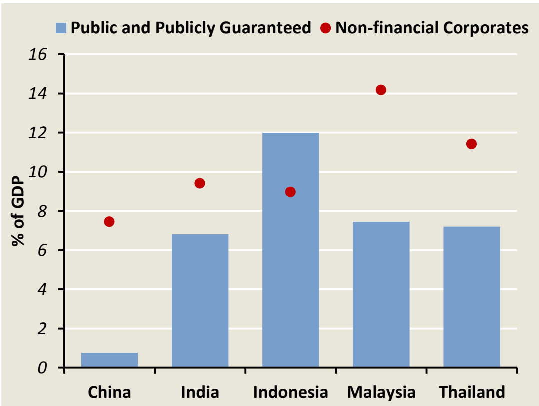
Source: Institute of International Finance and EPG, MAS estimates

Chart 1.19
Selected Asian Debt Service Ratios



Source: Bank for International Settlements

Chart 1.20
US Dollar-denominated Debt in Asia



Source: Haver Analytics, Institute of International Finance, World Bank and EPG, MAS estimates

1.3 Global Inflation

Weak Global Demand Will Keep Inflation Low

Global inflation has been muted in the last two years, with low oil prices exerting a strong dampening effect and sluggish aggregate demand restraining price pressures. In 2016, headline global inflation is expected to rise slightly to 1.4%, after coming in at 0.9% last year. While underlying price pressures are likely to stay weak on account of subdued growth, the energy-related drag should dissipate with the anticipated stabilisation of oil prices. However, in India and the ASEAN economies, where food forms a larger proportion of the CPI basket, a pickup in food prices due to the El Niño weather phenomenon may contribute to some inflationary pressures. In 2017, global inflation is projected to increase further to 2.1%, as economic activity strengthens and the direct and indirect impact of low energy prices fade.

Inflation remains below target in the G3.

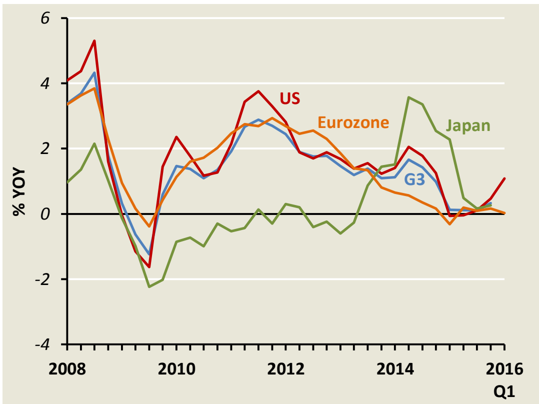
Inflation has begun to rise slightly in the US, while staying muted in the Eurozone and Japan. (Chart 1.21) US headline inflation rose to 1.1% in Q1 2016 from 0.5% in the previous quarter, as the disinflationary effects from energy prices eased further. Core inflation was also higher at 2.2% in Q1 2016, up from 2.0% in the previous quarter, reflecting continued improvements in labour and housing market conditions.

In the Eurozone, headline inflation eased, coming in flat in Q1, from 0.2% the quarter before. Despite the recent turnaround in oil prices early this year, muted core inflation prints of 1.0% y-o-y over the past two quarters suggest that the unwinding of excess capacity in the region remains incomplete. Meanwhile, Japan's headline CPI inflation came in at 0.3% y-o-y in Q4 2015, slightly higher than the 0.2% recorded in the preceding quarter. Lingering downward pressure from low oil prices will continue to depress inflation in 2016, alongside slow GDP growth. Overall, G3 inflation is projected to rise from 0.2% in 2015 to 0.8% in 2016.

Asia ex-Japan inflation is not expected to rise significantly in 2016.

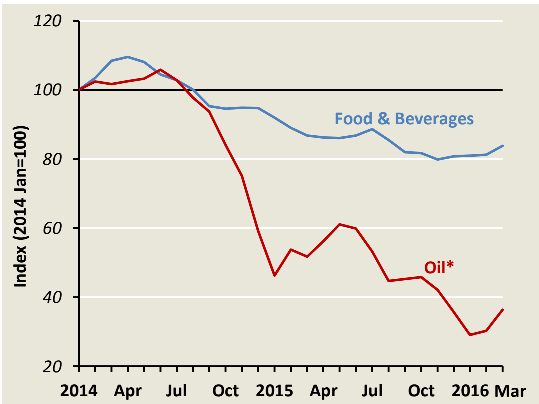
Inflation in Asia ex-Japan is likely to remain muted in the quarters ahead. Energy prices are still low despite some pickup since the beginning of this year (Chart 1.22), which will offset higher import prices caused by the depreciation of some Asian currencies, as well as higher food prices owing to the El Niño weather phenomenon. Accordingly, inflation in Asia ex-Japan is

Chart 1.21
G3 CPI Inflation



Source: CEIC and EPG, MAS estimates

Chart 1.22
Global Oil and Food Price Indices



Source: IMF

* Average of UK Brent, Dubai and West Texas Intermediate oil prices.

expected to come in at 2.5% this year, close to the 2.4% recorded in 2015. (Chart 1.23)

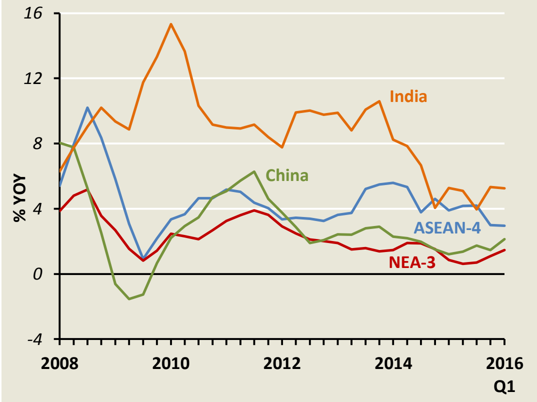
In China, headline inflation tapered alongside falling core inflation, from 1.7% y-o-y in Q3 2015 to 1.5% in Q4, due to a milder rise in food prices. However, in Q1 this year, pork prices surged anew by an average of 24.2%, lifting headline inflation to 2.1%. After worsening to 5.9% in Q4 2015, Chinese PPI deflation slowed in Q1 2016, with the index declining by 4.8% y-o-y. For 2016, China's headline CPI inflation is projected to average 1.9%.

India's CPI inflation rose to 5.3% y-o-y in Q4 2015 from 3.9% in Q3, largely on account of higher cost of food items. Nonetheless, headline inflation remained unchanged in Q1 2016 as food price inflation held steady. High food prices have been reined in over the past two years, aided by improved food management policies by the government. Consequently, CPI inflation in India is expected to decline further to 5.2% in FY2017.

In the NEA-3, inflation ticked up to 1.5% y-o-y in Q1 2016 from 1.1% in the preceding quarter. A cold spell at the turn of the year pushed food prices higher even as low energy prices continued to suppress inflation in the region. Consequently, food price inflation edged up in Korea, Taiwan and Hong Kong in Q1 2016. On the whole, inflation in the NEA-3 is expected to increase to 1.3% in 2016 as the base effect from low oil prices dissipates.

Headline inflation in the ASEAN-4 region stayed low in Q1 2016, at 3.0% y-o-y, partly due to weak energy prices, especially in Indonesia. Inflation in Thailand was in negative territory for the fifth consecutive quarter, as sub-par growth depressed underlying price pressures, and energy costs continued to fall sharply. In the Philippines, inflationary pressures stayed weak, held down by low food prices. Meanwhile, Malaysia saw a surge in inflation in Q1, due to the implementation of the Goods and Services Tax (GST) in April 2015, and upward adjustments to administrative prices. For the ASEAN-4 region as a whole, inflation is forecast to come in at 3.2% this year.

Chart 1.23
Asia ex-Japan Inflation



Source: CEIC and EPG, MAS estimates

Box A
China And The Global Export Slowdown

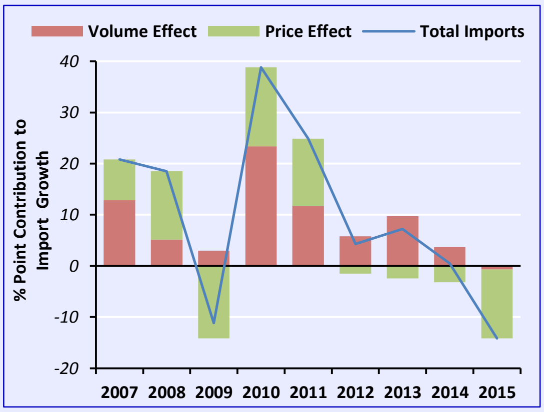
Introduction

Global trade growth slowed markedly in 2015, with emerging economies recording their first year of contraction in merchandise trade volumes since the GFC. A slowdown in China's imports, particularly in commodities, has been widely regarded as a key factor behind the trade slowdown. This Box examines developments in China's imports in recent years and the impact of the deceleration in the country's growth on the global economy, including across different countries and regions.

Decomposing China's Import Demand

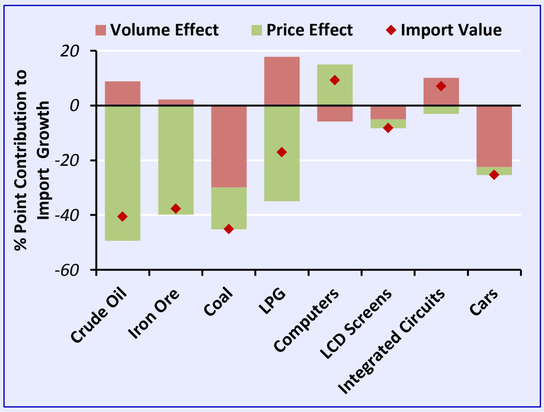
Despite perceptions that sharply falling Chinese demand was responsible for the plunging prices of commodities, such as oil, the country's total merchandise import volume contracted only marginally in 2015. After stripping out price effects, imports in real terms fell by 0.7% last year after rising by 3.7% in 2014. (Chart A1) This suggests that other factors, including structural shifts, were also important in explaining the deceleration in global trade growth.

Chart A1
China's Merchandise Import Growth: Volume and Price Effects, 2007–15



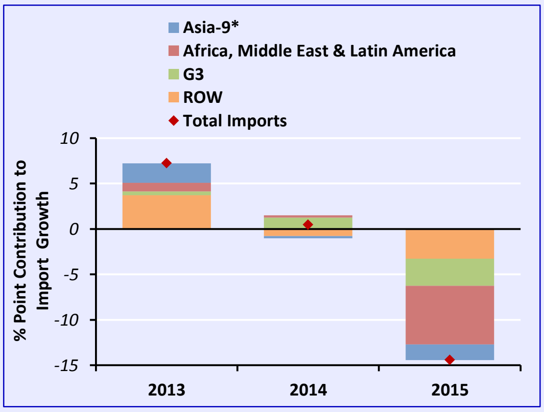
Source: CEIC, IMF and EPG, MAS estimates

Chart A2
China's Import Growth by Selected Products: Volume and Price Effects in 2015



Source: China General Administration of Customs and EPG, MAS estimates

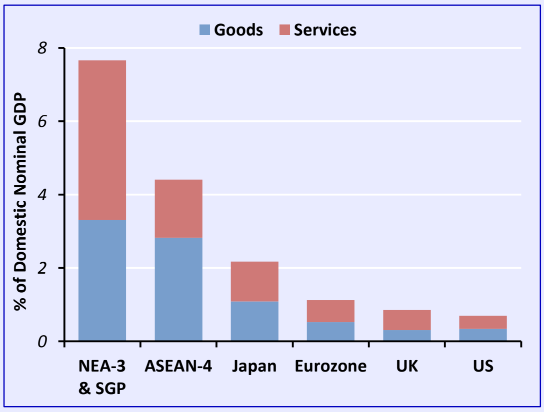
Chart A3
China's Nominal Merchandise Import Growth by Country



Source: CEIC and EPG, MAS estimates

* Asia-9 comprises Hong Kong, Indonesia, Korea, Malaysia, the Philippines, Singapore, Taiwan, Thailand and Vietnam.

Chart A4
Exposure to China's Import Demand in 2011



Source: OECD-TiVA Database and EPG, MAS estimates

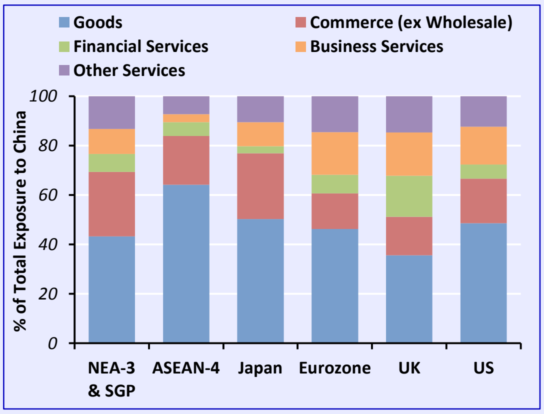
China's customs trade data show that trends in import volumes and values varied considerably across major products in 2015. Although the country imported larger quantities of crude oil, LPG, and iron ore, their unit prices fell by around 40%, resulting in lower import values for these products. (Chart A2) Conversely, China imported smaller quantities of manufactured products such as computers, display screens and cars, which contributed, in part, to the slump in intra-regional trade since early 2015. Meanwhile, Chinese imports of coal fell in both volume and price terms. In terms of geographical impact, the bulk of the decline in China's nominal imports last year was due to goods shipped from the Middle East, Latin America and Africa combined, while Asia-9 and the G3 accounted for smaller proportions. (Chart A3)

Estimating Country Exposure to China's Final Demand

A slowdown in Chinese demand will have the largest impact on the NEA-3 and ASEAN economies, given the strong economic linkages within the region and the large volumes of intra-regional trade. Applying the OECD-WTO Trade in Value-added (TiVA) dataset to obtain estimates of country exposure, in the form of domestic value-added embodied in China's final demand, the country's import demand for goods and services accounted for 7.7% of the combined nominal GDP of NEA-3 and Singapore, and 4.5% of ASEAN-4 in 2011. (Chart A4) The main channels of transmission are through the electronics industry, as well as the tourism-related industries of restaurants & hotels and retail trade. In comparison, the advanced economies are less exposed, with China's import demand averaging just 1% of G3 nominal GDP.

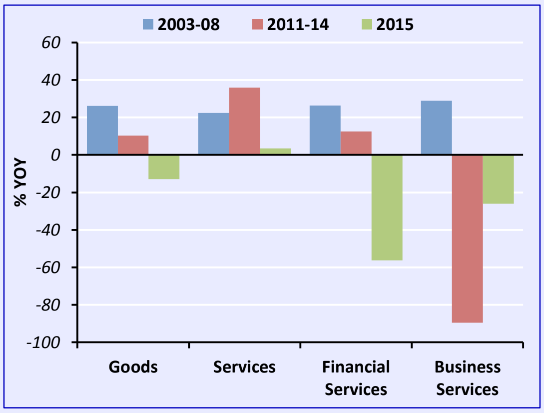
However, a closer look at sectoral exposure reveals that the advanced economies were not immune to a fall in Chinese demand last year. An estimate of China's TiVA-weighted imports from each country or region may be obtained by applying their respective 2011 exposure across the different sectors. Based on this, the UK was the worst affected, while China's imports from the US and the Eurozone suffered significant declines as well. These findings reflect the greater exposure of the advanced economies' financial and business services to China, relative to other sectors. In 2011, these sectors comprised 21–34% of China's TiVA imports from the UK, the Eurozone and the US. (Chart A5) In 2015, China's imports of financial and business services fell by about 56% and 26%, respectively. (Chart A6) Japan was less affected due to the smaller share of its financial and business services in China's imports.

Chart A5
Exposure to China by Sector in 2011



Source: OECD-TiVA Database and EPG, MAS estimates

Chart A6
China's Import Growth by Sector



Source: CEIC and EPG, MAS estimates

Sum-up

China's import volumes in real terms have contracted only marginally in 2015, suggesting that other factors also contributed to declining global trade. Despite importing greater quantities of commodities, such as crude oil, it was primarily plunging prices that caused China's overall import values to fall. The brunt of the decline fell on exporters from the Middle East, Latin America and Africa, while other Asian economies were less severely affected. However, a slowdown in Chinese demand will have a significant impact on nominal GDP in the NEA-3 and Singapore, while affecting the ASEAN-4 to a lesser extent. In addition, financial and business services exports to China from most of the advanced economies likely suffered notable declines in 2015.