Asia-Pacific
Economic Cooperation

APEC Economic Trends Analysis

APEC Policy Support Unit

31 May 2012

Advancing Free Trade for Asia-Pacific Prosperity

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APEC#212-SE-01.6

Highlights

APEC's economic growth decelerated in 2011

The APEC region's GDP growth in 2011 moderated from a strong 5.9% in 2010 to 4.1% in 2011. While the intensification of the Euro area sovereign debt crisis in late 2011 had a limited effect on the APEC region's financial conditions, it did have a significant impact on many APEC economies' trade and investment performance. This was further exacerbated by disruptions in the region's supply and production chains, caused by a series of devastating natural disasters.

Despite uncertainty in the external environment, private consumption in the APEC region remained strong and was the key driver of growth in many APEC economies.

Globally, economic performance in the first few months of 2012 remained mixed

Global industrial production has started to recover, suggesting that global growth could accelerate, albeit at a weak pace, in Q1 2012. However, economic performance has remained weak in much of Europe. The UK entered a technical recession in Q1 2012 while the Euro area registered no growth in the same quarter.

In the APEC region, the U.S. economy recorded its 11th consecutive period of growth in Q1 2012 while Japan rebounded strongly from the Q4 2011 recession. In emerging and developing APEC, export growth continued to weaken and contributed to moderated growth in some economies.

Short-term prospects for growth are uncertain with risks remaining on the downside

Global GDP is forecast to slow from 3.9% in 2011 to 3.5% in 2012 before accelerating to 4.1% in 2013.

The global economy is vulnerable to a fresh intensification of the Euro area crisis, which could be triggered by a severe recession from large-scale government budget-tightening across Europe and/or a drastic contraction of European banks' balance sheets.

Oil prices, which regained early-2011 highs in March 2012, could surge higher as a result of geopolitical concerns. A sustained 20% increase in oil prices could subtract global growth by a substantial 1.5 percentage points.

The APEC region is expected to outperform the world with growth forecast to accelerate to 4.3% in 2012 and 4.7% in 2013

Industrialized APEC has defied the global trend of moderating economic growth with GDP forecast to pick up by 2.1% in 2012. This is quite significant given that a recession of 0.1% is forecast for non-APEC industrialized economies in 2012.

Growth in emerging and developing APEC economies is expected to soften to 6.3% in 2012 before picking up by 6.9% in 2013. Despite this moderation in growth, emerging and developing APEC remains the fastest growing region in the world, contributing to more than 50% of global real GDP growth.

However, APEC's growth prospects are likely to be influenced by external forces

In industrialized APEC, both governments and households are expected to tighten spending in order to consolidate their balance sheets. The uncertain global economy, which could translate into lower investment and export growth, could seriously jeopardize the recovery process of these economies.

The uncertain global growth outlook remains the strongest headwind for emerging and developing APEC in 2012 and 2013. Economies with large and robust domestic markets and less reliance on exports as a driver of growth will be in a better position to weather the external slowdown. On the other hand, growth is expected to slow sharply among economies with relatively high exposure to the external market but with small domestic consumption bases.

The APEC region as a whole is a net oil-importer. Large and sustained increases in oil prices due to geopolitical concerns in the Middle East could also negatively impact APEC's growth by putting upward pressure on inflation and deteriorating the region's terms of trade.

APEC Policy Support Unit
30 May 2012

I. Economic Growth in the APEC Region in 2011: Strengths and Weaknesses

The APEC region's GDP growth in 2011 moderated from a strong 5.9% in 2010 to 4.1% in 2011. The slowdown in growth over the period from 2010 and 2011 was sharper in some economies, including Korea (from 6.3% in 2010 to 3.6% in 2011); Japan (from 4.4% to -0.7%); the Philippines (from 7.6% to 3.7%), Singapore (from 14.8% to 4.9%); Chinese Taipei (from 10.7% to 4.0%) and Thailand (from 7.8% to 0.1%).

Economic growth in Chile; Indonesia; Papua New Guinea and Russia was strong in 2011. Indonesian GDP expanded by 6.5%, marking the highest growth rate since the 1998 Asian financial crisis. Papua New Guinea extended its decade of uninterrupted expansion, with GDP growing by 8.9% in 2011. Despite the slowdown in Europe, Russia maintained a strong GDP growth rate of 4.3% in 2011.

With the exception of a few economies, private consumption remained the key driver of growth in 2011

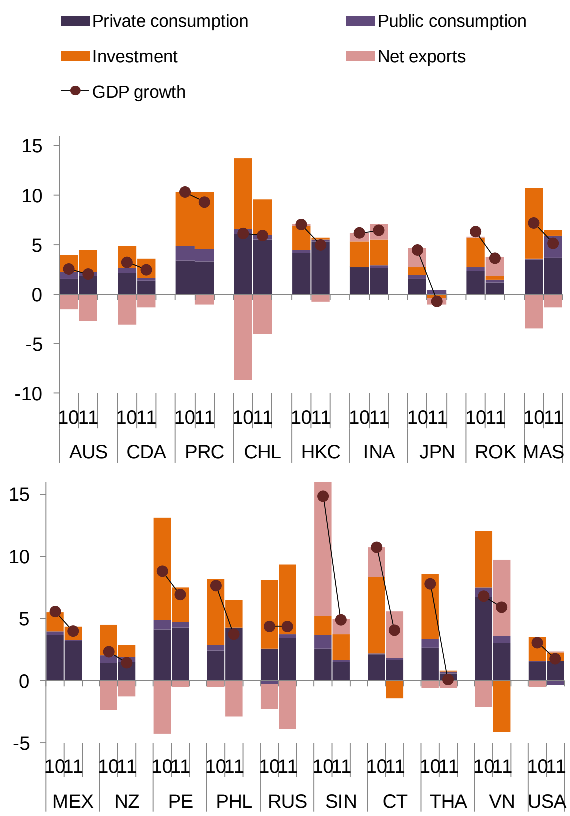
Amid the turbulent external environment, the APEC region's private domestic consumption was fairly robust in 2011 (Figure 1). This was supported by healthy employment growth and rising incomes, with most APEC economies reporting lower unemployment rates in 2011 compared to the previous year (Figure 2).

In Hong Kong, China, the annual unemployment rate declined visibly by 0.9 percentage point from 4.3% in 2010 to 3.4% in 2011. At the same time, employment surged to a record high. The tight labour market as well as the implementation of a statutory minimum wage significantly boosted wages and household incomes. As such, consumer spending was the main driver of growth for Hong Kong, China in 2011.

Domestic consumption in the APEC region has benefited from favorable credit conditions, which can be attributed to the continued easing of macroeconomic policy across most economies. Toward the end of 2011, many central banks in the APEC region have either lowered or stopped raising the monetary policy rate.

In some emerging economies where growth in private consumption decelerated, high inflation was one of the main underlying factors. In Viet Nam, private consumption growth decelerated to 2.4% in 2011 as high inflation – averaging at 18.6% - eroded real purchasing power. Similarly, consumer spending in Korea was also affected by inflation. Real household income actually declined in 2011: consumer prices rose by 4.0% while nominal wages grew by 1.2%. As Korean households have relatively low saving rates, there was not much buffer against price increases and they had little option but to opt for a reduction in spending.

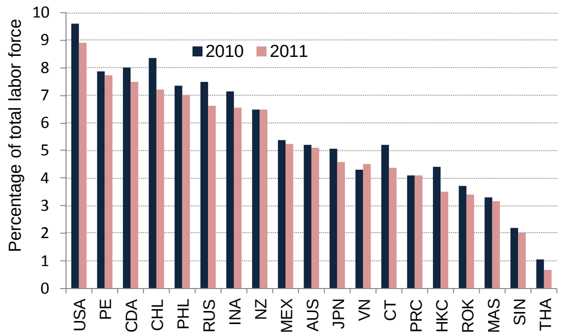
Figure 1: GDP growth: Selected APEC economies[1] in 2010 and 2011
(year-on year (y-o-y), percentage points)



Source: Thomson Reuters, APEC Policy Support Unit

[1] Abbreviations used for figures are as followed: Australia (AUS); Brunei Darussalam (BD); Canada (CDA); Chile (CHL); China (PRC); Hong Kong, China (HKC); Indonesia (INA); Japan (JPN); Korea (ROK); Malaysia (MAS); Mexico (MEX); New Zealand (NZ); Papua New Guinea (PNG); Peru (PE); the Philippines (PHL); Russia (RUS); Singapore (SIN); Chinese Taipei (CT); Thailand (THA); Viet Nam (VN).

Figure 2: Unemployment rates
(% of total labor force)

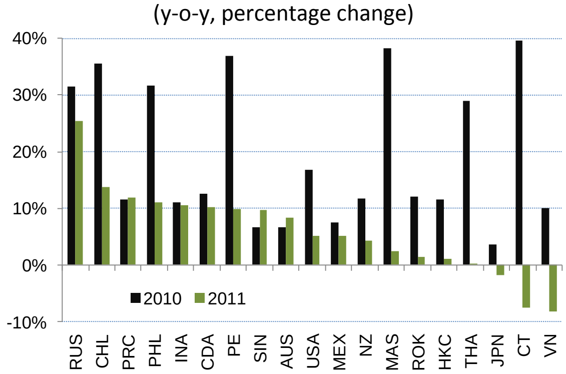


Source: IMF WEO April 2011

However, investment weakened sharply

Of the nineteen APEC economies where data on GDP by expenditure is available, sixteen saw investment[2] growth weakened in 2011 (Figure 3).

Figure 3: Investments in selected APEC economies
(y-o-y, percentage change)



Source: Thomson Reuters

In Viet Nam, real levels of investment contracted by 8.2% in 2011, owing to high lending rates and cuts in public infrastructure investment, both elements of policy tightening. Investment therefore became a significant drag for growth in 2011, subtracting 4.0 percentage points from real GDP growth rate. Gross capital formation as a ratio to GDP moderated to 38.7%, the lowest in 4 years.

The moderating pace was pronounced in Chile; Hong Kong, China; Korea; Malaysia; Peru; the Philippines, and Chinese Taipei. One common theme in the weakening of investment growth across these economies was that uncertainties in the global economic environment affected business plans for capacity expansion. This was reflected in decreasing investment in export-oriented industries such as automobiles and semiconductors in Korea and electronics in Chinese Taipei during the global economic slowdown in 2011. In Hong Kong, China, overall investment spending was dragged down by inventory building[3], which fell by 61% in 2011. As such, investment growth in Hong Kong, China slowed from 11.5% in 2010 to 0.8% in 2011, despite a sharp revival in business capital spending and a sustained increase in public construction works. In Chile; Mexico and Peru, uncertainty in the economic growth outlook has translated into reduced investment spending on machinery and equipment, especially those related to capital goods flows.

In those APEC economies that were struck by major natural disasters in 2011 – most notably Japan, New Zealand and Thailand – investment levels were inevitably affected. In Japan, the rapid pick-up in investment following the earthquake and tsunami disaster was disrupted again later in the year, due to supply constraints caused by severe flooding in Thailand. In these three economies, business fixed investment and public investment have been on an improving trend since late 2011, mainly reflecting pent-up domestic demand as well as the reconstruction process.

In the United States, low levels of investment reflected continued weakness in the real estate sector. A high inventory of vacant houses and an imminent pending supply of foreclosures exerted downward pressure on house prices and restricted the construction of new homes. Construction was also weak in the non-residential sector, due to high vacancy rates and tight credit conditions.

In Australia; Canada; China and Indonesia, investment remained robust. The strength of business investment in Australia and Canada reflected favorable credit conditions, high commodity prices and strong currencies. In the case of Indonesia, an increase in investment was partly attributed to the strong macroeconomic climate in the domestic economy. The spur of foreign direct investment (FDI), which reached a record high of USD 20 billion in 2011, provided further support to fixed business investment. Accordingly, investment grew strongly by 8.8% in 2011 contributing 2.1 percentage points to GDP growth.

In China, despite government measures to curb speculation in the real estate sector, fixed asset

[2] In this report, investment is the sum of gross fixed capital formation and changes in inventory

[3] Inventory investment is measured by changes in inventory

investment grew by almost 24% in 2011. Local government expenditure on infrastructure was also strong. This, together with the high level of private and foreign investment, saw investment remaining the main engine of growth in China, contributing to 5.7 percentage points to GDP growth.

Government spending growth was modest

The contribution of government spending to real GDP in most APEC economies was modest in 2011. This reflected the fiscal plans of many governments aimed at consolidating spending and unwinding fiscal stimulus packages which were introduced during the 2008 global financial crisis.

Malaysia is a notable exception. In 2011, government consumption grew strongly by 16.8% compared to 2010, when it grew by only 0.5%. Most of this increase can be attributed to higher emoluments and outlays on supplies and services.

Public spending was also strong in China, surging by 24.4% in 2011 as the government increased its budget on social spending programs, e.g. supporting medical reform, education programs for migrant workers' children in urban areas and other poverty relief measures.

The trend of tightening government spending is forecast to continue during what remains of 2012 and in 2013, especially in many advanced economies, in line with the fiscal plans being considered by some APEC economies.

Export growth was weakened sharply

The deteriorating global outlook in 2011 directly affected export earnings and impacted on growth in most APEC economies. Weakness in the external sector was compounded by natural disasters that severely disrupted the region's supply chains (Box 1). The earthquake in Japan and then the flood in Thailand, for example, caused plant closures and production outages. As Japan and Thailand are major suppliers of electronic components and automotive parts in APEC, the region's production and exports of electronics and automobiles in particular were severely affected.

Box 1: Estimated damages and losses from major natural disasters in the APEC region in 2011

Economy	Damages and losses (USD million)	% of GDP	Types of natural disasters
Australia	2,554	0.2	Storm and wildfire
Canada	2,300	0.1	Wildfire and Flood
China	12,339	0.2	Flood, storm, earthquake, extreme temperature
Japan	212,520	3.6	Earthquake and storm
Korea	52	0.0	Flood
Mexico	598	0.1	Extreme temperature and storm
New Zealand	18,000	10.7	Earthquake
Philippines	728.71	0.3	Storm
Thailand	40,317	11.9	Flood
United States	57,300	0.4	Storm, drought and flood
APEC Total	346,709	0.9	
World	*380,000*	*0.5*	

Source: International Disaster Database, Centre for Research on the Epidemiology of Disasters, available from www.emdat.be;

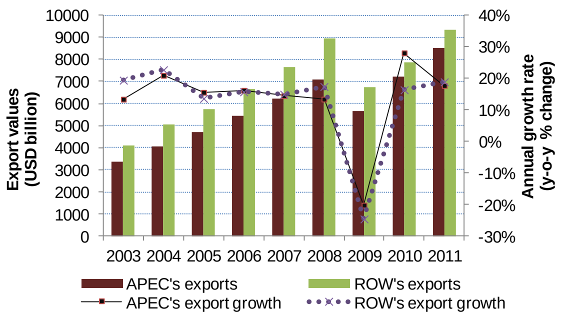
Devastating earthquakes and a large number of weather-related catastrophes meant that 2011 was the costliest year on record for natural disaster losses, in economic terms. In 2011, global economic losses from natural disasters are estimated to be USD380 billion, nearly two-thirds higher than in 2005, the previous record year when there were losses of USD220.5 billion. Less than 30% of 2011's economic losses were insured.

The APEC region incurred 91% of the total USD380 billion economic losses from natural disasters and weather calamities in 2011. It started with the 6.3 magnitude earthquake in Christchurch, New Zealand, in February 2011. The economic damage and losses from that earthquake are estimated to be USD18 billion, an equivalent of 10.7% of New Zealand's GDP.

The New Zealand earthquake was followed by a 9.0 magnitude earthquake in Tohoku, Japan, the most destructive event of the year. The damage from the tremors themselves was relatively moderate thanks to strict building codes, but the tsunami triggered by the quake devastated the northeast coast of the main island Honshu. The economic losses caused by the quake alone amounted to a record USD 212 billion. This does not take into account the consequences of the accompanying nuclear accident which added significantly to the economic cost.

In the second half of 2011, other severe weather-related catastrophes occurred in Asia and the USA. Severe flooding in Thailand in late 2011 inflicted more than USD40 billion worth of damage and losses and seriously hampered the region's supply and production chains.

Figure 4: Exports to world market, in current USD



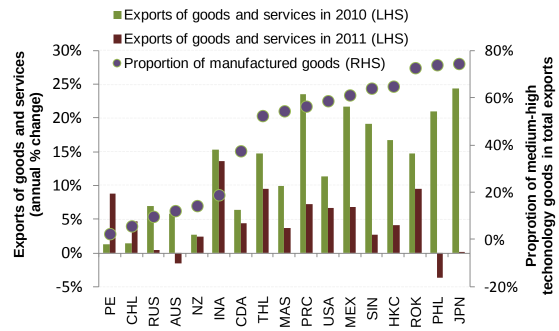
Source: IMF Financial Statistics, APEC Policy Support Unit

The compound effect of weak external demand and supply chain disruption undermined APEC's position in world trade. The annual growth of nominal export earnings in APEC dropped to 18% in 2011, from a strong growth of 28% in 2010 (Figure 4). In comparison, the rest of world's exports grew by 19% in 2011, from a 16% growth rate registered in 2010.

Among individual APEC economies, export performance varied markedly. The deceleration in export growth was most pronounced among economies where technological goods accounted for a large proportion of total exports (Figure 5). In the Philippines, where electronics and semiconductor shipments account for almost 50% of export revenues, the total value of exports in 2011 (in real terms) contracted by 3.8%, against a growth rate of 21.0% in 2010. Similarly, for Singapore, real export growth moderated to 2.6% in 2011, from the strong expansion of 19.1% a year earlier.

Among APEC's commodity producers, exports were weak in Australia and Russia in 2011. In real terms, Australian exports contracted by 1.6% in 2011 while they grew only marginally, by 0.4%, in Russia. The contraction in Australian real export earnings reflected a weakness in coal exports which were disrupted by floods in Queensland in early 2011. For Russia, as half of its exports traditionally go to Europe, slowing European growth had a negative impact on export earnings, despite high oil prices - which at their peaks in 2011 were more than triple the 2009 low.

Figure 5: Growth in real exports and the proportion of medium-high technology goods[4] in total exports



Source: Thomson Reuters, UN Comtrade and APEC Policy Support Unit

On the other hand, exports remained relatively strong among other APEC commodity exporters, partly supported by sustained high commodity prices. In this context, the performance of Peru's exports was notable, with the total real value of exports advancing strongly at 8.8% in 2011, compared to the 1.3% growth rate in 2010. This strong export performance was underpinned by strong global demand for agricultural and food products. Peru's export values (in nominal terms) for non-mining products grew 32.6%, more than offsetting the moderation in the mining exports.

II. Recent Economic Developments

In the first few months of 2012 weakness continued to pervade in the external economic environment

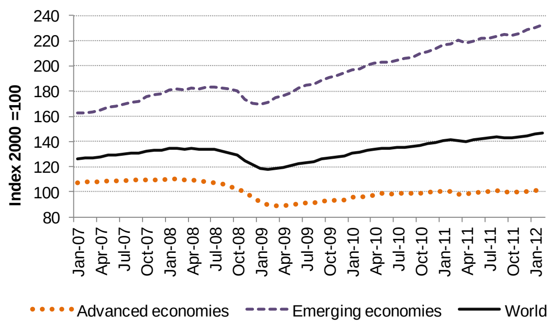
In the first few months of 2012, the global economy continued to show mixed signals. Global industrial production has started to recover after leveling out during in the second half of 2011, suggesting that global growth could accelerate, albeit tentatively, in Q1 2012. However, the pick-up in growth appears to be set for a softer patch, with the aggregate indicator of global activity – the JP Morgan Global All-Industry

[4] This report follows the United Nations Industrial Development Organization for the classification of medium- and high technology manufacturing goods. This information can be found at http://www.unido.org/fileadmin/user_media/Services/Research_and_Statistics/Technical_notes.pdf

index[5] – edging down to 52.2 in April 2012, from February's one-year high of 55.4. This indicates that while global output is still growing, it is doing so at an increasingly weaker pace.

There is also a wide divergence in performance among economies. In emerging and developing economies, growth is progressing at a much faster pace than in advanced economies. Industrial output in advanced economies is still well below its early 2008 level while it has risen by a considerable margin in emerging economies (Figure 6).

Figure 6: Industrial Production, excluding construction (Index 2000 = 100, seasonally adjusted)



Source: CBP Netherlands

In much of Europe, economic performance has remained weak. Q1 2012 GDP data from the United Kingdom revealed that the economy had entered a technical recession, defined as two or more consecutive quarterly falls in GDP. GDP contracted by 0.2% quarter-over-quarter (q-o-q) in Q1 2012, on the back of a 0.3% q-o-q in the final quarter of last year.

Following a contraction of 0.3% q-o-q in Q4 2011, the Euro area narrowly avoided a technical recession. The region's GDP was unchanged in the first three months of 2012 (0.0% q-o-q growth), with Germany registering strong growth (0.5% q-o-q) while Italy contracted by 0.8% q-o-q. Activity in the region is set for a period of softer growth in the second quarter of 2012. The latest survey of the Euro area's production, composed by Markit[6], showed that the downturn in the Euro area had deepened in April 2012.

Weakness in activity was widespread across all sectors in the Euro area. Activities in banking and the manufacturing of electronic and electrical equipment declined sharply. Despite recent job cuts, signs of spare capacity have persisted across Europe. If sustained, this is a harbinger of further job losses. Rising unemployment in parts of the Euro area would undoubtedly contribute towards dampening the underlying growth momentum in the region going forward.

Global financial markets have improved but significant headwinds are expected for the rest of 2012

In global financial markets, conditions have improved relative to late 2011, as reflected in the reduction of Chicago Board Options Exchange Market Volatility Index[7] (Figure 7). The successful implementation of the Long-term Refinancing Operation (LTRO) has bought time for European governments to work out necessary reforms that are required to put sovereign finances on a sustainable footing.

Figure 7: Evolution of the Chicago Board Options Exchange Market Volatility (VIX) Index

Source: Yahoo finance

However, since mid-April 2012, some degree of instability has re-emerged in the global financial market. At first, this was in response to concerns that some governments in the Euro area may not be able to live up to their deficit reduction plans. In Spain, for example, the government's plan to improve its fiscal position is being obstructed by two powerful forces:

- Firstly, months of unrelenting fiscal austerity are driving the economy into a severe

[5] A reading above 50 indicates an expansion in output whereas a reading below 50 indicates a contraction in output.
[6] The Markit's Composite Output Purchasing Manager Index for the Euro area fell to 46.7 in April, down from 49.1 in March. A reading below 50 indicates a contraction in output.

[7] The Chicago Board Options Exchange Market Volatility Index (VIX) is a popular measure of the implied volatility of the S&P 500 index options. It represents the market's expectation of stock market volatility over the next 30 day period and is often referred to as the fear index.

recession that might undo improvements achieved so far in state finances; and

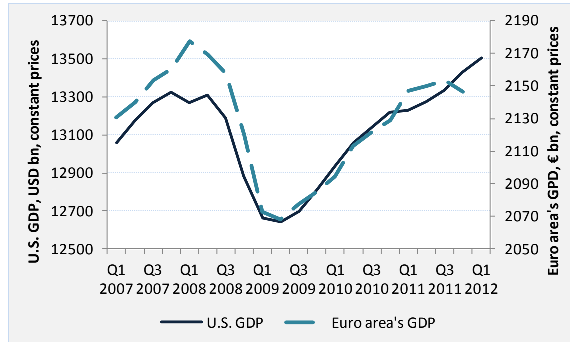
- Secondly, the central government's debt at 68.5% of GDP – while still significantly lower than that of Italy (120% of GDP) – is at risk of rapid expansion if the government is required to provide large financial assistance packages to troubled domestic financial institutions and local governments.

In early May, investors' fears about the possibility of Greece leaving the Euro area re-emerged after some European Central Bank officials publicly discussed for the first time a possible Greek exit from Europe's Monetary Union. In addition, political uncertainty, following the inconclusive general elections in Greece, cast serious doubts about the economy's commitment to pursue structural reforms and budget tightening measures demanded under its international financial assistance packages.

Industrialized APEC economies are defying the global trend of moderating economic growth

In the first quarter of 2012, economic activity in APEC industrialized economies has continued to be relatively positive. The U.S. economy in particular has performed well. Although the first estimate of Q1 GDP showed that the economy grew by less than expected, at a seasonally adjusted annualized rate (saar) of 2.2%, this represented the 11th consecutive quarter of positive growth. In volume terms, the U.S. economy is now 1.3% larger than its pre-crisis peak in 2007 (Figure 8). This is in stark contrast to the Euro area in which real GDP has not yet recovered from the 2008 global financial crisis. As such, the United States has remained one of the few drivers of global demand and economic growth since late 2011.

Figure 8: Gross Domestic Products: The United States and the Euro area
(in billions national currencies, constant prices)



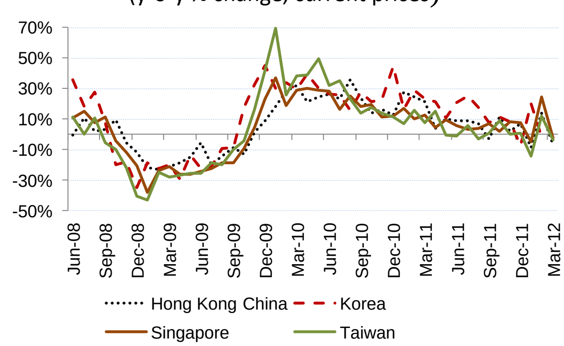
Source: Thomson Reuters, APEC Policy Support Unit

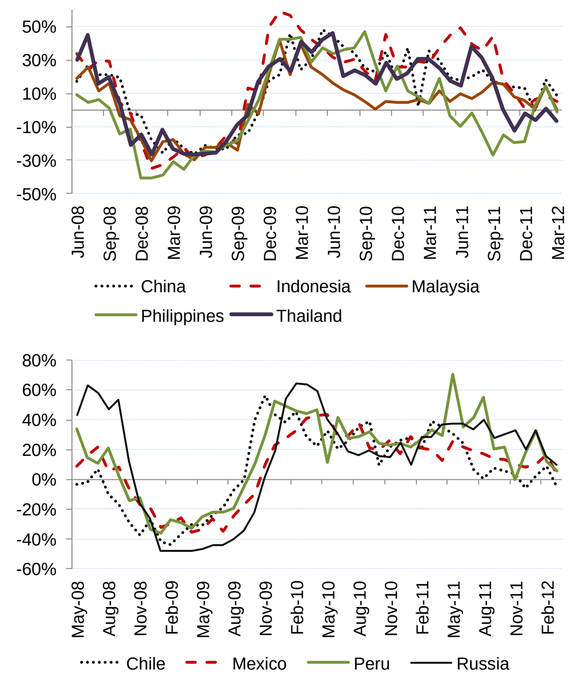
In Japan, the economy returned to growth in the first quarter of 2012 with GDP advancing robustly at an annualized rate of 4.1% (saar). Japan's export performance held up well in the quarter despite slower global growth. The appreciation of the Japanese yen, which raised concerns about the competitiveness of Japanese exports, has been restrained in recent months following the Bank of Japan's expansionary asset purchases. Stronger demand for Japanese exports from the United States has helped to provide a buffer against the weaker demand from other large trading partners.

Economic performance was mixed among emerging and developing APEC

Uncertainty in global growth has continued to affect developments in emerging and developing APEC economies during the first half of 2012. Export growth has been weak across emerging and developing APEC (Figure 9) and contributed to moderated growth in some economies, including in China and Indonesia.

Figure 9: Export growth in selected emerging and developing APEC economies
(y-o-y % change, current prices)





Source: Thomson Reuters, APEC Policy Support Unit

In China, real GDP grew at 8.1% (y-o-y) in Q1 2012, marking the first lowest quarterly growth figure in almost three years. Indonesia's economic growth also moderated slightly in Q1 2012 with GDP expanding 6.3% (y-o-y), down from a 6.5% growth in the fourth quarter of 2011. In Russia, weaker global demand has translated to a slowdown in industrial production which grew at 2.0% y-o-y in March 2012, the slowest pace in October 2009. However, more recent indicators suggest that the slowdown in large developing APEC economies has reached its nadir and that activity should pick up in coming quarters.

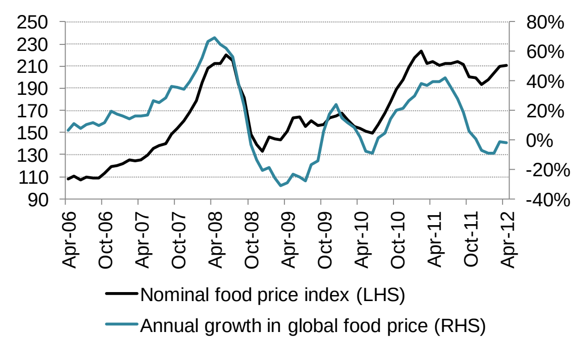
Despite slowing export growth, APEC Newly Industrialized Economies (NIEs) posted an upturn in growth in the first quarter of 2012. In Korea, real GDP advanced by a strong 3.6% (saar) in Q1 2012. In Singapore, real GDP advanced by 10.0% in Q1 2012 (saar), after contracting 2.5% in Q4 2011. Similarly, real GDP returned to growth in Chinese Taipei Q1 2012, rising 1.1% (saar). This broke a pattern of two consecutive quarters of decline during the second half of 2011. In Korea and Chinese Taipei, growth was supported by a strong rebound in investment.

APEC economies in Latin America continued to make strong gains in the first quarter of 2011. The Mexican economy showed signs of strengthening as growth in the U.S. economy stabilized and Mexican automobile production benefited from strong demand from the United States. After dropping by as much as 36% in the trough of the cycle, remittances have steadily recovered, thus contributing positively to economic growth.

III. The APEC region: Recent Evolution in Prices

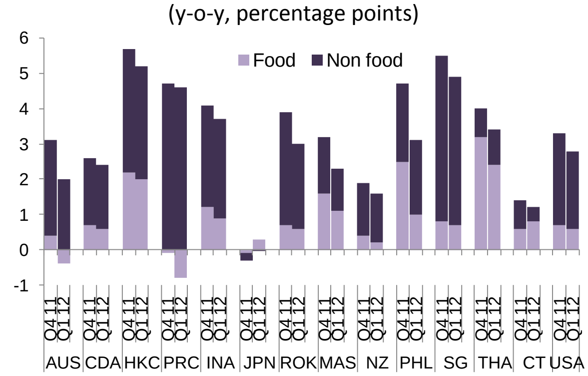
Consistent with the global trend, inflation pressure eased further in many APEC economies in the first quarter of 2012. Global food prices, which reached historical highs (in nominal terms) in February 2011, receded in the second of half of the year (Figure 10). As a result, food price inflation has moderated in Q1 2012, contributing to a lowering of headline inflation in the APEC region (Figure 11).

Figure 10: Recent evolution of global food prices



Source: World Bank

Figure 11: Contributions of food inflation in the headline inflation for selected APEC economies: Q4 2011 versus Q1 2012
(y-o-y, percentage points)



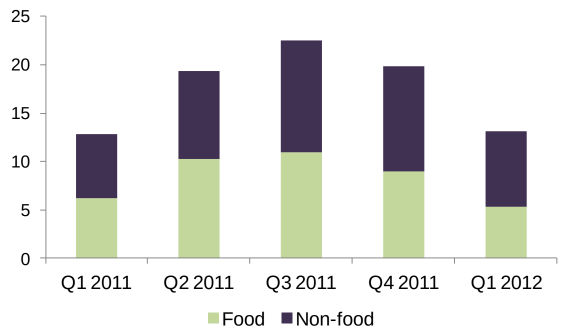
Source: Thomson Reuters, APEC Policy Support Unit

In Viet Nam, headline inflation in Q1 2012 was 15.9% (y-o-y), a significant decrease from the previous quarter when inflation reached 19.8% (y-o-y) (Figure 12). As food accounts for approximately 40% of Viet Nam's Consumer Price Index (CPI) basket, the sharp decline in food prices in Q1 2012 helped to bring down the headline rate.

In Thailand, as the impact of floods receded, prices for fresh food began to drop. This helped to bring the headline inflation rate down to 3.4% in Q1 2012, from 4.0% in Q4 2011. In order to maintain inflation at a moderate level, the Thai government has implemented a price freeze for natural gas and liquefied petroleum, as well as transportation fares.

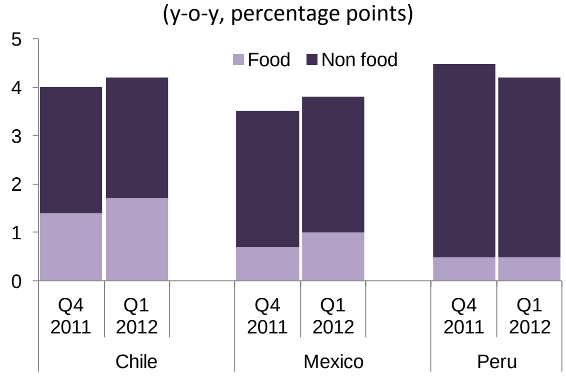
In the Philippines, high food prices contributed to a significant portion of headline inflation in Q4 2011. With food inflation falling from 5.0% (y-o-y) in Q4 2011 to 1.9% (y-o-y) in Q1 2012, headline inflation was lowered from 4.7% in Q4 2011 to 3.1% in Q1 2012.

Figure 12: Contributions of food inflation in the headline inflation for Viet Nam
(y-o-y, percentage points)



Source: Thomson Reuters, APEC Policy Support Unit

Figure 13: Contributions of food inflation in the headline inflation for APEC Latin America
(y-o-y, percentage points)



Source: Thomson Reuters, APEC Policy Support Unit

In Latin America, recent adverse weather has affected yields of food crops. As a consequence, food price hikes in Chile and Mexico, contributed to the rise in their inflation rates in Q1 2012 (Figure 13). In Peru heavy rains caused flooding in important agricultural areas. The subsequent loss in agricultural output is expected to exert upward pressure on food prices and contribute to overall price inflation in Peru over the short-term. Over the next few months, inflation is expected to remain elevated in Latin America.

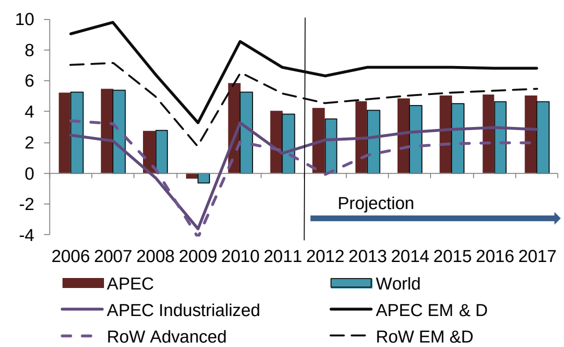
In Singapore, inflation has dropped from 5.5% in Q4 2011 to 4.9% in Q1 2012. However, over the short term, inflation in Singapore is likely to remain under pressure from higher vehicle prices and housing rentals, as well as rising costs of services and commodity-related items.

IV. Outlook for 2012 & 2013

a) Global growth forecasts for 2012 & 2013

In its latest World Economic Outlook (WEO) in April 2012, the International Monetary Fund (IMF) forecast that global GDP growth would slow from 3.9% in 2011 to 3.5% in 2012, followed by an acceleration of 4.1% in 2013 (Figure 14). These forecasts represent slight upward revisions from the January WEO update, which projected that global real GDP would grow by 3.5% in 2012 and 3.9% in 2013. In comparison, the APEC region as a whole is forecast to accelerate from 4.1% in 2011 to 4.3% in 2012 and 4.7% in 2013.

Figure 14: IMF forecasts for global GDP growth
(Percentage change over previous year)



Source: IMF WEO April 2012

b) Industrialized APEC

Economic activity in industrialized APEC economies as a whole is forecast to pick up at faster rates than non-APEC industrialized economies

Table 1: Growth forecasts for 2012 & 2013: Industrialized APEC and Rest of the World's Industrialized Economies (Annual % change, constant prices)

	2010	2011	2012	2013
	actual		*forecast*	
Australia	2.5	2.0	3.0	3.5
Canada	3.2	2.5	2.1	2.2
Japan	4.4	-0.7	2.0	1.7
New Zealand	1.2	1.4	2.3	3.2
United States	3.0	1.7	2.1	2.4
APEC Industrialized	***3.3***	***1.3***	***2.1***	***2.3***
RoW Industralized	***2.0***	***1.5***	***-0.1***	***1.2***

Source: IMF WEO April 2012, APEC Policy Support Unit

APEC industrialized economies as a whole are forecast to grow by 2.1% in 2012 and 2.3% in 2013 (Table 1). In contrast, a recession of 0.1% is forecast for non-APEC industrialized economies in 2012. These economies, however, are expected to bounce back in 2013 with GDP forecast to grow by 1.2%.

For Japan and New Zealand, the reconstruction processes following last year's major natural disasters will be important drivers of economic growth. In Japan, with the rapid restoration of supply chains, economic activity is expected to rebound this year, turning the contraction of 0.7% in 2011 to a strong growth of 2.0% in 2012.

In the United States, an improved labor market and low consumer lending rates will provide some support to consumer spending in 2012. For both the U.S. and Canada, the quickening pace of growth in emerging markets will help to offset the loss of demand from European markets, thus boosting export growth. For both of these economies, GDP is forecast to grow by 2.1% in 2012.

The growth outlook for industrialized APEC can be challenged on the sustainability of consumer spending

Across the five APEC industrialized economies, consumer spending has been strong. However, the strength of consumer spending growth has been accompanied by high levels of consumer debt. Strong consumer demand has also led to trade imbalances in some industrialized APEC economies which have caused net exports to be a drag on growth. Accordingly, questions are raised as to whether household spending will continue to hold up and if so, what effect will that have on net exports?

In New Zealand, growth in household consumption spending has fallen below the rate of income growth. In the first quarter of 2012, households' savings became positive for the first time in more than a decade. This pattern of increased savings is expected to be persistent as households work at rebuilding wealth lost through declines in financial and property values. Similarly, in the United States, consumption spending growth is expected to be modest by historical standards as households rebuild their balance sheets in an environment of persistently weak house prices, fiscal consolidation and only modest gains in employment.

If the trend of moderation in consumer spending continues, it is a concern that other sources of growth would not be strong enough to offset the reduction in private consumption. Business investment will remain a volatile source of growth given the uncertainty in global growth prospects. Furthermore, as industrialized APEC governments are taking measures to consolidate fiscal balances, government consumption will unlikely contribute significantly to growth, at least not in the short to medium term. Policy makers in industrialized APEC are therefore facing a daunting task of having to strike the right balance between preserving economic growth and reducing the imbalances in the economy.

c) Emerging and developing APEC (APEC EM&D)

Economic growth in emerging and developing APEC economies is forecast to soften in 2012 before accelerating in 2013

For the year 2012, the IMF forecast that economic growth in emerging and developing APEC economies as a whole would soften from 6.9% in 2011 to 6.3% in 2012 (Table 2). Growth prospects are expected to improve in 2013 when GDP is forecast to grow by 6.9%. Despite the slowdown in 2012, emerging and developing APEC economies remain the fastest growing in the world, contributing to more than 50% of global real GDP growth (Figure 15 & Figure 16).

Table 2: Growth forecasts for 2012 and 2013: Emerging and Developing APEC (APEC EM&D) versus Rest of the World's Emerging and Developing Economies (Row EM&D) (Annual % change, constant prices)

	2010	2011	2012	2013
	actual		*forecast*	
Brunei Darussalam	2.6	1.9	3.2	1.6
Chile	6.1	5.9	4.3	4.5
China	10.4	9.2	8.2	8.8
Hong Kong, China	7.0	5.0	2.6	4.2
Indonesia	6.2	6.5	6.1	6.6
Korea	6.3	3.6	3.5	4.0
Malaysia	7.2	5.1	4.4	4.7
Mexico	5.5	4.0	3.6	3.7
Papua New Guinea	7.6	8.9	7.7	4.0
Peru	8.8	6.9	5.5	6.0
Philippines	7.6	3.7	4.2	4.7
Russia	4.3	4.3	4.0	3.9
Singapore	14.8	4.9	2.7	3.9
Chinese Taipei	10.7	4.0	3.6	4.7
Thailand	7.8	0.1	5.5	7.5
Vietnam	6.8	5.9	5.6	6.3
APEC EM & D	***8.5***	***6.9***	***6.3***	***6.9***
RoW EM &D	***6.5***	***5.2***	***4.6***	***4.8***

Source: IMF WEO April 2012, APEC Policy Support Unit

Figure 15: Contribution to global real GDP growth: APEC vis-à-vis the rest of the world (in percentage points)

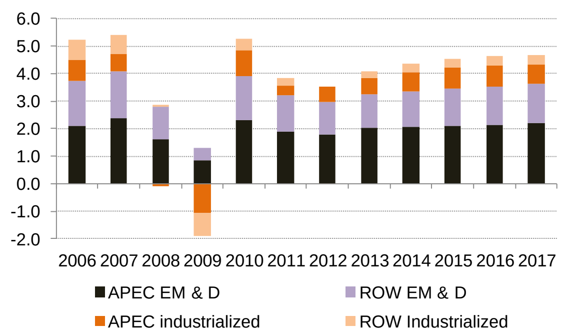
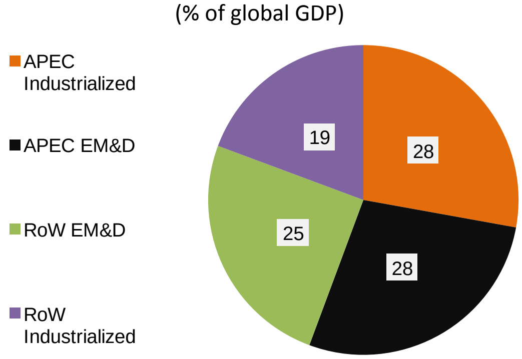


Figure 16: Share of Global GDP based on Purchasing Power Parity in 2011 (% of global GDP)



Source: IMF WEO April 2012, APEC Policy Support Unit

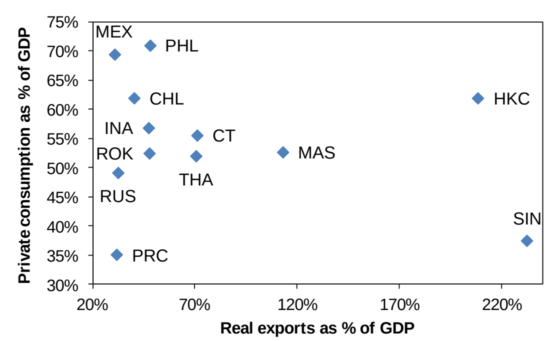
The uncertain global outlook remains the strongest headwind for emerging and developing APEC in 2012 and 2013

The forecast moderation in growth in emerging and developing economies in 2012 is largely attributable to weaker external demand. The magnitude of the slowdown in 2012 is likely to vary substantially across the region, depending on the size of individual economy's domestic market and the extent of reliance on external trade.

Economies with large and robust domestic markets and less reliance on exports (e.g. Indonesia) will be in a better position to weather the external slowdown. On the other hand, growth is expected to slow sharply among economies with relatively high exposure to the external market but with small domestic consumption base. In this respect, Singapore is most vulnerable due to the relatively small size of their domestic market and a large reliance on exports as a source of growth (Figure 17). In 2012, Singapore's GDP is forecast to slow to 2.7%, down from a 4.9% growth in 2011 and less than one-fifth of a 14.8% growth in 2010.

The composition of exports is also important in determining growth. As seen in the 2008 and 2011 downturns, during hard times consumers and companies typically forgo the purchase of electronic products such as new computers and electronic appliances. This trend is expected to continue in 2012, consistent with the slowdown in the production of electronic and electrical equipment in Europe.

Figure 17: Proportion of exports and private consumption in GDP for selected emerging and developing APEC economies (2007-2011's average)



Source: Thomson Reuters, APEC Policy Support Unit

For commodity exporters, the fluctuations in commodity prices are the most obvious source of macroeconomic volatility. Currently, the growth outlook for commodity exporters is relatively more favorable as commodity prices are expected to remain high after strong gains in the first quarter. Oil prices, for example, have been sustained on supply concerns which in turn will benefit the export performance of Brunei Darussalam, Papua New Guinea and Russia. Similarly, the price of copper, an export mainstay of Chile and Peru, is likely to be supported in the second quarter from the tighter supply environment in the international market. However, the strength of commodity prices is directly related to the strength of the global economy. Therefore, if global growth is to deteriorate further, the risks for lower economic growth in these economies will increase.

V. Risks to the Economic Outlook

An improvement in lead indicators of global growth momentum in the last few months has helped to mitigate the risk of a hard-landing in large emerging economies. In Europe, the risk of a disorderly Greek sovereign default has been avoided to-date following the finalization of the world's biggest debt-restructuring deal – the Private Sector Involvement (PSI) – between the Greek government and its private bond holders in February 2012. The €1 trillion extra liquidity provided to the banking system in Europe by the European Central Bank helped to ease rising borrowing costs and the consequent risk of a credit crunch. Despite these positive developments, there continues to be significant downside risks to global growth prospects.

a) The re-intensification of the Euro area crisis

The future course of the crisis emanating from Europe remains central to the downside risks of global economic growth. Although this risk has been mitigated to some extent since December 2011, fundamental challenges as to how to deal with the unsustainable fiscal deficit of some Euro area economies remain unresolved. Furthermore, the path towards a resolution for Europe will not be a smooth one and it will remain vulnerable to economic and policy setbacks. Currently, governments in Europe are confronting a divided market with one group pushing governments to tighten budgets while the other reacts negatively when fiscal austerity deflates growth.

Two potential triggers for a fresh intensification of the Euro area crisis include:

- a severe recession from large and concerted government budget-tightening across Europe; and
- a drastic contraction of European banks' balance sheets, which could see banks unwinding around USD 2,600 billion worth of risky assets in their portfolios. If not properly monitored, a synchronized and large-scale deleveraging process by banks could spark financial instability and severely impact growth.

Developments in Spain and Greece will also need to be watched closely. Any further deterioration could have a contagion effect on other markets in Europe, with Italy being particularly vulnerable. A debt restructuring or default by the Euro area's third and fourth largest economies – Italy and Spain – would be devastating for Europe and the global economy as it would lead to far greater losses than the private sector could absorb, or that could be covered by any of Europe's existing or proposed rescue facilities.

b) Potential oil price hikes

Since the February 2012 edition of APEC Economic Trends Analysis, the risk of rising oil prices as a result geopolitical tensions in the Middle East has increased. Brent crude prices regained early-2011 highs in March, underpinned by concerns about supply disruptions. Further increases in oil prices could occur, particularly if unrest were to spread to other large oil producers. In an extreme scenario, increased tensions in Iran could shut the transit of oil through the Strait of Hormuz, equivalent to 20% of global oil production and 5% of gas. If that were to occur, oil prices could be pushed upward by 20%, equivalent to a USD 24 increase on the current Brent prices of USD 120 per barrel.

The net effect of further oil price increases on global growth would be negative. According to the International Energy Agency (IEA)[8], a sustained USD 24 increase in the price of oil would subtract as much as 1.5 percentage points off global growth. This would reduce the IMF forecast for global growth from 3.5% to 2.0% in 2012.

[8] According to the IEA, a USD 10 increase in oil price potentially reduce global growth by 0.5 percentage points

VI. APEC Economies: Implications of Downside Risks

APEC businesses remain vulnerable by a re-intensification of the Euro area crisis

As seen in late 2011, the intensification of the Euro area's sovereign debt crisis has created an uncertain business environment, causing firms to scale back investments. Going forward, if the Euro area crisis were to deteriorate further, businesses and firms in the APEC region would be affected through four channels:

a) A sharp contraction in aggregate demand

A recent Asian Economic Monitor (AEM) report[9] by the Asian Development Bank illustrated that if the Euro area's GDP in 2012 were to contract sharply (e.g. contracting by 3.9% vis-à-vis the current forecast of a 0.1% contraction) as the result of an intensification of the crisis, economic growth could slow to 1.6% in both the United States and Japan in 2012. The negative impact of such a scenario would be larger for Hong Kong, China and Singapore – with 2012 GDP growth 1.2 and 2.0 percentage points below their baseline forecasts, respectively. GDP growth in China and Chinese Taipei would also fall by 1.2 percentage points due to their large trade exposure to Europe. For major ASEAN economies, the crisis could subtract between 0.5 to 0.8 percentage point off the 2012's GDP growth baseline forecasts.

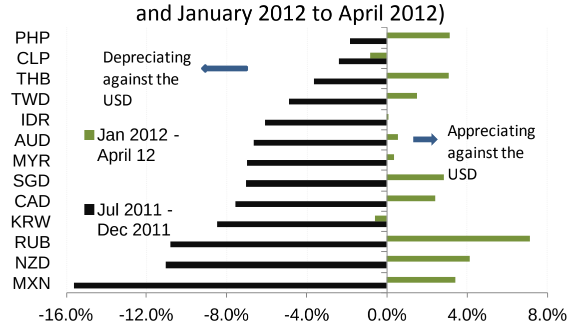
Any economic downturn in the world economy would directly affect the APEC region's business environment by reducing market opportunities. After being battered by the 2008-09 global financial crisis and then again by the global slowdown in 2011, some businesses may not be able to survive another round of global turmoil.

b) Increased exchange volatility

Global financial instability is typically associated with a reduced risk appetite and increased market volatility. This in turn can result in sharp fluctuations in the currency markets. In particular, financial instability makes the carry-trade less appealing, thus putting downward pressure on perceived 'risky' currencies. On the other hand, currencies that are perceived as a 'safe-haven' would see large appreciation.

Currency fluctuations were evident in the global financial crisis of 2008-09 and again in 2011. During both of these periods, many APEC economies experienced abrupt and large capital flows, leading to sharp depreciation in their nominal exchange rate. The Mexico peso, for example, depreciated by almost 16%, over the period between July 2011 to December 2011, as the crisis in the Euro area intensified (Figure 18). On the other hand, larger APEC economies, such as the United States and Japan, experienced substantial capital inflows, leading to marked appreciation of their currency. The Japanese yen reached record highs on a nominal basis in late 2011, gaining as much as 7.4% against the USD in 2011.

Figure 18: Large fluctuations in the nominal values of the currency of selected APEC economies
(% change over two periods: July 2011 – December 2011 and January 2012 to April 2012)



Source: Thomson Reuters and APEC Policy Support Unit

If the Euro area debt crisis were to materialize into a full-scale crisis, there could be precipitous fluctuations in the currency of many APEC economies, similar to that experienced during the global financial crisis of 2008-09. Unexpected fluctuations in the value of foreign currencies would increase commercial risk, introduce uncertainty into costs and can seriously affect the profitability and solvency of businesses. .

In the case of an economy with a perceived 'risky' currency, an acute exchange rate depreciation would affect business operating costs because imported inputs would be higher as a result of the new exchange rate. On the one hand, a depreciation of the local currency would stimulate demand for goods and services of export-oriented businesses. However, in the case of global financial turmoil, most export-oriented businesses would face lower revenues as external demand collapses. The

[9] Asian Development Bank (2011), Asia Economic Monitor December 2011

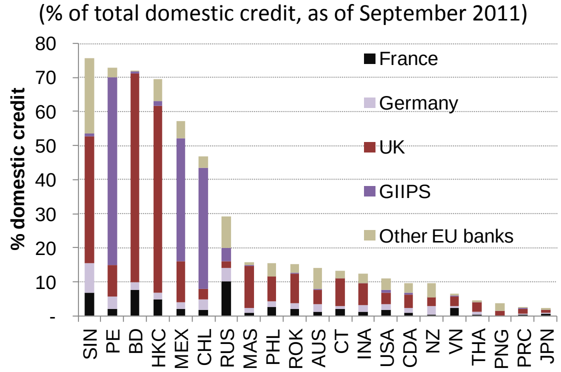
combination of lower revenues and tighter costs would squeeze profit margins, and in some cases, make some businesses unprofitable.

Currency fluctuations are particularly problematic for Small and Medium Enterprises (SMEs). Unlike large corporations that would have a contingency plan and sophisticated processes to hedge against currency risks, most SMEs typically do not have the capacity or resources to prepare for these challenges.

c) Tighter credit conditions

The ongoing sovereign and banking challenges in the Euro area have already affected credit conditions in some APEC economies. While the APEC region is not significantly exposed to the Euro area's sovereign debt, some APEC economies rely heavily on European banks for funding: EU banks account for more than 70% of total domestic credit in Brunei Darussalam; Peru and Singapore (Figure 19). As European banks are under pressure to recapitalize by July 2012, some of them have already reduced their foreign lending in order to strengthen their balance sheets. This has translated into reduced availability of funds in some APEC economies. The cost of funds in wholesale funding markets has also been rising, which in turn pushes up borrowing costs for businesses.

Figure 19: European banks' lending to selected APEC economies
(% of total domestic credit, as of September 2011)



Source: The Bank for International Settlement's Quarterly Review, March 2012

If the Euro area crisis worsens, banks may become reluctant to lend to each other due to concerns over counterparty risk. This can lead to tightened liquidity in the interbank market, thus reducing further the availability of credit and increasing funding costs. These developments would negatively impact on business operations. Asian businesses and households, which have traditionally benefited from relatively low interest rates, would potentially suffer a larger impact from rising funding costs.

d) Liquidity crunch in trade finance

About 80% to 90% of world trade is supported by trade finance.[10] During the 2008-09 global financial crisis, trade finance in advanced economies fell by 9.2% over the period between October 2008 to January 2009, compared to the decline in goods exports of 31.0%. Over the same period, trade finance in developing Asia decreased by 9.1%, relative to the fall in goods exports of 8.8%.[11]

A general liquidity squeeze and increased risk aversion to finance cross border trade operations made it increasingly difficult for banks to provide trade credit.[12] The price of trade credit also spiked due to a combination of scarce liquidity and a re-assessment of customer and country risks.

As European banks deleverage in order to boost their capital adequacy ratios as a cushion against any fallout of the Euro area debt crisis, one of the non-core assets at risk is trade finance in Asia. If the Euro area crisis deteriorates, a substantial contraction in the supply of trade finance could occur due to a liquidity squeeze and re-pricing of risks. The interruption to trade credit lines would severely affect import and export businesses in the APEC region because they would not be able conduct their normal trade.

Net impact of oil price hike on APEC would be negative

The APEC region as a whole is a net importer of oil. While oil is imported from a number of different economies, four of those (Iran, Saudi Arabia, United Arab Emirates and Venezuela) provided over half of the region's imports. By far, the largest share of oil trade from the Middle East is destined for Asia, reflecting the region's large share of demand as well as its own limited crude oil production. Therefore, an intensification of geopolitical tensions in this area would significantly impact on the oil supply flow to

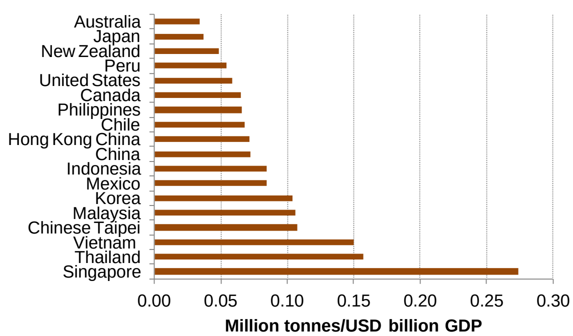
[10] International Chamber of Commerce (2010), Global Survey: Rethinking Trade Finance; and WTO (2009), Restoring Trade Finance during a period of Financial Crisis, Staff Working Paper ERSD-2009-16.
[11] Asmundson, T., Dorsey, T., Khachatryan, A., and Saito, M. (2011), Trade and Trade Finance in the 2008-09 Financial Crisis, IMF Working Paper.
[12] IMF and BAFT Trade Finance Survey (2009).

Asia, which in turn would translate into higher costs for oil imports.

Economic growth in net oil importers (e.g. Australia; Chile, China; Hong Kong, China; Japan; New Zealand; Peru; the Philippines; Korea; Singapore, Thailand and the United States) would be negatively affected by higher oil prices. This is because sustained high oil prices would result in reduced real disposable income, deteriorating terms of trade and rising costs of oil inputs. The degree of the impact on net oil-importing economies depends on both their level of oil intensity and the proportion of oil used in total energy consumption.

An economy with relatively high oil intensity[13] and high reliance on oil as the source of energy consumption would be more adversely affected by rising oil prices than an economy with lower oil intensity. As shown in Figure 20, industrialized APEC economies tend to have lower levels of oil intensity than APEC emerging and developing. This partly reflects the adoption of less oil-intensive technology as well the expansion of the service sectors within their domestic economies.

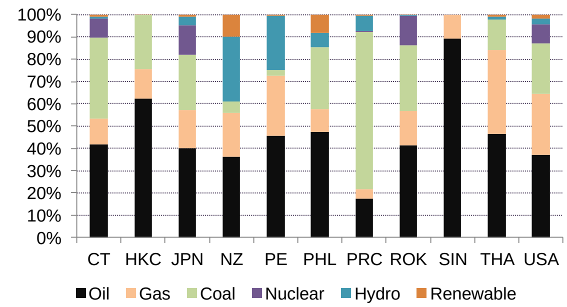
Figure 20: Indicators of oil intensity[14]: Selected APEC economies 2010



Source: BP Statistical Review of World Energy 2011, IMF WEO April 2012

The direct impact of sustained high oil prices would be larger for some emerging and developing economies - such as Korea; Malaysia; the Philippines; Chinese Taipei and Thailand - as they have relatively a high level of oil intensity. In these economies, oil is also the primary source of energy consumption, accounting for more than 35% of total energy use (Figure 21).

Figure 21: APEC's net oil importers: Mix of energy use in 2010



Source: BP Statistical Review of World Energy 2011

Singapore is an interesting case. The impact of high oil prices on the economy would be negative, as oil accounts for 89% of total primary energy consumption, the highest among all APEC economies. However, the magnitude of the impact is unclear. Among APEC economies for which data is available, Singapore has the highest level of oil intensity. However this reflects its role as a regional importer and refiner of crude oil and exporter of petroleum products, rather than high levels of domestic oil consumption.

In comparison to industrialized economies, China has a relatively higher level of oil intensity as a result of rapid industrial growth and increases in its automobile ownership. However, oil accounts for less than 20% of total energy consumption. The primary source of energy in China comes from coal, which accounts for 70% of total primary energy consumption. This indicates that the impact of high oil prices on China can be mitigated to some extent.

Not surprisingly, increases in oil prices are more often than not beneficial for net oil exporters (e.g. Canada; Indonesia; Malaysia; Mexico; Russia and Viet Nam). This is usually true when rising oil prices are led by an increase in world aggregate demand. The gain in real income associated with the improvement in the terms of trade and higher export volumes would be more than offset increases in costs for businesses and households.

However, if an increase in oil prices is associated with supply disruptions from other oil exporters, the net benefit for oil exporters in the APEC region may be reduced. This is because lower economic growth in the economies of their main trading partners would depress demand for oil as well as demand for other

[13] High oil intensity indicates that an economy is relatively more reliant on oil as an input to production than in an economy with lower oil intensity

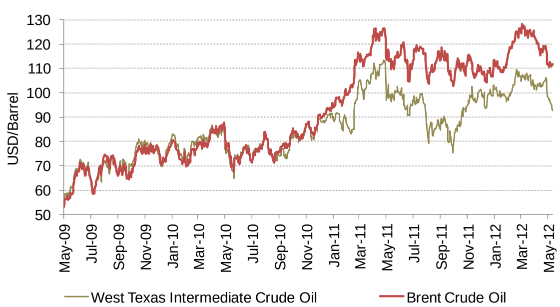
[14] In this report, oil intensity is calculated as the ratio of total oil consumption and level of GDP

non-oil commodities. The positive effects could be further reduced if higher oil prices have spill-over effects on other commodity, raising the price of their imported commodities.

Canada, for example, has not benefited from recent rises in the price of oil, despite the fact that it is a net oil exporter. As the current evolution in oil prices has been largely driven by concerns over supply disruptions from certain oil producing markets in the Middle East, the price of oil that Canada imports (more closely tied to Brent crude oil) has increased. On the other hand, new production of crude oil in North Dakota and Canada and decreased U.S. demand have limited the increases in price of oil that Canada exports (more closely tied to West Texas Intermediate (WTI)) (Figure 22). By itself, the wedge between the price of oil that Canada imports and the price of oil it exports could deteriorate its terms of trade, which in turn reduces gross domestic income.

The increase in the price of imported-oil has also raised production costs for Canadian firms. Furthermore, as half of the gasoline consumed in Canada is produced from imported crude oil, consumers and businesses have been faced with higher gasoline prices. Together, rising costs and reduced income have dampened spending on domestically produced goods and services.

Figure 22: Recent evolution in oil prices: Brent versus West Texas Intermediate (WTI) crude oil



Source: Thomson Reuters

VII. Concluding Remarks

After a year which has seen a deepening crisis in the Euro area, volatile stock market activity and devastating natural disasters, 2012 is proving to be another challenging year for the global economy. For APEC, the short-term economic outlook will continue to be influenced by global economic and financial developments. A re-intensification of the crisis in the Euro area could setback growth in the APEC region, with small and open economies being the most vulnerable. There are also concerns over oil supplies if Middle East sources are disrupted.

A potential worsening of the Euro area crisis would create an uncertain business environment, causing firms to scale back investment, and negatively impacting on business activity through four channels:

- A sharp contraction in aggregate demand;
- Increased exchange volatility;
- Tighter credit conditions; and
- Liquidity crunch in trade finance

The APEC region as a whole is a net importer of oil. Sustained and large increases in oil prices could result in reduced real disposable income, deteriorating terms of trade and rising costs of oil inputs, thereby reducing the region's overall economic growth.

Despite the external challenges confronting APEC, the region as a whole is expected to outperform global trends in the period ahead, with APEC growth forecast to accelerate to 4.3% in 2012 and 4.7% in 2013. Significantly, industrialized APEC economy GDP is expected to stay strong with a 2.1% pick-up in 2012 while industrialized economies outside the region are facing the prospect of a mild recession of 0.1%. Developing and emerging APEC members' GDP growth is meanwhile forecast to soften to 6.3% in 2012. Yet they will remain the world's fastest growing economies, contributing more than 50 percent of global real GDP growth.

The APEC Policy Support Unit provides APEC members and fora with professional and tailor-made research, analysis, policy support and evidence-based policy suggestions.

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