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INTERNATIONAL ECONOMIC PERFORMANCE AND COOPERATION

International Economic Performance and Cooperation

Overview

Moderate global expansion

The global economy is expected to remain on a moderate and uneven growth trajectory in 2014 supported by a pickup in the US and the UK along with a steady, albeit lower pace of expansion, in major emerging market economies. Improvements in the euro area and Japan during the second half of the year are also expected to contribute positively to world economic activity. Asian economies, including China, India and major ASEAN countries, are expected to continue to drive global economic growth.

In the first half of 2014, the expansion in advanced economies gained strength. Growth in the US picked up in the second quarter, after the most severe winter, the coldest in 60 years. Increased consumer spending, higher fixed investment and net exports supported the expansion. The nascent recovery in the euro area economies gained traction with uneven growth across the region. Meanwhile, the UK registered robust growth supported by broad-based expansion in all sectors. In Japan, the economy expanded moderately as the impact of the 2013 stimulus measures abated while consumption weakened due to the increase in sales tax since April 2014. Among the emerging economies, the pace of growth moderated, particularly in China, which showed signs of stabilisation. China implemented reform measures to sustain growth, including tax relief for exporters, accelerated fiscal spending as well as targeted monetary easing to increase lending. India recorded stronger growth as the energy sector strengthened, while the agriculture sector rebounded. Growth in Russia slowed, given the geopolitical tensions, while growth in Brazil

remained sluggish. Major ASEAN economies, including Malaysia, the Philippines, Indonesia and Viet Nam continued to register strong growth, supported by domestic demand and exports.

In the second half of 2014, the expansion in the US is expected to gain strength as unemployment eases and consumer sentiment improves further. The euro area is projected to grow at a modest pace, supported mainly by an accommodative monetary policy. Meanwhile, growth in Japan is expected to strengthen as the impact of the consumption tax fades and monetary stance remains accommodative. Growth in China is expected to remain steady backed by government support measures to sustain growth. India's economy is also envisaged to improve following measures taken by the government to boost investment.

The risks to global growth are overall better balanced although somewhat tilted to the downside. Challenges in the advanced economies include persistently high unemployment and sluggish productivity, particularly in the euro area, high public sector and household debts as well as fragilities in the financial sector. Prolonged low inflation in the euro area could lead to deflation and hence the need for further monetary easing. In addition, as the US normalises its accommodative monetary policy, it will have spillover implications, particularly for emerging economies. This can lead to large capital outflows from emerging markets, which could exert downward pressure on global growth. Gradual monetary policy tightening measures in the US coupled with accommodative macroeconomic policies and structural adjustments in the euro area and Japan may avoid shocks to global financial markets.

Meanwhile, growth in emerging market economies may be affected, as a result of cyclical slowdown, given their domestic weaknesses, such as infrastructure shortages, large budget deficits and inflationary pressures, as well as external uncertainties. The financial and credit conditions are expected to be tightened further, thus impacting growth. Furthermore, geopolitical tensions in various regions and Ebola outbreak in Western Africa are expected to exert downward pressures on global growth with possible spillover effects. Overall in 2014, global growth is expected to remain stable at 3.3% (2013: 3.3%) with stronger growth in advanced economies at 1.8% (2013: 1.4%) and slightly slower growth in emerging markets at 4.5% (2013: 4.7%). The expansion is expected to be supported by slightly stronger

growth of 3.9% (2013: 3%) in world trade following higher demand in the US and emerging economies. Meanwhile, foreign direct investment (FDI) flows are expected to rise 10.3% to USD1.6 trillion (2013: 9.2%; USD1.5 trillion) mainly driven by investments in developed economies that have started to recover.

Global Economic Performance

Developing Asia leads growth

The **US** economy grew 2.2% during the first half of 2014 (January – June 2013: 1.8%) supported by a stronger pickup in the second quarter despite a slowdown in the first quarter due to a severe winter. Growth was contributed mainly by an upturn in private investment which rose sharply by 6.1% (January – June 2013: 2.5%). Fixed investment expanded 4.9% (January – June 2013: 4.3%) attributed to growth in non-residential assets at 5.6% (January – June 2013: 2.3%). In addition, personal consumption expenditure grew at a stable pace of 2.3% (January – June 2013: 2.3%) driven by higher demand for big-ticket items such as automobiles, appliances and home electronics. The economy also gained from moderate growth in exports of goods and services which increased 3.4% (January – July 2013: 2.7%), mainly contributed by automotive vehicles, parts and engines, consumer goods, travel and transport as well as maintenance and repair services.

On the supply side, industrial production rose to 4.2% (January – August 2013: 2%) with capacity utilisation increasing slightly to 78.9% (January – August 2013: 77.7%), mainly contributed by increased production of automotive vehicles and parts as well as consumer goods. Manufacturing activity picked up as reflected by an increase in the Institute for Supply Management manufacturing index to 55 points (January – August 2013: 52.8 points). However, the housing industry weakened as reflected by lower new home sales, housing starts and building permits during the first half of 2014. Consequently, residential investment

TABLE 2.1

Real GDP for Selected Economies 2013 – 2015

	2013	Change (%)	
		2014 ¹	2015 ²
World	3.3	3.3	3.9
Advanced economies	1.4	1.8	2.3
United States	2.2	2.2	3.1
Euro area	-0.4	0.8	1.3
Japan	1.5	0.9	0.8
Emerging and developing economies	4.7	4.5	5.0
China	7.7	7.4	7.1
Republic of Korea	3.0	3.7	3.8
India	5.0	5.6	6.4
ASEAN			
Singapore	3.9	3.0	3.0
Thailand	2.9	1.5 – 2.0	4.6
Indonesia	5.8	5.2	5.5
Philippines	7.2	6.2	6.3
Viet Nam	5.4	5.5	5.6
Malaysia	4.7	5.5 – 6.0	5.0 – 6.0

¹ Estimate.

² Forecast.

Source: International Monetary Fund and national authorities.

slowed significantly to 2.2% (January – June 2013: 13.3%). Retail sales grew 3.9% (January – August 2013: 3.4%), supported by strong sales in health and personal care products, motor vehicles as well as food and beverage. Inflation increased 1.8% (January – August 2013: 1.6%) due to higher prices of rental, food and beverage.

The US Federal Reserve (Fed) has tapered the third quantitative easing from USD85 billion in December 2013, reducing monthly asset purchases by USD10 billion at each of its last six Federal Open Market Committee meetings, to USD25 billion in August 2014. The reduction in the pace of asset purchases will progress in measured steps if improvements in the labour market continue and inflation moves towards its longer-term objective target of 2%. The unemployment rate has trended down to 6.4% (January – August 2013: 7.6%) mainly due to job creation in the manufacturing and services sectors. The Fed has indicated that the federal fund rate, which is currently low at between 0% and 0.25%, will be increased sooner than expected if the labour market improves significantly. Overall growth for the year is anticipated to remain strong at 2.2% (2013: 2.2%) mainly supported by better job creation, stronger consumer confidence and higher business profits.

During the first half of 2014, economic activity in the **euro area** turned around to register a marginal growth of 0.9% (January – June 2013: -0.9%) with uneven recovery across countries. Among the larger economies, Germany, France, Spain and the Netherlands grew at a modest pace, while Italy's growth remained subdued. Significant improvements were seen in Spain with growth rebounding at 0.9% (January – June 2013: -1.8%), largely due to the implementation of economic, financial and fiscal reform programmes since 2012. Meanwhile, some of the periphery economies, including Poland and Portugal also registered improved growth.

Growth in the euro area was supported by investment, which rebounded to 1.6% (January – June 2013: -4.4%), while household

consumption grew 0.7% (January – June 2013: -1%), mainly due to higher credit supply following improved financial market sentiments. On the supply side, most sectors registered positive performance, except for construction as well as information and communication services, which declined 0.8% and 0.3%, respectively (January – June 2013: -5.1%; -1.1%). Meanwhile, efforts to revive growth, improve fiscal and bank balance sheets as well as implement structural reforms in the euro area have also slowed down, affected by the lacklustre growth momentum among the largest economies and the prolonged disinflationary pressures in the region.

The unemployment rate was slightly lower at 11.6% (January – July 2013: 12%) with wide divergence across the area. In July 2014, unemployment ranged from a low of 4.9% in Austria, Iceland and Germany to a high of 24.5% in Spain. The inflation rate trended down to 0.6% (January – August 2013: 1.6%) despite continuous measures introduced by the European Central Bank (ECB) to maintain an accommodative monetary policy that would revitalise growth. In August 2014, inflation remained at its lowest rate since October 2009 at 0.4% due to lower prices of food and energy. In an effort to stimulate economic growth and boost inflation to 2%, effective 10 September 2014, the ECB further lowered the interest rates on main financing operations, marginal lending facility and deposit facility by 10 basis points (bps) each to 0.05%, 0.30%, and -0.20%, respectively. The ECB has also announced additional measures to further loosen monetary policy in the euro area. These include a series of targeted longer-term refinancing operations beginning September 2014, aimed at improving lending in the euro area, as well as the purchase of asset-backed securities and covered bonds starting from October 2014. In 2014, growth in the euro area is expected to increase modestly by 0.8% (2013: -0.4%) weighed down by prolonged disinflationary pressures; increased unemployment in some countries; geopolitical tensions between Russia and Ukraine followed by a series of EU sanctions imposed on Russia; conflicts in the Middle East; as well as a slowdown in key emerging markets.

GDP growth in **Germany** rose 1.8% during the first six months of 2014 (January – June 2013: 0.1%), supported by stronger domestic demand amid a weak external sector. Improved domestic conditions boosted household spending, investment and government expenditure. Household consumption increased 1% (January – June 2013: 0.5%) while investment rose markedly by 5% (January – June 2013: -3.5%), particularly in machinery and equipment at 4.5% (January – June 2013: -5%). Favourable weather conditions facilitated construction activities with investment in construction growing 6.7% (January – June 2013: -3.2%).

On the supply side, all sectors recorded positive growth. Manufacturing growth was favourable at 2.5% (January – June 2013: -1.8%), with the Purchasing Managers Index (PMI) increasing to 53.4 points (January – August 2013: 49.7 points). The construction sector was revitalised, registering a growth of 6.5% (January – June 2013: -4.3%), following a mild winter that facilitated public underground construction works. The services sector remained upbeat, spearheaded by higher performance in trade, transport, accommodation and food services subsectors, which rose 2.1% (January – June 2013: -0.7%). Inflation dropped to 0.9% (January – August 2013: 1.7%), mainly due to lower energy prices. Meanwhile, the labour market has been strengthening gradually, with the unemployment rate falling to 5.1% (January – July 2013: 5.4%), among the lowest in the region, after Austria. Nevertheless, lower growth in France, a key trading partner; the Ukraine-Russia crisis, followed by the imposition of EU sanctions against Russia; and slower external demand are expected to weigh on the pace of economic activities in Germany. In 2014, growth in Germany is anticipated to increase 1.4% (2013: 0.5%).

In **France**, GDP remained weak at 0.5% in first half of 2014 (January – June 2013: 0.2%), largely due to lower domestic demand, uncertain external conditions and prolonged disinflationary pressures. Household consumption continued to contract 0.2% (January – June 2013: -0.3%) due to weaknesses in the labour market, which

TABLE 2.2

Inflation Rate for Selected Economies 2013 – 2014

	Change (%)	
	2013	2014 ¹
World	3.3	3.7
Advanced economies	1.4	1.6
United States	1.5	2.0
Euro area	0.8	1.0
Japan	0.4	2.7
Emerging and developing economies	5.9	5.5
China	2.6	2.3
Republic of Korea	1.3	1.6
India	9.5	7.8
ASEAN		
Singapore	2.4	1.4
Thailand	2.2	2.1
Indonesia	6.4	6.0
Philippines	2.9	4.4
Viet Nam	6.6	5.2
Malaysia	2.1	3.4

¹ Estimates.

Source: International Monetary Fund and national authorities.

resulted in prolonged unemployment. Furthermore, the increase in value-added tax during the first quarter of 2014 further weakened household spending.

On the supply side, manufacturing output expanded moderately by 0.5% (January – June 2013: -2.3%) largely supported by an increase in the production of transport equipment which rose 3.4% (January – June 2013: -3.3%). Construction activity also turned around and grew 1.4% (January – June 2013: -3.2%) largely due to the extension of the Paris Metro Line 14. Inflation trended downwards to 0.7% (January – August 2013: 1.1%) as disinflationary pressures showed no signs of abating. The unemployment rate remained high at 10.2% (January – July 2013: 10.4%). France's economy is expected to increase marginally by 0.4% in 2014 (2013: 0.3%).

The **UK** registered a robust growth of 3.1% during the first half of 2014 (January – June 2013: 1.3%), supported by broad-based expansion in all sectors. Domestic demand continued to increase bolstered by higher private investment and household consumption following improvements in credit conditions and improved consumer confidence. On the supply side, the manufacturing sector recorded a healthy expansion of 3.5% (January – June 2013: -0.8%) contributed by rising optimism among domestic producers. The construction sector expanded 5.8% (January – June 2013: 1.8%), benefiting from vibrant home building activities following steady demand for housing boosted by low interest rates. Meanwhile, the services sector registered a buoyant performance with growth at 3.1% (January – June 2013: 1.9%) underpinned by strong expansion in the distribution, hotels and restaurants (5%) as well as the business services and finance (3.9%) subsectors.

The unemployment rate was lower at 6.6% (January – June 2013: 7.8%), largely due to higher job creation in the private sector. However, wage pressures and productivity gains remained weak. Consequently, inflation was also lower at 1.7% (January – June 2013: 2.7%), and for the first time since November 2009, below the 2% target set by the Bank of England (BOE). This was also partly due to lower food and energy prices as well as the recent appreciation of the pound sterling that pushed down import prices. The BOE has maintained its policy rate at 0.50% since 5 March 2009 to spur economic growth. The BOE also decided to maintain the stock of purchased assets financed by the issuance of its reserves at GBP375 billion to stimulate domestic demand and increase prices. Going forward, broad-based growth momentum in the UK is expected to continue, despite faltering external demand, particularly from the euro zone and key emerging markets. Domestic demand is envisaged to be stronger bolstered by improvements in employment, credit availability and confidence in the economy, while the services sector is expected to remain the key driver of growth.

Amid these developments, the UK's economic growth is projected to increase 3.2% in 2014 (2013: 1.7%).

During the first half of 2014, **Japan's** GDP expanded 1.5% (January – June 2013: 0.6%), largely driven by exports and private investment. Exports increased significantly by 7.5% (January – June 2013: -1.8%) due to a weaker yen and improved exports to the EU, mainly motor vehicles and capital goods. Meanwhile, private investment also surged 9.4% (January – June 2013: -4.9%), particularly due to the increase in production in the first quarter, to meet the high demand before the sales tax hike to 8% in April 2014. In contrast, private consumption growth slowed to 0.5% (January – June 2013: 1.5%) mainly due to the effect of the sales tax hike in the second quarter.

On the supply side, the manufacturing sector expanded as indicated by growth in industrial production, partly in response to the front-loaded increase in demand. Production of business-oriented machinery rose contributed by higher demand from domestic businesses and exporters. Production of electronic parts and devices also expanded on account of high demand for smartphones and tablets. This was reflected in the manufacturing PMI, which averaged 52.7 points (January – June 2013: 50.3 points). Inflation accelerated 2.7% (January – August 2013: -0.1%) mostly due to the sales tax increase in April 2014. This was in line with the government's effort to counter deflation. Unemployment decreased to 3.7% (January – August 2013: 4.1%), as the number of new job offers rose. The Bank of Japan maintained its policy rate between 0.00% and 0.10% to boost economic growth as well as continued its quantitative and qualitative monetary easing. Japan's GDP is projected to register a growth of 0.9% in 2014 (2013: 1.5%).

China's economy grew 7.4% in the first half of 2014 (January – June 2013: 7.6%), following improved external demand coupled with government reform measures, aimed at stabilising the economy.

Exports grew marginally by 0.9% (January – June 2013: 10.3%) partly owing to the inflated base effect of 2013, while imports grew at a slower pace of 1.5% (January – June 2013: 6.7%) due to weakening of the yuan. Private consumption strengthened with per capita income of urban and rural households increasing 9.6% and 12%, respectively (January – June 2013: 9.1%; 11.9%), as a result of better labour market conditions. Meanwhile, investment in fixed assets grew 17.3% (January – June 2013: 20.1%). This was supported by growth in primary industry investment at 24.1% (January – June 2013: 33.5%), particularly in the agriculture sector, following the reserve requirement ratio cuts for rural banks to encourage lending for small companies and agriculture. Investment in real estate subdued at 14.1% (January – June 2013: 20.3%) as sales and new property construction slipped.

The manufacturing sector remained stable, as indicated by the manufacturing PMI which averaged 50.5 points (January – June 2013: 50.5 points). This was a result of improved external demand as well as support measures to facilitate trade and domestic economic activities. Retail sales grew at a slower pace of 12.1% (January – June 2013: 12.7%), mainly due to the sluggish motor vehicles sales following the new guideline to reduce public sector spending on motor vehicles. However, online sales registered strong growth at 48.3%, leveraging the role of technology innovation in spurring growth. The CPI eased to 2.2% (January – August 2013: 2.5%) due to moderating food prices, particularly for meat and vegetables. Unemployment in China remained at 4.1% (January – June 2013: 4.1%) following the nationwide scheme to help graduates secure jobs. The People's Bank of China has maintained its policy rate at 6.00% since July 2012 to support the economy. China's GDP is projected to grow 7.4% in 2014 (2013: 7.7%).

The Republic of Korea (ROK) recorded a growth of 3.8% during the first half of 2014 (January – June 2013: 2.4%), mainly supported by an upswing in private investment and better

performance in the manufacturing and services sectors. The ferry tragedy in April 2014 and high household debt impacted private consumption, which grew marginally by 2% (January – June 2013: 1.9%). Nevertheless, consumer confidence improved as shown in the consumer sentiment index, which increased to an average of 107.5 points (January – June 2013: 103.2 points). Meanwhile, exports trended downwards to 4.1% (January – June 2013: 5.8%) due to the strengthening of the won, the uneven recovery in Europe as well as lower demand from China. Private investment rose significantly to 7.6% (January – June 2013: -8.5%), particularly contributed by higher investment in automobiles and other transport equipment subsectors.

On the supply side, growth in the manufacturing sector increased 5.5% (January – June 2013: 2.3%) on the back of higher demand for vehicles, chemical and liquid crystal display products. Likewise, the services sector grew 3.1% (January – June 2013: 2.5%) as health and social work as well as business activities increased. The unemployment rate edged up to 3.5% (January – June 2013: 3.2%) due to an increase in the number of jobseekers entering the labour market. Inflation grew at a steady pace of 1.4% (January – August 2013: 1.5%), mainly due to the marginal increase in prices of clothes and utilities. The government announced stimulus measures in July 2014 to bolster the property market and increase public spending. These include a rise in government spending by more than USD11 billion as well as a total of USD25.4 billion allocated for small and medium-sized companies through loans and other financial support. Mortgage rules that limit household loans for home buyers were eased in order to stimulate the real estate market. The Bank of Korea cut its key interest rate further in August 2014 by 25 bps to 2.25%, the lowest rate since November 2010, in a bid to improve the property market conditions and shore up the economy. Overall, the ROK is forecast to register a growth of 3.6% in 2014 (2013: 3%).

India registered a stronger growth of 5.2% in the first half of 2014 (January – June 2013: 4.6%), largely due to a healthy growth in the energy sector and a rebound in the agriculture sector. The energy sector expanded strongly by 8.7% (January – June 2013: 2.4%) due to higher electricity generation to cater for the high demand, while the agriculture sector grew 5.1% (January – June 2013: 2.8%) supported by robust farm output amid a good harvesting season. Private consumption expanded 6.9% (January – June 2013: 5.4%) attributed to higher motor vehicle purchases. Gross fixed capital formation increased 3.1% (January – June 2013: 0.3%) on account of the improving investment climate, including implementing stalled projects, easing labour regulations and expediting approvals. The manufacturing sector experienced a marginal growth of 1.1% (January – June 2013: 0.9%) due to higher production of copper and copper products, cable, rubber-insulated products as well as vitamins. Meanwhile, mining activity turned around with growth at 0.9% (January – June 2013: -4.4%), attributed to the lifting of the mining ban in Goa in April 2014. The economy also benefited from a strong growth in services led by the finance, insurance, real estate and business services subsector, which grew 11.4% (January – June 2013: 12.1%). Exports increased 4.7% (January – June 2013: 2.2%) driven by higher demand for engineering goods, ready-made garments and petroleum products, while imports expanded 9.4% (January – June 2013: 1.9%) due to higher oil imports as well as the lifting of import restriction on gold.

Inflation, as measured by the wholesale price index, trended downwards to 5.6% (January – June 2013: 5.8%) as prices of onion and vegetables fell while fuel cost rose marginally. The Reserve Bank of India increased its key policy repo rate by 25 bps to 8.00% in January 2014 and has maintained it to contain inflation. In an effort to further improve the investment environment, in July 2014, the new government announced higher equity limits for FDI in the defence and insurance sectors from 26% to 49%. Additionally, in August 2014, the government liberalised railway infrastructure investment ownership to 100%

foreign equity as well as set up eight electronic manufacturing hubs and seven manufacturing electronic clusters across the country. Given these policy measures, India's growth is expected to be higher at 5.6% in 2014 (2013: 5%).

Australia's economy grew 3.3% in the first half of 2014 (January – June 2013: 2.6%) driven by increases in net exports, consumption and private investment. Net exports increased mainly contributed by travel and tourism-related services, while consumption rose due to both government and household expenditure. The increase in private investment was driven by higher construction activities which rebounded to 1% (January – June 2013: -0.4%). The unemployment rate increased to 6% (January – September 2013: 5.9%) as a result of a slowdown in the mining sector, which also affected employment in related industries such as construction and technical services. Inflation remained within the target range at 3% (January – June 2013: 2.4%), driven by higher costs of healthcare, new housing and furniture. The Reserve Bank of Australia has maintained its main policy interest rate at 2.50% since October 2013 to cope with a slowdown in the mining sector. In 2014, Australia's GDP growth is expected to remain stable at 2.8% (2013: 2.3%) supported by growth in transport, information technology, as well as food and beverage industries, while growth in the mining sector remains subdued given the slowdown in coal and iron ore exports to China, its largest trading partner.

In the first half of 2014, the ASEAN economies recorded positive growth, underpinned by strong domestic demand and exports, particularly in Malaysia, the Philippines, Indonesia, Viet Nam and Singapore. **Indonesia's** GDP grew at a slower pace of 5.2% (January – June 2013: 5.9%), the lowest level registered since the first half of 2011, amid contraction in exports and reduced government consumption. Exports contracted 0.7% (January – June 2013: 4.2%) due to the ban on exports of unprocessed minerals and metals, enforced on 12 January 2014. Government consumption moderated to 1.2% (January – June 2013: 1.4%) partly due

to lower public expenditure. On the supply side, growth was mainly supported by transport and communication at 9.9% (January – June 2013: 10.7%) as well as construction industries at 6.6% (January – June 2013: 6.9%). Inflation rose slightly to 6.6% (January – August 2013: 6.3%) mainly due to the lingering effect of the sharp increase in fuel prices in June 2013. Bank Indonesia has maintained its policy rate at 7.50% since November 2013 to curb the inflationary impact of the fuel price hike and support the depreciating rupiah. Overall growth for 2014 is expected to be slower at 5.2% (2013: 5.8%).

The **Philippines'** GDP moderated to 6% during the first half of 2014 (January – June 2013: 7.8%), due to slower growth in the industry and services sectors. Growth in the industry sector slowed down to 6.6% (January – June 2013: 10.9%) due to deceleration in several subsectors mainly construction, utilities and manufacturing. The services sector grew at a slower pace of 6.4% (January – June 2013: 7.2%) contributed by moderate growth in financial intermediation and government services. Meanwhile, exports posted a double-digit growth of 11.8% (January – June 2013: -9.1%) following increased demand for mineral products as well as agro-based and forest products. Inflation rose to 4.4% (January – August 2013: 2.8%), mainly due to the enduring impact of Typhoon Haiyan in 2013, particularly on food, fuel and electricity prices. Consequently, the Bangko Sentral ng Pilipinas increased its policy interest rate by 25 bps to 3.75% in July 2014, the first increase since October 2012 and again in September 2014 to 4.00% in order to curb inflationary pressures. Overall growth for 2014 is envisaged to remain strong at 6.2% (2013: 7.2%).

In **Thailand**, GDP shrank 0.1% (January – June 2013: 4.2%) due to the prolonged political turmoil in the first five months of 2014, slower growth of exports and continuous decline in car production and sales. Political uncertainty led to a contraction in private consumption and total investment of 1.4% and 8.1%, respectively (January – June 2013: 3.4%; 5.2%). Exports shrank 0.6% (January – June 2013: 5.6%) due

to slower global economic recovery and decline in export prices. In addition, car production and sales contracted sharply by 24.1% and 44.4%, respectively, contributing to a decline in manufacturing production and private consumption. Meanwhile, the tourism industry, a key contributor to the economy, remained weak as foreign tourist arrivals contracted 10.1% (January – June 2013: 23.2%) amid sociopolitical and security issues. Inflation eased to 2.2% (January – August 2013: 2.5%) as the new military administration capped prices in several categories of household goods, particularly diesel and cooking gas. In March 2014, the Bank of Thailand lowered its policy rate from 2.25% to 2.00%, the lowest level since December 2010, to lend more support to the economy. Thailand's GDP is projected to grow by 1.5% – 2% in 2014 (2013: 2.9%) contributed by an expected pickup in factory output, exports, tourism and investment in the second half of the year.

Singapore's economy expanded 3.6% during the first half of 2014 (January – June 2013: 2.8%) mainly driven by manufacturing activities. The manufacturing sector registered a strong growth of 5.7% (January – June 2013: -2.8%). This was mainly supported by a sharp rebound in the biomedical manufacturing cluster and robust growth in the chemicals and transport engineering clusters in the first quarter. Meanwhile, the construction sector moderated to 5.4% (January – June 2013: 5.8%) following sluggish private sector construction activities. The services sector grew 3.3% (January – June 2013: 5%), largely contributed by the finance and insurance as well as transportation and storage subsectors. Inflation eased to 1.5% (January – August 2013: 2.6%) due to moderation in car prices and housing costs. The economy is expected to grow 3% for the year (2013: 3.9%), buoyed by a favourable external environment, particularly the strengthening of the US economy.

In the first half of 2014, the GDP of **Viet Nam** grew 5.2% (January – June 2013: 4.9%) mainly contributed by strong growth in the services as well as the industry and construction sectors. The services sector, which accounted for 43.6%

of GDP, grew 6% (January – June 2013: 5.9%) mainly contributed by tourism and travel-related activities. Additionally, the industry and construction sector, which accounted for 38.7% of GDP, grew 5.3% (January – June 2013: 5.2%) largely attributed to power generation and distribution as well as manufacturing. Meanwhile, exports grew 14.9% (January – June 2013: 16.1%) supported by global price increases for Viet Nam's key commodities, particularly pepper and cashew nuts while imports rose 11% (January – June 2013: 17.4%). Inflation has trended downwards to 4.7% (January – August 2013: 6.9%) despite increases in the prices of garments, footwear and food. The State Bank of Vietnam lowered its policy rate from 7.00% to 6.50% in March 2014, to further stimulate economic growth. Overall growth for 2014 is expected to improve slightly to 5.5% (2013: 5.4%).

In 2014, **Cambodia's** growth is expected to expand 7.2% (2013: 7%), largely driven by the garment and tourism sectors. Growth will also be contributed by increases in private consumption, construction activities and external demand as well as infrastructure and business investment. However, several downside risks such as political uncertainty, labour issue and a lower demand from China may impact Cambodia's growth. **Lao PDR** is forecast to register a moderate growth of 7.5% (2013: 8.2%) with the government's ongoing efforts in tightening fiscal and monetary policies. In addition, the services, food processing and beverage sectors are expected to grow supported by strong domestic demand.

Myanmar is anticipated to post higher growth of 7.8% (2013: 7.5%) boosted by growing investment and improved business confidence. The easing of economic sanctions has accelerated the nation's growth, especially with investment from China, ROK and Thailand, predominantly into power, petroleum and infrastructure industries. In addition, private consumption, which accounts for around 80% of GDP, is expected to remain as the major contributor to boost growth. Meanwhile, growth in **Brunei** is projected to rebound by 5.4% (2013: -1.2%) supported by gradual expansion in

the non-oil and gas sector as well as recovery in hydrocarbon production. The infrastructure construction sector is also expected to contribute to overall growth.

The **Middle East and North Africa Region** (MENA) is projected to record higher GDP growth of 2.6% in 2014 (2013: 2.3%) contributed by oil production and exports, sustained high levels of public infrastructure investment and consumer spending. Growth in **oil-exporting nations** such as Saudi Arabia, United Arab Emirates (UAE), Iraq and Qatar is expected to increase 2.6% (2013: 2.3%) benefiting from stable oil output and buoyant non-oil activity. The expansion in construction and retail trade as well as strong private sector credit are expected to drive growth in the Gulf Cooperation Council (GCC) countries, including Bahrain, Kuwait, Qatar, Saudi Arabia, Oman and UAE, while post-conflict reconstruction is anticipated to support the non-GCC countries.

Saudi Arabia is expected to register a slightly higher growth of 4.6% (2013: 4%) mainly due to strong private sector growth with government expenditure increasing moderately. Oil production is expected to remain stable at 2013 levels. Large-scale infrastructure projects and spending on housing will continue to support growth in the non-oil sector. The UAE economy is estimated to expand 4.3% (2013: 5.2%). The growth is primarily attributed to the resurgence of the non-oil segment of the economy, particularly the services and construction sectors. Government spending as well as the upswing of the property sector coupled with the hosting of the World Expo in 2020 have increased investments significantly. In Iraq, growth is expected to decline 2.7% (2013: 4.2%) due to the impact of the conflict in Northern Iraq on non-oil activity. Qatar's growth is forecast at 6.1% (2013: 6.5%), partly due to public sector investment in preparation for the 2022 World Cup. Several infrastructure projects and facilities, including stadiums and roads will be built for the event. Inflation in the oil-exporting nations is projected to drop to 6.8% (2013: 9.5%) on account of low food prices.

Meanwhile, economic growth in **oil-importing economies**, including Egypt, Sudan and Morocco is expected to remain flat at 2.6% (2013: 2.6%) amid uncertainties arising from political transitions and security concerns. Structural issues continue to dampen confidence and plague economic activity in these countries. Egypt is projected to grow 2.2% (2013: 2.1%) as political uncertainty and security issues weigh on tourism and FDI. Egypt has announced two fiscal stimulus packages amounting to 3.4% of GDP, financed through GCC aid of USD17 billion in order to boost growth. Growth in Sudan is expected to remain stable at 2.8% (2013: 2.8%) as a result of fiscal consolidation including reduction of subsidies. Morocco's economy is projected to moderate at 3.5% (2013: 4.4%) mainly due to the poor grain harvest caused by insufficient rainfall during the agricultural season. Inflation in oil-importing nations is expected to trend upwards to 8.5% (2013: 8.3%) as energy subsidies are being phased out. However, inflationary pressures will be partly mitigated by declining global commodity prices.

Economic growth in **Russia** remained stable at 0.9% in the first half of 2014 (January – June 2013: 0.9%) as the conflict with Ukraine and ensuing sanctions from the US and EU affected investment activity and consumer spending. In addition, low business confidence, constraints in accessing long-term financing and declining profits also hampered investment. Consumer spending slowed considerably mainly due to high inflation, contributed by a weakening of the ruble. Retail sales growth moderated between 2% and 3% in the first half of the year (January – June 2013: 3% – 4%). Inflation remained high at 7.1% (January – August 2013: 7.1%) and is expected to rise as the ban on food imports from Western nations takes effect. As part of efforts to contain inflation, stem capital outflow and protect the ruble from depreciating further, the Central Bank of the Russian Federation embarked on a tighter monetary policy. The key policy rate was increased three times by a total of 2.5 percentage points from 5.50% in March to 8.00% in July 2014. In contrast to weak domestic

demand, the external sector performed better with exports rebounding to 1.3% (January – June 2013: -4.2%) supported by higher volume of gas and agricultural commodities exports. Russia's growth is projected to decelerate to 0.2% in 2014 (2013: 1.3%).

In **Brazil**, GDP contracted 0.4% in the first half of 2014 (January – June 2013: 1.1%). Industrial unrest in May 2014 and slower activities due to the 2014 World Cup led to a sharp drop in manufacturing and construction output. The unemployment rate moderated slightly to 4.9% (January – August 2013: 5.7%), with more Brazilians dedicating their time to technical training as encouraged by the government in upskilling the labour force. The inflation rate remained high at 6.2% (January – August 2013: 6.4%), above the Banco Central Do Brasil (BCB) target of 4.5% on account of higher prices of food and beverage following a prolonged drought and a surge in demand due to the 2014 World Cup. The BCB increased the policy rate by 25 bps to 11.00% in April 2014 to curb inflation. Brazil is expected to register a slower pace of growth at 0.3% in 2014 (2013: 2.5%) due to tighter financial conditions and continued weakness in consumer and business confidence.

Growth in **Mexico** expanded 0.7% in the first half of 2014 (January – June 2013: -0.3%) due to higher exports of manufactured goods and recovery in the services sector. In addition, higher public spending on infrastructure projects, reform of telecommunications and energy sector as well as higher exports to the US also helped to lift the economy. The inflation rate remained high at 3.9% (January – August 2013: 3.9%) due to price increases in food, beverage, tobacco and transport. The Banco de Mexico further lowered its interest rate from 3.50% to 3.00% in June 2014 to boost the economy. The unemployment rate remained stable at 5% (January – August 2013: 5%) as the recovery gained strength with job creation in manufacturing, services and construction sectors. Mexico is expected to register a higher growth of 2.4% in 2014 (2013: 1.1%).

International Economic Cooperation

Strengthens further

As economies become more interdependent and integrated, cooperation and policy coordination at the regional and international level is becoming increasingly essential, particularly to promote global economic stability and shared prosperity. The international financial institutions provide an important forum for multilateral cooperation, while supporting growth and development through their lending, advisory and capacity building initiatives for member countries. On the regional front, efforts have been continued to foster and strengthen financial sector cooperation towards optimising mutually-reinforcing growth. In this regard, Malaysia has participated actively at both regional and international forums, to further strengthen cooperation and transition towards a high-income and developed nation.

The **International Monetary Fund (IMF)** provides various assistance in the form of policy advice, financing facility and technical support to help member countries overcome economic difficulties, reduce poverty and improve the management of their economies. In promoting international stability, the Fund undertakes economic and financial surveillance in member countries through its bilateral consultation. In Malaysia, the IMF has been actively involved in this consultation on an annual basis to evaluate the current economic conditions and the possible risks to stability. To strengthen the effectiveness of its current surveillance framework, the IMF is implementing improvements based on its 2014 Triennial Surveillance Review.

The IMF also provides technical assistance and training, especially to low and middle-income countries for capacity building that helps promote economic stability and inclusive development. In Malaysia, the Fund, has been providing technical assistance and policy advice in several areas. These areas include: improving the compilation and reporting of government financial statistics

according to the Government Finance Statistics Manual 2001, scheduled to be completed in 2015; strategy for the implementation of accrual accounting; implementation of Goods and Services Tax and various capacity building programmes at the Fiscal Policy Office of the Ministry of Finance in 2014.

Apart from these, the Fund aims to publish a book on Malaysia, entitled 'Malaysia: Achieving High-Income Status Through Resilience and Inclusive Growth,' by 2015. The book will record Malaysia's development experience and growth achievements since independence and the ongoing transformation initiatives towards achieving a developed and high-income economy. This will be the IMF's first such publication, bringing together the lessons learnt from Malaysia's journey to economic achievements as well as a reference for the middle-income economies in general.

The **World Bank Group (WBG)** continues to strive for alleviation of global poverty and enhance shared prosperity in developing countries. Amid undergoing organisational change, the WBG's commitment for the financial year (FY) 2014 rose sharply by 16% to USD61 billion (FY2013: USD52.6 billion). These funds were channelled in the form of loans, grants, equity investments and guarantees to promote economic growth, reduce poverty and assist private enterprises in developing countries.

Malaysia has established a long standing relationship with the WBG since the nation joined the International Bank for Reconstruction and Development in 1958. The relationship has evolved and matured towards one of knowledge-sharing and is centered on supporting the country's vision of bringing Malaysia among the ranks of high-income and developed economies through inclusive and sustainable growth. Since 2009, with the signing of the Reimbursable Advisory Services agreement, both parties have been collaborating on a number of knowledge-sharing and advisory projects in many areas, including economic management, human capital development and competitiveness. Since 2009

ASIAN BOND MARKETS INITIATIVE: CREDIT GUARANTEE AND INVESTMENT FACILITY

Introduction

Bond market development in the Asian region intensified after the 1997/98 financial crisis. It is recognised that bond markets can act as an additional source to raise funds and alleviate systemic risk on the banking sector as experienced during the crisis. Vibrant bond markets allow for capital to be mobilised in large amounts at fixed interest rates on a long-term basis directly between the investors and borrowers.

Apart from individual countries developing their respective bond markets, regional collective efforts have also been undertaken. The Asian Bond Markets Initiative (ABMI) was established in 2003 with the primary objective of developing more accessible and well-functioning bond markets that will facilitate investors to tap into abundant regional savings in the ASEAN+3 region. Several initiatives have been introduced under the ABMI framework such as Asian Bonds Online, ASEAN+3 Bond Market Forum as well as the Credit Guarantee and Investment Facility (CGIF).

What is CGIF?

CGIF is a fund established in November 2010, through the contributions from the governments of ASEAN+3 countries and the Asian Development Bank (ADB). Its main objective is to support the issuance of local currency-denominated corporate bonds in the region. CGIF's initial authorised capital was USD700 million, which was divided into 7,000 shares with a nominal value of USD100,000 each. All shares have been fully subscribed and fully paid up since April 2012. The adoption of the new Roadmap+ with support from the ADB in May 2012 has further enhanced CGIF's role. In 2013, CGIF began operations and increased its guarantee capacity to USD1.75 billion.

TABLE 1

Initial Capital Contribution

Contributions		
Contributors	USD million	%
ASEAN	70	10.0
China	200	28.6
Japan (JBIC)	200	28.6
Korea	100	14.3
ADB	130	18.6
Total	700	100.0

Source: Progress Report Task Force 1: Promoting Issuance of Local Currency Denominated Bonds, 2014.

CGIF's Operations

CGIF guarantee operations mainly focus on transactions that have significant impact to the local currency denominated bond markets. Focus is therefore being directed to areas such as:

- Promoting cross-border transactions** – facilitating ASEAN+3 local companies to raise bonds in matching currencies as they expand across the region and help mobilise cross-border capital flows within an increasingly integrated ASEAN region;
- Encouraging first time issuers to tap the domestic bond markets** – support companies that have no access to the bond market to issue bonds for the first time;
- Extending tenures to promote long-term investments** – enable companies to extend maturities without elevated premium levels making the cost of long-term funding more attractive to match their long-term investments;
- Broadening of investor base** – encourage regional investors who are unable to invest in lower-rated countries to discover investment opportunities in ASEAN local currency bonds and understand these economies better; and

- e) **Introducing new bond instruments** – encourage new instruments, structures and issuers which domestic bond investors in the region are not familiar with at the onset.

Progress and Achievements

Since inception, CGIF has received enquiries from companies originating from 11 countries in the ASEAN+3 region. CGIF has issued three guarantees, with more catalytic transactions being pursued and expected to be launched soon.

- a) **Noble Group Limited's (Noble): 2.85 billion Thai baht denominated bond** – CGIF's first guarantee was issued on 26 April 2013 to enable Noble to tap the Thai baht bond market and reach Thai investors for the first time. This enabled Noble to further diversify their funding sources after tapping the ringgit bond market earlier.
- b) **PT BCA Finance's (BCAF): 420 billion Indonesia rupiah denominated bond** – CGIF's second guarantee was issued on 4 December 2013 to enable BCAF to tap institutional Japanese investors who were not able to purchase Indonesian rupiah bonds before. This marked the first time for a particular insurance company from Japan to purchase rupiah bonds. It also enabled BCAF to tap regional sources of savings to meet the strong demand for automobile financing and increase vehicle ownership in Indonesia. The success of this transaction was followed by a second tranche of guaranteed bonds issued to another Japanese insurance company on 18 March 2014.
- c) **Kolao Holdings' (Kolao): 60 million Singapore dollar denominated bonds** – with CGIF's guarantee, Kolao successfully issued 'AA' rated bonds to Singapore investors on 21 August 2014. Kolao manufactures and sells its own Daehan trucks and Kolao motorcycles in addition to distributing Hyundai and Kia automobiles in Lao PDR. This demonstrates CGIF's role in mobilising cross-border capital flows.

Ratings

It is essential for CGIF to attain high credit ratings to reflect its strong capital position and credit strength. The international rating agency, Standard and Poor's rates CGIF 'AA' for its long-term and 'A-1+' for its short-term foreign currency global scale ratings with a stable outlook as well as 'axAAA' rating on its ASEAN scale. Meanwhile, Malaysia's RAM Ratings has accorded 'AAA' on its global, ASEAN and national rating scales to CGIF. Malaysian Rating Corporation and TRIS Rating from Thailand have also accorded CGIF 'AAA' ratings based on their respective national rating scales.

Malaysia's Involvement

Malaysia is fully committed to the success of CGIF with a contribution of USD12.6 million to the initial capital and also plays an active role in all the ABMI initiatives. Malaysia's establishment of Danajamin Nasional Berhad (Danajamin) in 2009 as the region's first financial guarantee institution, pioneered the concept of developing bond markets via bond guarantees. CGIF is able to leverage on Malaysia's experience via a Strategic Collaboration Agreement with Danajamin as well as having experienced Malaysians serving as an advisor to its Board of Directors and members of its leadership team; to help replicate the success of the ringgit bond market in lesser developed bond markets in ASEAN.

Conclusion

Encouraged by an increasing number of cross-border regional opportunities, CGIF envisages a more integrated region with the realisation of the ASEAN Economic Community and is contributing towards building the foundations for greater capital flows among ASEAN as well as the +3 countries. CGIF is also looking to strengthen nascent local bond markets and develop new bond markets. CGIF's initiative not only increases the region's resilience to crises but also help to drive stronger economic growth across the region to better realise ASEAN's collective potential.

until July 2014, a total of 14 advisory projects, which served as inputs to policymaking, was completed, while there are 10 ongoing projects on areas such as transport, social protection system, small and medium enterprises and taxation.

Apart from providing advisory services, the WBG has also been publishing the Malaysia Economic Monitor (MEM) report twice a year. The MEM provides analysis on policy challenges facing Malaysia as well as covers recent economic developments and issues with a special theme for every report. As of June 2014, 10 reports have been published, with the latest report focused on boosting trade competitiveness. The MEM series is a key pillar in this partnership and serves as a platform for public discussion, analysis and sharing of knowledge on the challenges facing Malaysia in achieving the objective of transforming into a high-income economy.

In an effort to assist the poorest countries Malaysia became an International Development Association donor in April 2014, with a total contribution amounting to USD27 million. This effort, among others, is in line with Malaysia's desire to promote inclusive and sustainable global growth as well as further strengthens Malaysia's commitment as a member of the WBG.

Additionally, Malaysia is working towards establishing a WBG office in Kuala Lumpur. The office will provide opportunities for Malaysia to leverage the WBG's global knowledge and expertise as well as share development policies and experiences with other developing countries in the region.

The **Islamic Development Bank** (IDB) was established in 1973 with the aim of promoting socioeconomic growth among member nations. The Bank is tasked with providing loans and grants based on Shariah principles for development projects and provide a wide range of advisory services and technical assistance to member countries and Muslim communities worldwide.

In view of its 40th year of establishment, the IDB has embarked on an assessment of its progress as well as a study for the next 10-year strategy encompassing the views of its stakeholders from across the globe. In an effort to facilitate the accumulation and synthesis of ideas and recommendations, the Bank has held four high-level regional forums in Kuala Lumpur, Almaty, Dakar and Jeddah. The forum in Kuala Lumpur was held on 16 – 17 December 2013 and was the inaugural forum which gathered participants from the public sector, private sector and civil society within the region. Among the discussion points included the apparent need for the IDB to further customise and adapt its product and engagement tools with member countries to better serve their growing needs. Other proposals were for the IDB to enhance its capacity to develop Islamic finance and investment in member countries in line with the sector's growth worldwide. In addition, the Bank was also requested to focus on environmental issues, as countries in this region are vulnerable to climate change and natural calamities.

At the regional level, efforts are being intensified to strengthen **ASEAN** financial sector integration to support the realisation of the ASEAN Economic Community (AEC) 2015. ASEAN Finance Ministers continue to engage in various activities under the Roadmap for Monetary and Financial Integration of ASEAN (RIA-Fin). The ASEAN Capital Market Infrastructure Task Force (ACMI TF) was established to consider modalities for integrated access, clearing, custody and settlement, in support of the ASEAN Trading Link. On financial services sector liberalisation, member countries are working towards finalising the Sixth Package of the ASEAN Framework Agreement on Services (AFAS).

Under the ASEAN Capital Markets Forum (ACMF), a Memorandum of Understanding to establish the ASEAN Framework for the cross-border offers of ASEAN collective investment schemes (CIS) was signed in October 2013, by the relevant authorities of Malaysia, Singapore and Thailand. The implementation of this framework will open

the door for more business opportunities in the private sector while offering a new range of products for investors to diversify their portfolios. This is another step towards achieving the AEC under the ACMF implementation plan. The Securities Commission of Malaysia was elected as the Chair of the ACMF in September 2014.

The 10th ASEAN Finance Ministers' Investor Seminar (AFMIS) was held in Manila, Philippines on 20 May 2014. The seminar provided a platform for investors to engage with ASEAN Finance Ministers in promoting ASEAN as an attractive investment destination as well as to exchange views on the impact of current economic issues on implementation of the AEC 2015.

Myanmar is scheduled to join the ASEAN Infrastructure Fund (AIF) in 2014, the tenth member of ASEAN to partake in this initiative, which would make the AIF a truly ASEAN endeavour. Indonesia, the current Chair of the AIF would be handing over the Chairmanship of AIF to Malaysia in 2015. Malaysia will also assume the Chairmanship of ASEAN in the same year.

The **ASEAN+3** process has made significant progress in fostering financial cooperation among its member countries in 2014. During the ASEAN+3 Finance Ministers' and Central Bank Governors' Meeting in May 2014 held in Astana, Kazakhstan, the Ministers and Governors noted the work progress in developing the first full-set of indicators for the Economic Review and Policy Dialogue Matrix which comprises various economic and financial indicators of all the ASEAN+3 members. In order to ensure the Chiang Mai Initiative Multilateralisation's (CMIM) effectiveness and enhance the ASEAN+3 Macroeconomic Research Office's (AMRO) capacity as an independent regional economic surveillance unit, the Meeting also endorsed the guidelines for further cooperation with the IMF. Recognising the importance of frequent exchange of views and information on regional macroeconomic developments, the Meeting encouraged AMRO to strengthen cooperation

and establish strategic partnerships with other international financial institutions. In addition, the Meeting also announced the scaling-up of the guarantee capacity of the Credit Guarantee and Investment Facility from USD700 million to USD1.75 billion.

One of the commendable milestones achieved for this year was the enhanced CMIM Agreement which entered into force on 17 July 2014. Among the enhancements made to the CMIM agreement were the doubling of the reserve pool from USD120 billion to USD240 billion and the introduction of a crisis prevention facility.

The **Asia-Pacific Economic Cooperation** Finance Ministers' Meeting (APEC FMM) serves as a platform for the economies to exchange views and share best practices on economic management, finance and policy priorities at the domestic and regional levels. China will host the 21st APEC FMM, scheduled in October 2014 in Beijing. The main agenda of the 21st APEC FMM is to discuss the performance and prospects of regional economies, issues related to cooperation in infrastructure investment and financing, fiscal policy for the restructuring of the economy, as well as to improve financial services for the real economy at the regional level. This meeting will also discuss a number of proposals and initiatives to enhance cooperation in the field of finance such as treasury and budget reforms, measures to accelerate the development of infrastructure in the Asia-Pacific region, as well as the progress of existing initiatives related to, among others, finance development programmes, financial inclusion, capacity development as well as small and medium enterprises.

Prospects for 2015

Outlook improves

The global economy is expected to strengthen in 2015 given the continued policy mix of fiscal and monetary measures undertaken by major

REGIONAL COMPREHENSIVE ECONOMIC PARTNERSHIP

The Regional Comprehensive Economic Partnership (RCEP) is a free trade agreement (FTA) between ASEAN Member States (AMS) and its six FTA Partners (Australia, China, India, Japan, Republic of Korea and New Zealand). RCEP negotiations were formally launched in November 2012 at the 21st ASEAN Summit in Phnom Penh, Cambodia. The negotiations aim to achieve a modern, comprehensive, high-quality and mutually beneficial economic partnership agreement. The partnership agreement aims to establish an open trade and investment environment in the region, facilitate the expansion of regional trade and investment as well as boost economic growth and promote balanced economic development. Taking into consideration the different levels of development of the participating countries, RCEP would also include appropriate forms of flexibility including provision for special and differential treatment, with additional flexibility for the least-developed AMS.

In addition, RCEP would advance economic cooperation as well as broaden and deepen regional integration, which would build upon ASEAN's existing economic linkages. The partnership agreement covers among others, trade in goods, trade in services, investment, economic and technical cooperation, intellectual property, competition and dispute settlement. As of June 2014, five rounds of negotiations have taken place. RCEP negotiations are expected to be concluded by the end of 2015.

ASEAN has implemented FTAs with Australia, China, India, Japan, Republic of Korea and New Zealand (known as ASEAN+1 FTAs). RCEP would have broader and deeper engagement with significant improvements over the existing ASEAN+1 FTAs, while recognising the individual and diverse circumstances of the participating countries. RCEP would include provisions to facilitate trade and investment, enhance transparency among member nations, as well as increase participation in the regional and global supply chains. The timely conclusion of RCEP will enhance the integration of the ASEAN Economic Community (AEC) into the global economy.

RCEP is important as it would create the world's largest trading bloc and have major economic benefits for Asian countries and the world. RCEP represents 49% of the world's population, 30% of world GDP and 40% of global trade. In 2013, the combined FDI inflows to the 16 participating countries amounted to USD343 billion, accounting for 24% of global FDI flows. RCEP has been designed to deepen the relationship between the participating countries and progressively lower tariff and non-tariff barriers. This will benefit corporations based within the ASEAN region with lower trade barriers and improved logistics. With greater economic integration, these corporations can secure economies of scale and link to the global supply chain to compete in the global market and enhance productivity, create employment as well as drive growth in international trade.

Malaysia, as a member of the ASEAN+1 FTAs, is already implementing various commitments through liberalisation of import tariffs, services and investments. For a trading nation with a small domestic market, RCEP offers tremendous opportunities for Malaysian companies to increase exports and investment within the region.

economies, aimed at spurring growth. The advanced economies are expected to grow 2.3% in 2015 (2014: 1.8%) led by the US and the UK, while the euro area and Japan are expected to improve. The US growth is forecast to remain strong at 2.2% (2014: 2.2%) supported by strong capital investment, particularly in the oil and gas sector as well as the stronger performance in the manufacturing and services sectors. These sectors are expected to create more jobs. Despite an anticipated upward revision of interest rates by the Fed in 2015, the relatively low interest rate regime and a more sustainable level of household debt will continue to spur capital investment and consumer spending. The euro area is forecast to grow 1.3% in 2015 (2014: 0.8%) supported by accommodative fiscal and monetary policies as well as structural adjustments which are expected to boost capital spending and stimulate private consumption.

Emerging markets and developing economies are expected to expand 5% in 2015 (2014: 4.5%), with developing Asia continuing to drive growth. China's GDP is projected to moderate to 7.1% (2014: 7.4%) towards a more sustainable growth path. India is expected to grow 6.4% (2014: 5.6%) on account of improvements in business sentiment coupled with investment liberalisation measures after the elections in May 2014. ASEAN

economies are also envisaged to strengthen further contributed by strong domestic demand and an improving external sector as world trade is expected to increase.

Global inflation is projected to remain mild due to large output gaps in advanced economies. In addition, commodity prices are expected to trend downward. Oil prices are forecast to decrease due to an increase of shale gas production in the US and Canada, while prices of other minerals and agricultural commodities are expected to remain stable due to sufficient supplies, despite a continuous increase in demand. Inflation in advanced economies is forecast to increase to 1.8% (2014: 1.6%) while in emerging market and developing economies, inflation is expected to remain at 5.5% (2014: 5.5%).

Overall, the global economy is expected to register a stronger growth of 3.9% in 2015 (2014: 3.3%). The stronger expansion is expected to be driven by growth in world trade by 5% (2014: 3.9%), and increase in investment flows at 12.5% to USD1.8 trillion (2014: 10.3%; USD1.6 trillion). However, downside risks that may affect the projected growth include insufficient structural reforms and failure to manage disinflationary pressures in the euro area, tighter fiscal and monetary policies in the US and Japan as well as geopolitical tension in MENA and Eastern Europe.

INFRASTRUCTURE FINANCING

Introduction

Infrastructure is fundamental to a nation's development as it provides the catalyst for economic growth and promotes the general well-being of the population. The provision of modern facilities coupled with balanced development programmes and a stable economy are prerequisites for sustainable and inclusive growth.

Among the means in which infrastructure can contribute to sustainable growth are as follows¹:

- Enhance and facilitates trade flows;
- Reduce costs for businesses;
- Create employment;
- Develop and enhance human capital by improving access to education and training; and
- Improve the well-being and quality of life of the population through better healthcare facilities.

The traditional sources of infrastructure financing are government budget appropriation and debt instruments, which utilise public funds to develop infrastructure. Governments also have the option of commissioning specific government-owned enterprises to develop new infrastructure assets with borrowings from private financial institutions or from the capital market. Additionally, countries may source their financing requirement from external institutions such as Multilateral Development Banks (MDBs).

The need for infrastructure development is increasing significantly with nations striving to upgrade and construct their infrastructure system. The strident pace of globalisation has made infrastructure development a key priority in many countries. The underlying dilemma of infrastructure financing is that while infrastructure development brings about economic growth, economic growth itself intensifies demand for further infrastructure development.

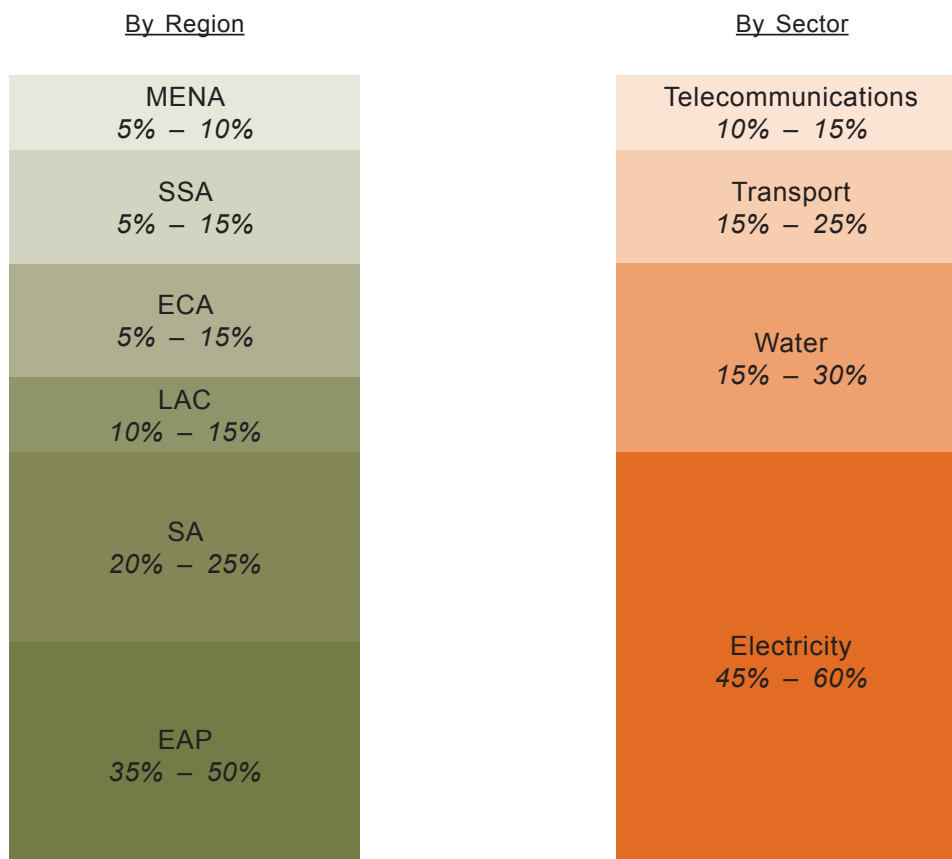
Financing Gaps

There is considerable need for infrastructure development. However, a critical gap exists between demand for funds and actual financing available. In 2014, the World Bank estimates that long-term investment needs of developing countries is between USD1.2 trillion and USD1.5 trillion a year while the amount of financing available is valued at USD800 billion. The Bank projects that the amount of investment needed by these countries to reach USD1.8 trillion – USD2.3 trillion a year in 2020, with East Asia and Pacific alone accounting for 35% – 50% of the share.

¹Source: Infrastructure for Economic Development and Poverty Reduction in Africa, United Nations Human Settlements Programme 2011.

CHART 1

Infrastructure Investment Requirement in Developing Countries in Year 2020 (USD1.8 trillion to USD2.3 trillion*)



Note: MENA = Middle East and North Africa; SSA = Sub-Saharan Africa; ECA = Eastern Europe and Central Asia; LAC = Latin America and Caribbean; SA = South Asia; EAP = East Asia and Pacific.

*2008 constant prices.

Source: World Bank.

The prevailing fiscal constraints and competing needs experienced by many developing countries have greatly limited the availability of public funds to finance infrastructure projects. These countries are increasingly viewing other alternatives to finance their infrastructure programmes without undue pressure on their national budget. Among the alternatives available for developing economies are the involvement of the private sector through public-private partnership (PPP) programmes and concession-based projects. While these options are available for nations with a reasonably developed private sector, other less developed economies seeking to build basic infrastructure are in need of concessional financing from MDBs.

Role of MDBs in Infrastructure Financing

MDBs have been in the forefront of infrastructure financing for decades as it correlates with their overall objective of eradicating poverty and improving the livelihoods of the citizens of member nations. A closer look at the financing disbursement of these institutions reveal that a major share of their financing is geared towards some form of infrastructure financing in multiple sectors. MDBs generally provide infrastructure financing through the following methods:

- Loans, grants and guarantees;
- Indirect financing through investment in private equity and participation via PPP based programmes; and
- Technical assistance.

Despite the emphasis on infrastructure financing by MDBs, the rapid growth of developing economies that comprise the bulk of MDB member nations have brought about a scenario whereby demand outstrips supply. MDBs are responding to this situation by consolidating their resources, fine tuning their financing products and seeking additional capital from their shareholders. Some MDBs have introduced unique solutions such as the Global Investment Facility (GIF) by the World Bank. The GIF aims to pool private financing assets such as pension funds, insurance companies and sovereign wealth funds to finance infrastructure projects in developing countries. GIF will operate as a multi donor trust fund comprising of donors, international financial institutions as well as public and private financial institutions.

The Islamic Development Bank (IDB), an MDB based in Jeddah has also been in the forefront of infrastructure financing for the past 40 years. Comprising 56 nations, IDB has played a crucial role in facilitating the development of infrastructure among its member countries through its lending operations. In 2001, IDB launched its first private equity fund called the IDB Infrastructure Fund with a capitalisation of USD730 million supported by pension funds and sovereign wealth funds of selected member countries. The Fund has successfully invested in infrastructure projects in several countries such as Saudi Arabia, Pakistan, Oman and Jordan. Following the success of the Fund, IDB has launched its second infrastructure fund in July 2014 with a targeted size of USD2 billion to invest in projects across the Muslim world.

Regional Financing Initiatives

At the regional level in Asia, various initiatives have taken place to improve access for infrastructure financing. The Asian Development Bank (ADB), the leading MDB in Asia has been actively providing financing for infrastructure projects in the region since its inception in 1966. ADB constitutes 67 members, with a vast majority of developing nations in its ranks. As of March 2014, the cumulative loan amount approved by ADB since its establishment is approximately USD156.8 billion, many of which was channeled to infrastructure related projects. ADB is in the midst of a major operational change to enhance its lending capacity by combining the lending operations of its concessional window,

the Asian Development Fund (ADF), with the Ordinary Capital Resources (OCR) balance sheet. The combination of both OCR and ADF will significantly increase the equity base of ADB which in turn will allow ADB to increase its financing operations. ADB's OCR equity base is expected to expand from USD18.3 billion to USD53 billion after the combination takes place. In addition, the ASEAN Infrastructure Fund and Central Asia Regional Economic Cooperation, both established to promote regional cooperation with infrastructure financing spearheading their operations have also contributed to the development of infrastructure in the region.

In 2013, China announced the establishment of a new MDB, Asian Infrastructure Investment Bank (AIIB), aimed at providing financing for infrastructure projects in Asia. The AIIB aspires to complement the role of existing MDBs in infrastructure financing among Asian nations and is expected to commence operations in 2015. The emerging markets of Brazil, Russia, India, China and South Africa have also agreed to establish a new MDB called New Development Bank to foster economic cooperation among them and provide financing for infrastructure projects. The Bank will be based in Shanghai, China. In other regions of the world, regional MDBs such as the Inter-American Development Bank and the African Development Bank also play a major role in providing development financing in line with their respective mandates and objectives.

Conclusion

Infrastructure plays a major role in ensuring a nation's growth and the welfare of its citizens. As countries strive for economic growth, the requirement for infrastructure financing will continue to expand. The widening gap between demand and resource available for financing warrants a careful assessment of current methods and practices employed in infrastructure financing. It compels nations and MDBs to seek innovative ways to finance infrastructure-based projects in partnership with private entities to ensure a sustainable flow of funds to meet the demand for financing.

