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APEC Economic Trends Analysis: Economic resilience amidst global headwinds

APEC Policy Support Unit
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Key Messages

APEC economies proved resilient in 2014 amid challenging external conditions

- Economic output in APEC as a whole grew by 2.9 percent in 2014, compared with world GDP growth of 3.4 percent, amid uncertainties surrounding the path of oil prices and the timing of monetary normalization in the United States.
- Growth among APEC economies mirrored the uneven pace of global economic recovery as GDP expanded between 0.7 percent and 8.0 percent, while some economies contracted slightly.
- Private consumption expenditures remained the key driver behind the continued expansion of APEC economies. Government spending was relatively stable even as gross fixed capital formation expenditures played a notable supporting role, with quarterly contributions to GDP growth remaining in positive territory.
- Economy-specific factors also weighed in on growth via the domestic demand channel, with other economies benefiting from stimulus measures to boost consumption spending amid adverse local developments.
- Generally accommodative monetary policy settings in 2014 provided support to the growth requirements of APEC economies, with 14 economies either reducing or maintaining their respective interest rates, while five members hiked policy rates.

Near-term outlook points to higher GDP growth for the APEC region, even as the varying impact of falling oil prices on oil importers and oil exporters is expected to result in diverging growth paths for APEC economies

- Forecasts by the International Monetary Fund (IMF), World Bank, and the Asian Development Bank (ADB) in the near-term point to mixed growth in the APEC region, with most economies expected to post higher GDP levels in 2015 compared to 2014. This growth momentum is expected to be sustained through 2016.
- Based on IMF forecasts, the APEC region is projected to post a more rapid growth of 3.2 percent in 2015-2016, comparable to forecasts of world GDP during the same period.
- Economic growth in the near-term will hinge on the strength of domestic demand; the impact of lower oil prices; the effect of US economic resurgence vis-à-vis China's new normal of growth moderation; and the normalization of US monetary policy.
- Taking into account the varying impact of falling oil prices, growth among APEC economies is expected to continue to diverge in the near-term, with positive effects accruing on oil importers while oil exporters will weaken.
- Upside opportunities for growth come mainly from domestic factors, particularly robust household spending that is ably supported by steady government consumption and investment.
- Accommodative financial conditions marked by low interest rates and strong credit growth remain important determinants of private consumption expenditures along with lower oil prices by raising households' purchasing power.
- Downside risks are largely external in nature, stemming from uncertainties in the path of oil prices and US monetary policy combined with moderated economic activity in China.

Sound macroeconomic fundamentals afford APEC economies the opportunity to address policy challenges that could boost medium-term growth prospects

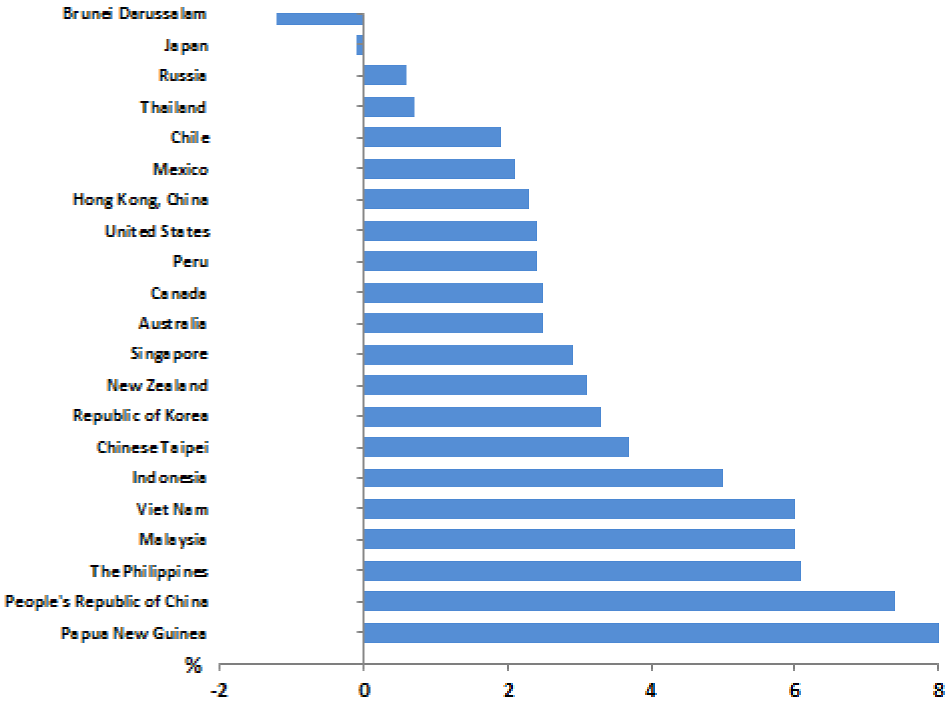
- The APEC region is poised to record relatively robust growth for the period 2015-2016, with domestic demand as the main regional driver. This gives enough room to implement policy reforms that will lead economies towards a more sustainable growth path.
- Events in 2014 show the importance of structural reform to sustain economic growth. The increasing weight of private consumption expenditure as a driver of growth points to the significance of behind-the-border conditions—rather than reliance on export-led growth—to sustain growth.
- APEC economies have addressed structural reforms issues in recent years. Economies have identified their 2011-2015 priorities under the APEC New Strategy for Structural Reform (ANSSR), which have the effect of upgrading financial and fiscal systems, improving productivity, and making economic growth more inclusive—all of which are needed to address risks to future growth.
- Beyond 2015, as economies rebalance towards domestic drivers of growth, economies will need to strengthen private consumption through more inclusive and sustainable growth by (1) increasing labor productivity and innovation and (2) providing social safety nets to help households smooth consumption.
- Economies could consider implementing fiscal consolidation programs (e.g., spending rationalization, revenue generation, and subsidy reforms), where appropriate, that will provide fiscal space for programs aimed at improving economic inclusiveness, sustainability, and innovation.
- In turn, skills development, investments in infrastructure, making labor markets more open for women and disadvantaged groups, and enhancing institutions and governance will need to be prioritized.

I. Economic Developments in 2014

APEC economies proved resilient in 2014 amid challenging external conditions, with the global economy marked by diverging growth. These include the strong rebound in the United States vis-à-vis the continued weakness in Japan and the Euro area; the higher growth trajectory trekked by oil importers while growth among oil exporters trended lower; and the sustained pace of expansion among developing economies in contrast to China's moderation amid the ongoing restructuring of its economy.

GDP growth among APEC economies in 2014 mirrored the uneven global economic recovery (Figure 1). As a whole, APEC's overall output reflected uncertainties surrounding the path of oil prices and the timing of monetary normalization in the United States as well as some economy-specific factors.

Figure 1. GDP Growth Rates, 2014



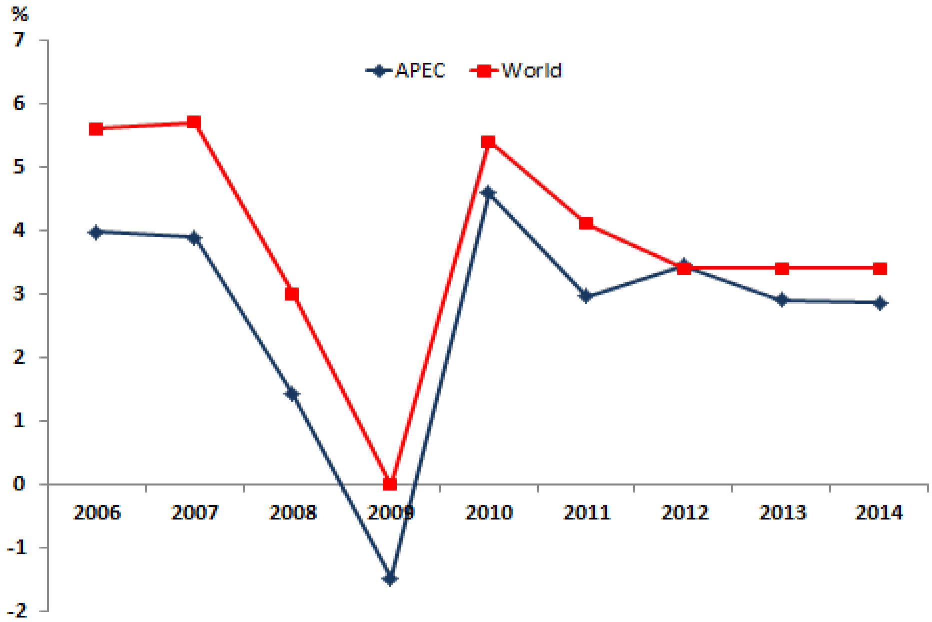
Sources: Thomson Reuters Datastream, IMF, ADB, and economy sources.

Industrialized economies[1] generally moved in tandem as GDP growth was between 2.4 percent and 3.1 percent. Japan is an exception because the economy shrank by 0.1 percent as household consumption weakened due to the hike in consumption tax. Growth in APEC developing economies was more divergent, expanding between 0.7 percent and 8.0 percent, although Brunei Darussalam contracted by 1.2 percent on account of the drop in oil prices.

On average, GDP growth for APEC economies was at 2.9 percent in 2014, similar to the level in 2013, but lower compared to the 3.4 percent world GDP growth estimate by the International Monetary Fund (IMF) (Figure 2).

[1] Industrialized economies include Australia; Canada; Japan; New Zealand; and the United States. The rest of the APEC members are classified as developing economies.

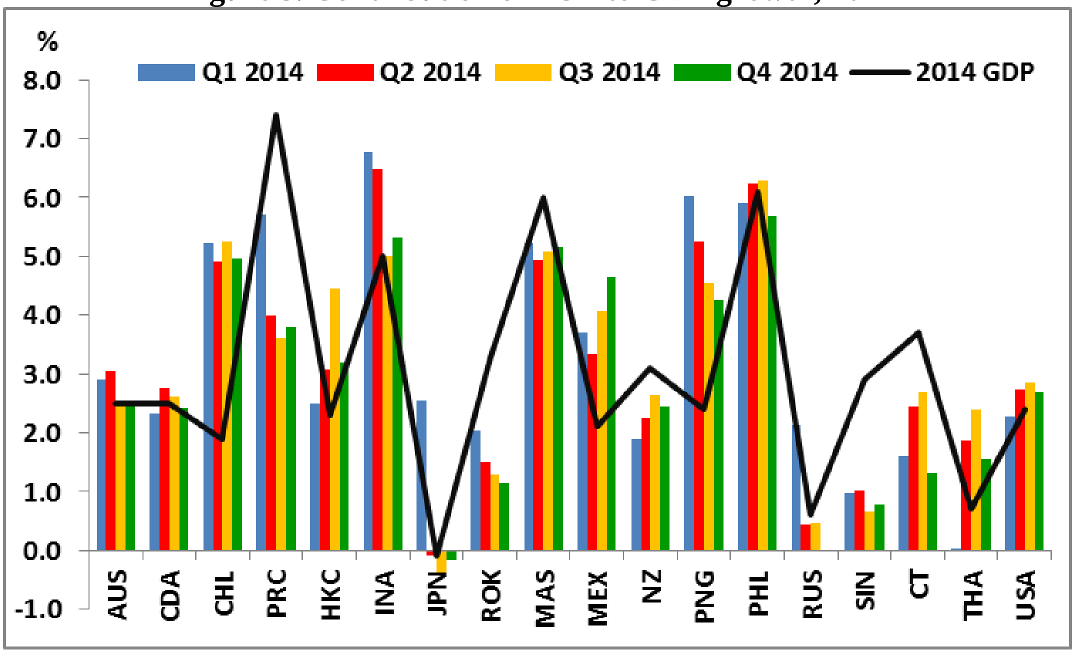
Figure 2. Average GDP growth, 2006-2014



Sources: APEC, IMF, ADB, and economy sources. APEC Secretariat, Policy Support Unit calculations.

Private consumption expenditures (PCE) remained the key contributor to growth, moving in line with GDP growth (Figure 3) of APEC economies. On average, PCE contributed 2.6 percent to the APEC region's GDP growth in 2014. Domestic demand in APEC as a whole was boosted by a combination of low interest rates and strong credit growth, underpinned by generally accommodative financial conditions and monetary policies.

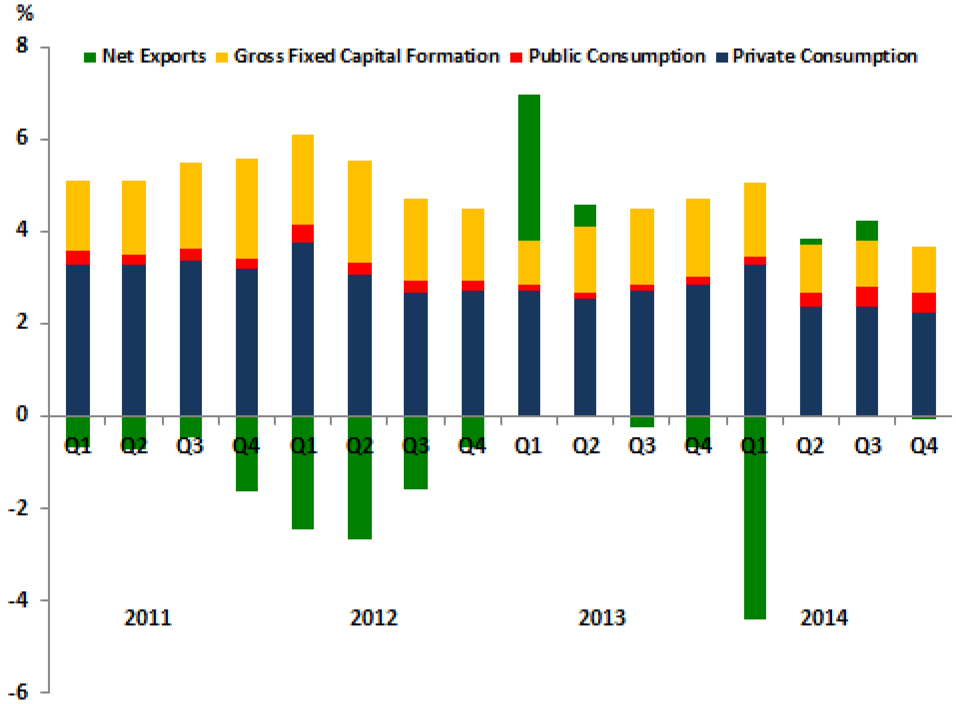
Figure 3. Contribution of PCE to GDP growth, 2014



Notes: Data not available for Brunei Darussalam; Papua New Guinea; and Viet Nam. The bars represent the quarterly contributions of PCE to GDP growth; while the line shows the 2014 GDP growth rates of APEC economies.
Sources: Thomson Reuters Datastream and economy sources. APEC Secretariat, Policy Support Unit calculations.

Government spending was relatively stable in 2014, even as gross fixed capital formation (GFCF) expenditures played a notable supporting role, with quarterly contributions to GDP growth remaining in positive territory across APEC economies (Figure 4). Net exports showed some volatility as external demand reflected the uneven pace of global growth. Specifically, after a sluggish start in Q1 2014, exports picked up in Q3 2014 but dipped again in Q4 2014. Nonetheless, reduced import bills from falling oil and metal prices contributed to a generally healthier trade picture for most economies in 2014.

Figure 4. Contributors to GDP growth in APEC, 2011-2014

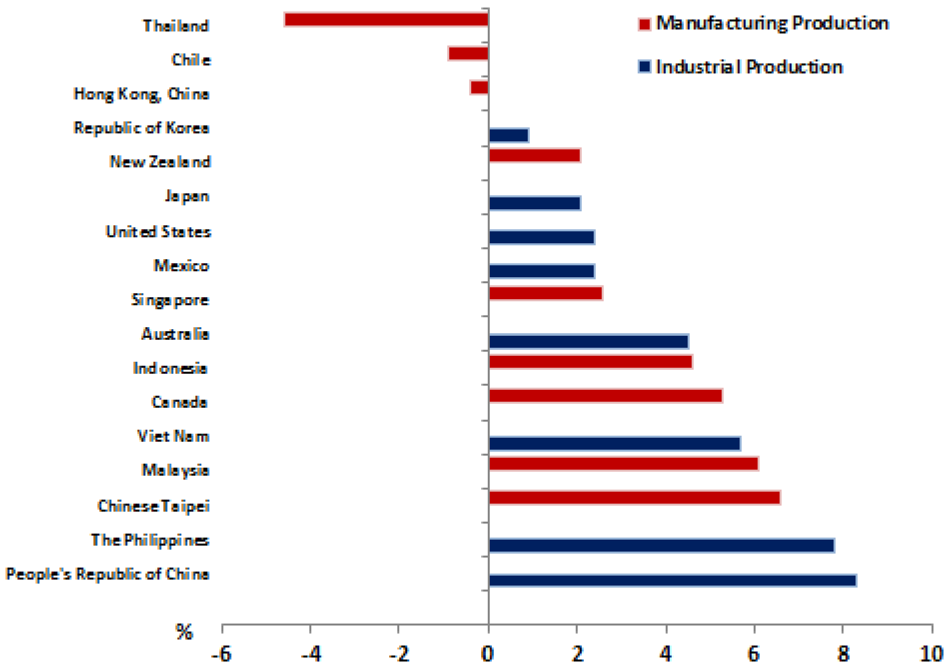


Notes: Data not available for Brunei Darussalam; Papua New Guinea; and Viet Nam. The stacked bars reflect the weighted contributions of major expenditure items to APEC GDP growth.
Source: Thomson Reuters Datastream and economy sources. APEC Secretariat, Policy Support Unit calculations.

On the production side, the industrial sector continued to contribute significantly to GDP growth, particularly the manufacturing sector which sustained its strength in majority of APEC economies. Growth in industrial and manufacturing production was robust for most economies in 2014 (Figure 5). In Thailand, manufacturing production contracted due to the fall in automotive production as local demand dropped following the end to the government's first-car tax incentives in 2013[2]. Manufacturing production in Chile was weighed down by reduced output of food and beverages on the back of lower domestic consumption, while rising labor costs, particularly in the clothing and shoe-making industries was behind the decline in Hong Kong, China.

[2] The scheme refunds taxes of first-time car buyers, with certain conditions, like buyers must be at least 21 years old and hold ownership of the car for at least five years. The vehicle must be manufactured in Thailand with a maximum value of THB 1.0 million and engine capacity of 1,500 cc. Cars must also be purchased from 16 September 2011 to 31 December 2012 and refunds will be made from 1 October 2013 onwards.

Figure 5.Growth in industrial and manufacturing production, 2014



Notes: Data not available for Brunei Darussalam; Papua New Guinea; Peru; and Russia. Manufacturing production measures the total output of the manufacturing sector, including components and finished products that are for sale. Industrial production measures the output of businesses in the economy's industry sector (including sub-sectors such as mining, manufacturing, construction, among others).
Source: Economy sources.

The mining sector was affected by reduced investment levels due, in turn, to larger-than-expected declines in the prices of metals, particularly iron ore. As of March 2015, the US dollar market price for iron ore has dropped by about 49.1 percent to USD 56.94 per metric ton[3] compared to a year ago, and almost 70 percent from its peak in early 2011.

Economy-specific factors also weighed in on growth via the domestic demand channel. In Australia, a slowdown in mining activity as the price index for metals declined by about 17 percent in December 2014 from the year-ago level, has translated into reduced household income and expenditures, slowing down economic activity. As of March 2015, IMF's price index for metals stood at 169.5 (2005=100, in USD terms), lower by around 14.0 percent and 18.4 percent than the levels posted in December 2014 and March 2014, respectively. In Japan, a hike in the consumption tax rate from 5 percent to 8 percent effective April 2014 has dampened household spending, resulting in a slight contraction in its 2014 GDP growth. Meanwhile, Russia's economy was pulled down by the significant slump in oil prices since oil is the economy's top export commodity, representing 29.5 percent of total exports and 8.3 percent of GDP in 2013[4].

Other economies have benefited from implementing supportive measures to counter adverse idiosyncratic factors. For example, the persistent slowing of real property prices and sales volume in China combined with decelerating growth in credit and investment prompted authorities to implement targeted stimulus measures–such as increased infrastructure

[3] Data on iron ore prices sourced from the IMF, available at http://www.imf.org/external/np/res/commod/index.aspx.
[4] Based on data from UN Comtrade and UN Service Trade.

investment–to stabilize domestic demand [5]. In Thailand, fiscal stimulus measures combined with reduced political uncertainty allowed its economy to rebound sharply in Q4 2014 after posting lower growth in the preceding quarters [6].

The growth requirements of APEC economies found support from generally accommodative monetary policy settings. In 2014, 14 APEC economies decided to either reduce or maintain their respective interest rates, while five members opted to hike rates (Table 1).

Table 1. Monetary policy in APEC economies, 2014

APEC member-economies	Monetary Policy Instrument	Policy Rate Movements (in %)		
		Jan-14	End-2014	Change
Australia	Cash rate target	2.50	2.50	...
Brunei Darussalam	Currency Board System [1]			N.A.
Canada	Target for the overnight rate	1.00	1.00	...
Chile	Monetary policy rate	4.50	3.00	1.50
People's Republic of China	Central Bank base interest rate [2]	6.00	5.60	0.40
Hong Kong, China	Currency Board System [3]			N.A.
Indonesia	Bank Indonesia rate	7.50	7.75	2.50
Japan	Monetary base	JPY 60-70 trillion	JPY 80 trillion	JPY 20 trillion
Republic of Korea	Base rate	2.50	2.00	0.50
Malaysia	Overnight policy rate	3.00	3.25	0.25
Mexico	Overnight interbank interest rate	3.50	3.00	0.50
New Zealand	Official cash rate	2.50	3.50	1.00
Papua New Guinea	Kina facility rate	6.25	6.25	...
Peru	Monetary policy interest rate	4.00	3.50	0.50
Philippines	Overnight borrowing rate	3.50	4.00	0.50
	Overnight lending rate	5.50	6.00	0.50
Russia	Overnight credit rate	6.50	18.00	11.50
Singapore	Exchange rate policy band [4]			...
Chinese Taipei	Discount rate [5]	1.88	1.88	...
Thailand	Policy interest rate	2.25	2.00	0.25
United States	Target range for Federal funds rate	0-0.25	0-0.25	...
Viet Nam	Discount Rate	5.00	4.50	0.50
	Refinancing Rate	7.00	6.50	0.50

Notes: Figures in green indicate monetary easing while figures in red denote monetary tightening; ... indicates no change; and N.A. means Not Applicable since member economy uses currency board system.

[1] The monetary policy framework in Brunei Darussalam is based on a currency board system, with the Brunei dollar anchored to the Singapore dollar at par.

[2] Aside from the central bank interest rate, the monetary policy instruments applied by the People's Bank of China include the following: reserve requirement ratio, rediscounting, central bank lending, open market operation and other policy instruments specified by the State Council.

[3] Hong Kong, China maintains a currency board system pegged against the US dollar, at around HK$7.80 to US$1.

[4] Monetary policy is conducted through the trade-weighted exchange rate, which is allowed to fluctuate within a policy band. The operating targets for the S$NEER are expressed in the level, slope and width of the policy band which determine the direction of monetary policy. In 2014, there was no change in the level, slope and width of the policy band, indicating steady monetary policy settings.

[5] The Central Bank also makes use of other monetary policy instruments, namely, the rate on accommodations with collateral, and the rate on accommodations without collateral.

Notes: … = change; N.A. = Not Applicable since member uses currency board system

Source: Economy sources

[5] As reported by China's state radio, Chinese Premier Li Keqiang announced in June 2014 that policy makers will focus more on targeted measures to support economic growth, including increased spending on rail, water and energy projects. Report available at http://www.wsj.com/articles/china-to-focus-on-targeted-measures-premier-li-keqiang-says-1402401966.

[6] On 1 October 2014, Thailand approved plans for stimulus measures worth THB 364 billion (or USD 11.2 billion) to boost economic activity. Report available at http://www.reuters.com/article/2014/10/01/us-thailand-economy-measures-idUSKCN0HQ37H20141001.

To further stimulate economic activity, Japan decided to expand anew its quantitative and qualitative easing program in October 2014. The monetary base was expanded to JPY 80 trillion,[7] equivalent to a JPY 20 trillion increase from the start of the year. In addition, asset purchases were increased on an annual basis by JPY 30 trillion to JPY 80 trillion, while extending the average remaining maturity of Japanese Government Bond (JGB) purchases by three years to about 7-10 years. Moreover, the Bank of Japan will also buy exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITS) with the view of increasing their outstanding amounts at an annual pace of JPY 3 trillion and JPY 90 billion, respectively.

In contrast, the United States Federal Open Market Committee (FOMC) concluded its asset purchase program in October 2014. Instead, in its March 2015 meeting, the FOMC decided to maintain its existing policy of reinvesting principal payments from its holdings of agency debt in agency mortgage-backed securities. It also continued rolling over maturing Treasury securities at auction. Both actions are aimed at maintaining accommodative financial conditions.

As of March 2015, eight APEC economies moved to ease their monetary policy settings, as benign inflation levels afforded policy space to boost domestic demand amid uncertainties in the external front. Policy rates were cut by 25 basis points in Australia; China; Indonesia; Korea; Peru; and Thailand, while Russia lowered its overnight credit rate by 100 basis points. Singapore, meanwhile, reduced the slope of its S$NEER policy band as the economy takes into account receding imported inflationary pressures, implying a more accommodative monetary policy. The rest decided to keep key policy rates unchanged.

Box 1. Impact of Lower Oil Prices on APEC Economies:
The Dichotomy between Importers and Exporters

Crude oil prices have plunged by about 49 percent from USD 111.90 per barrel in June 2014 to USD 52.83 per barrel as of March 2015. Supply glut was largely behind the price slump as the Organization of the Petroleum Exporting Countries’ (OPEC) November 2014 decision to maintain production levels did not counter increased production from the United States. The weakness in demand amid slower global economic activity also exerted downward pressure on oil prices. Significantly lower crude oil prices are expected to have different consequences for importers and exporters.

Eight APEC economies are crude oil exporters, while the rest are crude oil importers (Table B1). Latest available data show that Russia is the largest exporter of crude oil, accounting for 52.3 percent of total APEC exports of crude oil for the period 2012-2013, followed by Canada (23.9 percent) and Mexico (12.9 percent). Japan is the biggest importer of crude oil during the same period, procuring 35.7 percent of total APEC crude oil imports, followed by Korea (24.4 percent) and Thailand (9.5 percent).

[7] About USD 740 billion using the October 2014 exchange rate of USD 1 = JPY 108.06.

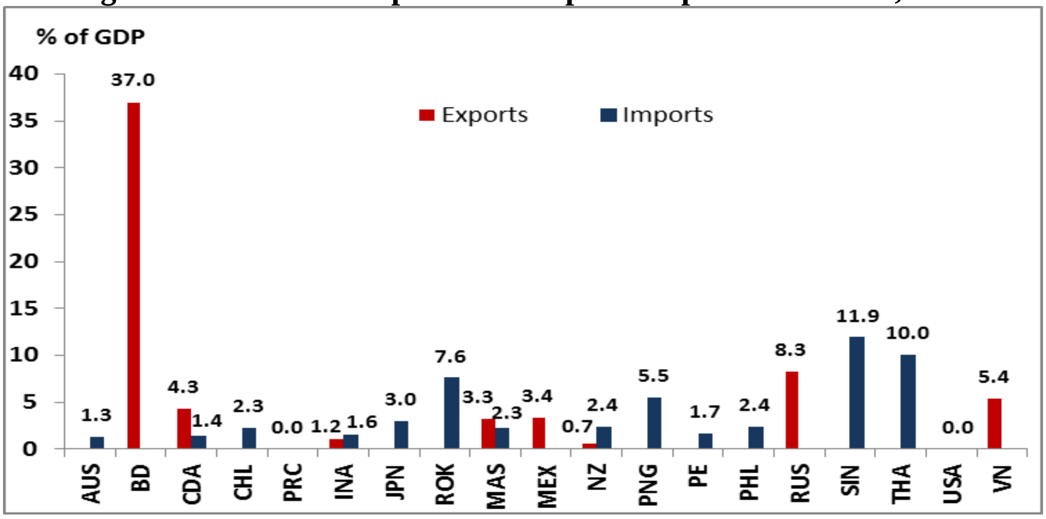
Table B1. Exports and Imports of Crude Oil, 2012-2013 (in USD million)

APEC member economies	Exports	Imports
Australia		19,494.40
Brunei Darussalam	6,271.30	
Canada	79,344.80	
Chile		6,274.10
People's Republic of China		219.70
Hong Kong, China		
Indonesia	10,204.70	13,585.80
Japan		145,720.80
Republic of Korea		99,333.20
Malaysia	10,212.40	7,162.70
Mexico	42,803.70	
New Zealand	1,206.00	4,299.20
Papua New Guinea		846.00
Peru		3,355.50
The Philippines		6,617.10
Russia	173,669.50	
Singapore		35,538.70
Chinese Taipei	N.A.	N.A.
Thailand	38,916.90	
United States		279.10
Viet Nam	8,398.00	

Notes: Latest available data for Brunei Darussalam; Papua New Guinea; and Viet Nam are for 2012. Blank entries denote zero exports/imports for period covered. N.A. = no data.
Source: UN Comtrade and UN Service Trade

Among APEC economies, Brunei Darussalam is the most reliant on crude oil, with exports of this commodity accounting for 37 percent of GDP in 2012 (Figure B1). Meanwhile, crude oil exports amounted to 8.3 percent of GDP in Russia in 2013.

Figure B1. Crude oil exports and imports as percent of GDP, 2013



Notes: Data as of 2013, except for Brunei Darussalam (2012); Papua New Guinea (2012); and Viet Nam (2012). Imports of crude oil in 2013 by China and the US are minimal at 0.002 percent of GDP. Hong Kong, China had no exports and imports of crude oil for 2012-2013, while data are not available for Chinese Taipei.
Source: UN Comtrade and UN Service Data. APEC Secretariat, Policy Support Unit calculations.

Although the magnitude and timing of the impact vary across economies, the benefits of lower prices on oil importers accrue via four key channels. First, reduced oil prices translate into increased income for households and businesses. This, in turn, is expected to boost consumption spending. Second, falling oil prices mean lower cost of final goods, and conversely, higher profits and investments. The profit effect is especially sizeable for energy-intensive firms such as those in the electronics or automotive industries. Third, terms of trade are expected to improve with the fall in oil import bills. Fourth, a pass-through effect of lower oil prices is a slowdown in inflation, especially if imported oil accounts for a significant share of energy consumption. Lower inflation allows for policy space among economies with interest rates that are not zero-bound, giving them room to reduce policy rates even further. For economies with near-zero rates, there is a strong case for continued accommodative monetary policy measures to prevent the premature increase in real interest rates given prevailing deflation concerns and associated risks.

The degree of the impact on oil exporters and producers is hinged largely on economies' reliance on oil export revenues. The general outcome mirrors a ripple effect wherein lower prices reduce profits and incomes, and ultimately, growth. First, oil revenues decline with crude oil prices. Second, the decline in oil export profits leads to lower overall growth, since energy substantially contributes to GDP growth. Third, the deceleration in GDP results in less optimistic growth prospects, which also affect factors such as exchange rates and inflation levels. In economies where expectations are not well-anchored on inflation or growth objectives, substantial depreciation in exchange rates can lead to sudden increases in inflation, risk aversion and capital outflows.

Nevertheless, a World Bank study[8] finds that even with real income shifts from oil exporters to oil importers, lower oil prices will yield a positive net outcome for global economic activity. In particular, a supply-driven oil price decrease of 45 percent translates into a 0.7-0.8 percent increase in global GDP growth over the medium-term, with a decline in global inflation by around 1 percent in the short-term.

The substantial and sustained decline in the prices of oil commodities gives rise to policy implications that require the calibration of fiscal and monetary policies to counter adverse macroeconomic effects, both in the short-term and medium-term.

For oil importers, the fall in oil prices is expected to act like a tax cut, reducing costs for firms and raising disposable incomes for consumers, thus encouraging more consumption spending. On the fiscal side, subsidy savings from lower oil prices could be directed towards targeted transfer programs, while being mindful of the opportunity to implement reforms to trim down energy subsidies that result in market distortions. The drop in oil prices is also anticipated to temper inflation, providing more monetary policy space for economies with interest rates that are not zero-bound. However, for low-inflation economies, the drop in oil prices could further complicate monetary policy, as disinflation or deflation has the potential to result in unmanageable expectations, leading to higher risks and lower output.

For oil exporters, reduced oil revenues will exert pressure on public finances, requiring prudent government spending, especially since oil prices are anticipated to remain low for

[8] Baffes, J. M.A. Kose, F. Ohnsorge, and M. Stocker. "The Great Plunge in Oil Prices: Causes, Consequences, and Policy Responses." *World Bank Policy Research Note*. (March 2015)

some time. Economies that have substantial fiscal buffers accumulated from past high prices of oil could allow larger fiscal deficits to support GDP growth. For economies with limited fiscal space, adjustments will include greater exchange rate depreciation. In such cases, a strong monetary policy framework is crucial to ensure that episodes of significant depreciation do not lead to a sudden and continued hike in inflation.

The different effects of the downward trend in oil prices on oil importers and oil exporters are expected to result in continued diverging growth paths for APEC economies, particularly in the short-term period since oil prices are expected to partially recover to about USD 72 per barrel only in 2019[9].

II. Outlook and Policy Challenges

The near-term growth of APEC economies is hinged on the following factors: 1) strength of domestic demand; 2) impact of lower oil prices; 3) effect of US economic resurgence vis-à-vis China's new normal of growth moderation; and 4) normalization of US monetary policy.

A. Near-term Economic Outlook

Forecasts in the near-term point to mixed growth in the APEC region, with most economies, particularly oil importers, expected to post higher GDP levels in 2015 compared to the previous year. This growth momentum is anticipated to be sustained through 2016. APEC as a whole is projected to post a more rapid growth of 3.2 percent both in 2015 and 2016 from the 2.9 percent expansion in 2014. This growth is comparable to the IMF's forecast of acceleration in world GDP to 3.5 percent in 2015 and 3.8 percent in 2016, propelled largely by the sharp recovery in the US (Table 2).

[9] IMF. "Learning to Live With Cheaper Oil amid Weaker Demand". *Regional Economic Update: Middle East and Central Asia Department.* (January 2015)

Table 2. GDP growth forecasts, 2015-2016

		IMF		ADB		WB	
	2014*	2015	2016	2015	2016	2015	2016
Australia	2.5	2.8	3.2				
Brunei Darussalam	-1.2	-0.5	2.8				
Canada	2.5	2.2	2.0				
Chile	1.9	2.7	3.3				
People's Republic of China	7.4	6.8	6.3	7.2	7.0	7.1	7.0
Hong Kong, China	2.3	2.8	3.1	2.8	2.9		
Indonesia	5.0	5.2	5.5	5.5	6.0	5.2	5.5
Japan	-0.1	1.0	1.2			1.2	1.6
Republic of Korea	3.3	3.3	3.5	3.5	3.7		
Malaysia	6.0	4.8	4.9	4.7	5.0		
Mexico	2.1	3.0	3.3			3.3	3.8
New Zealand	3.1	2.9	2.8				
Papua New Guinea	8.0	19.3**	3.3	15.0**	5.0		
Peru	2.4	3.8	5.0				
The Philippines	6.1	6.7	6.3	6.4	6.3		
Russia	0.6	-3.8	-1.1			-2.9	0.1
Singapore	2.9	3.0	3.0	3.0	3.4		
Chinese Taipei	3.7	3.8	4.1	3.7	3.6		
Thailand	0.7	3.7	4.0	3.6	4.1	3.5	4.0
United States	2.4	3.1	3.1			3.2	3.0
Viet Nam	6.0	6.0	5.8	6.1	6.2		
APEC	**2.9**	**3.2**	**3.2**				
World	**3.4**	**3.5**	**3.8**			**3.0**	**3.3**

*Actual GDP growth rates for 2014
**The jump in 2015 GDP forecast for Papua New Guinea takes into account the economy's first full production of liquefied natural gas (LNG), which is expected to boost export growth.
Sources: IMF World Economic Outlook (April 2015); Asian Development Outlook (March 2015); and World Bank Global Economic Prospects (January 2015). APEC Secretariat, Policy Support Unit calculations.

Upside opportunities for growth come mainly from domestic factors, particularly robust household spending that is ably supported by steady government consumption and investment. In turn, accommodative conditions marked by low interest rates and strong credit growth remain important determinants of private consumption expenditures. Meanwhile, falling oil prices continue to generate positive impact for oil importers via the consumption channel by increasing households' purchasing power.

Downside risks are largely external in nature. Uncertainties surrounding the trajectory of oil prices and the timing of US monetary policy normalization combined with slower economic activity in China will impact on the near-term GDP growth of APEC economies. The steady and significant decline in oil prices is expected to directly affect oil exporters, weighing down output levels.

Moreover, the eventual normalization of US monetary policy will have major growth and financial stability implications on economies as the expected hike in interest rates could cut into the income of both households and firms. Economies holding dollar-denominated liabilities will be most vulnerable as they will be hit by both the hike in rates and an appreciating US dollar. Consequently, household consumption patterns and corporate activity will be affected; and thus, the overall pace of economic activity.

China's announcement of a "new normal" of moderated GDP growth at around 7.0 percent in 2015 from the previous target of 7.5 percent will also shape growth among APEC economies. In particular, China's moderation could translate into mixed trends for overall APEC exports to China. As the economy restructures away from an investment-driven growth, exports of raw materials to China will be negatively affected. At the same time, China's direction towards a domestic-demand driven growth should boost consumption goods exports to China.

Taking into account the upside opportunities and downside risks to growth, particularly the varying impact of falling oil prices, growth among APEC economies is expected to continue to diverge in the near-term.

B. Policy Challenges

APEC economies are poised to continue to post relatively robust growth for the period 2015-2016, with domestic demand as the main regional driver. Although output expansion is expected to diverge across APEC economies, particularly with the different effects of falling oil prices on oil importers and oil exporters, near-term economic outlook remains on positive trajectory for the majority. This affords APEC economies the opportunity to address challenges that could boost medium-term growth prospects and lead their respective economies towards a more sustainable path.

Events in 2014 show the importance of structural reform to sustain economic growth. The increasing weight of private consumption expenditure as a driver of growth points to the significance of behind-the-border conditions—rather than reliance on export-led growth—to sustain growth. Although accommodative monetary policy settings provided support to the growth requirements of economies, there is a need to further increase monetary effectiveness by enhancing transmission mechanisms and credit conditions to be able to directly impact on economic activity. As such, the only remaining levers to encourage economic growth towards the path of sustainability are structural reform priorities that can improve productivity, resilience, and competitiveness in an economy.

APEC economies, by and large, have attempted to address these challenges by focusing on structural reforms in recent years. In 2011-2015, economies identified their priorities for the APEC New Strategy for Structural Reform (ANSSR) under five key areas: (1) more open, well-functioning, transparent, and competitive markets; (2) better functioning and effectively regulated financial markets; (3) labor market opportunities, training, and education; (4) sustained SME development and enhanced opportunities for women and vulnerable populations; and (5) effective and fiscally sustainable social safety net programs. These priorities have the effect of upgrading financial and fiscal systems, improving productivity, and making economic growth more inclusive—all of which are needed to address risks to future growth.

For 2015 and beyond, as economies rebalance towards domestic drivers of growth, economies will need to strengthen private consumption through more inclusive and sustainable growth. This will require both increasing labor productivity and innovation to raise wages and living standards, as well as reducing income uncertainties through safety nets and social insurance to allow households to smooth consumption. Economies could consider implementing fiscal consolidation programs, where appropriate, that will take into account spending rationalization, revenue generation, and subsidy reforms, which will make public funds available for programs aimed at improving economic inclusiveness, sustainability, and innovation. These programs, in turn, will need to cover skills development, investments in infrastructure (including regulatory and financial reforms), making labor markets more open for women and disadvantaged groups, and enhancing institutions and governance at all levels to strengthen transmission mechanisms between policy and inclusive growth.