**Question 2 Economic challenges in different economies**

**Extract 5: US hiked interest rate for the first time since 2006**

The US Federal Reserve (Fed) hiked interest rate for the first time in nearly a decade, signalling faith that the US economy had largely overcome the 2008 financial crisis.

The Fed raised interest rate by 0.25 per cent in view of the projected rise in the rate of inflation to 2% in the medium term. With the economy performing well and expected to continue to do so, the Fed committee judges that a modest increase in the interest rate is appropriate. "Policy remains accommodative," Fed Chairman, Yellen said. "The US economy has shown considerable strength. Domestic consumer spending has continued to rise and investment by firms have risen”.

*Adapted from Reuters, 16 Dec 2015*

**Extract 6: China takes steps to transit to a knowledge-based economy**

China posted its weakest economic growth in the fourth quarter of 2015, adding pressure on policymakers to take more steps to ward off a sharper slowdown that could jolt global markets.

The government could widen the budget deficit to about 3 percent this year as leaders turn to tax cuts and increased spending on infrastructure to support growth. While the government is expected to lean more on fiscal policy to support growth this year, the central bank may still need to ease monetary policy to help cushion the impact of structural reforms on the economy. The central bank has already cut interest rates six times since November 2014 to spur economic growth.

China intends to transit to a knowledge-based economy by encouraging its organizations and people to acquire, create and use knowledge more effectively for greater economic and social development. Strong economic incentives and institutions are required to enable organizations and people to adjust to changing opportunities in flexible and innovative ways.

The government plans to push forward “supply-side reforms” by cutting corporate tax, upgrading the information and communication technology (ICT) and R&D infrastructure and removing barriers to encourage domestic entrepreneurship and foreign direct investment in the services sector. There is a need to establish clear rule of law and property rights. They also strive to privatize big, highly inefficient state-owned enterprises into market-oriented institutions.

In the short term, the critical challenge for China is to ensure a smooth and efficient transition, minimizing unemployment that will inevitably result from the restructuring. Retraining also needs to be provided for millions of workers that may be displaced. Even though literacy rates had soared due to government’s increased spending on education, there is still overemphasis on knowledge transfer rather than the development of imaginative and creative capabilities. This has proved to be a major hindrance to its education reforms.

*Adapted from Asian Development Bank, World Bank & The Guardian, 9 May 2016*

**Extract 7: Singapore faces external headwinds**

While manufacturing remained in the doldrums, Singapore’s economic growth in the fourth quarter of 2015 was supported by public-sector construction activities, and the finance and insurance sectors. With no signs of external demand picking up yet, economists, however, were cautious about the outlook for the coming year despite the better-than-expected fourth quarter performance. Barclays’ economist Leong said: “The US economy is strong but it is offset by China’s growing weakness, precipitated by a weaker ability to import due to the weaker Chinese yuan.”

DBS economist, Irvin pointed out the risks of potential capital flight that could result from further US rate hikes and fears of further economic slowdown in China. “Growth outlook in the next six to nine months will remain modest before an improvement in the later part of 2016,” he added.

Adapted from *Today, 4 January 2016*

**Extract 8: Singapore’s top export partners**

Singapore shipped US$346.8 billion worth of products around the globe in 2015.

The top 5 export markets are:

1. China: US$47.7 billion (13.8% of total Singapore exports)
2. Hong Kong: US$39.7 billion (11.4%)
3. Malaysia: US$37.8 billion (10.9%)
4. Indonesia: US$28.4 billion (8.2%)
5. United States: US$23.2 billion (6.7%)

*Source:* [*http://www.worldstopexports.com/singapores-top-import-partners/*](http://www.worldstopexports.com/singapores-top-import-partners/)*, 17 Apr 2016*

**Table 1: Macroeconomic Indicators (China)**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | 2011 | 2012 | 2013 | 2014 | 2015 |
| Real GDP growth (% per year) | 9.5 | 7.8 | 7.7 | 7.3 | 6.9 |
| Rate of inflation (%) | 5.4 | 2.6 | 2.6 | 2.0 | 1.4 |
| Unemployment (% of labour force) | 4.3 | 4.5 | 4.6 | 4.7 | 4.8 |
| Government budget balance (% of GDP) | 0.1 | -0.3 | -0.7 | -1.2 | -2.6 |
| Current account balance (US$ billion) | 136.1 | 215.4 | 148.2 | 219.7 | 330.6 |

**Table 2: Macroeconomic Indicators (United States)**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | 2011 | 2012 | 2013 | 2014 | 2015 |
| Real GDP growth (% per year) | 1.6 | 2.3 | 2.2 | 2.4 | 2.0 |
| Rate of inflation (%) | 3.2 | 2.1 | 1.5 | 1.6 | 0.1 |
| Unemployment (% of labour force) | 9.0 | 8.2 | 7.4 | 6.2 | 5.0 |
| Government budget balance (% of GDP) | -10.7 | -9.3 | -6.4 | -5.8 | -2.4 |
| Current account balance (US$ billion) | -460.4 | -449.7 | -376.8 | -389.5 | -484.1 |

**Table 3: Macroeconomic Indicators (Singapore)**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | 2011 | 2012 | 2013 | 2014 | 2015 |
| Real GDP growth (% per year) | 6.2 | 3.4 | 4.4 | 2.9 | 2.0 |
| Rate of inflation (%) | 5.3 | 4.5 | 2.4 | 1.0 | -0.5 |
| Unemployment (% of labour force) | 2.9 | 2.8 | 2.8 | 2.7 | 2.8 |
| Government budget balance (% of GDP) | 1.2 | 1.7 | 1.1 | -0.3 | -1.2 |
| Current account balance (US$ billion) | 60.6 | 49.8 | 54.1 | 58.8 | 57.5 |

Source: *The Economist, World Bank (2015),* [*http://stats.mom.gov.sg*](http://stats.mom.gov.sg)*, 28 Apr 2016*

**Questions**

**(a) (i)** Compare the change in China’s current account balance with that of the US for the period 2011 to 2015. [2]

**(ii)** Explain whether the US should be concerned about the changes to her current account balance. [2]

**(b)** Explain whether the US central bank’s action of raising the interest rate is justified. [4]

**(c)** Explain how the slowdown in China’s economic growth will affect its government budget balance. [4]

**(d)** With reference to the data, discuss the likely impact of China’s monetary policy (Extract 6) on the Singapore economy. [8]

**(e)** Assess the effectiveness of China’s supply-side reforms in facilitating a smooth transition to a knowledge-based economy. [10]

[Total: 30]