DEVELOPMENTS IN THE THIRD QUARTER OF 2014

INTERNATIONAL ECONOMIC ENVIRONMENT

Moderate global economic expansion

The global economy continued to expand at a moderate pace in the third quarter of 2014, with uneven growth performances across economies. While the US economy continued to show broader signs of improvements, growth in the euro area remained subdued amid persistent structural constraints and weakening sentiments. In Asia, economic activity continued to expand, although growth was more moderate in several economies. Global monetary conditions remained accommodative, but the direction of monetary policy diverged across both the advanced and emerging economies.

Financial market volatility increased in the third quarter, particularly in the latter half of September. Although additional monetary easing by the European Central Bank (ECB) provided some support to market sentiments, overall investor confidence was weighed down by weaker-than-expected data, particularly in the euro area and Japan, expectations for a more rapid pace of increase in US interest rates, and ongoing geopolitical developments. In Asia, most Asian equities trended lower following growing concerns on global growth prospects and higher investor risk aversion. Nevertheless, Japanese equities improved, as the weaker yen supported market expectations for a stronger export performance.

The US economy continued to expand, although at a more moderate pace, in the third quarter (2.3%; 2Q 2014: 2.6%), supported by both private consumption and investment activity. Government spending also contributed positively to growth for the first time in 16 quarters. On a seasonally adjusted annualised basis, the economy grew by 3.5% (2Q 2014: 4.6%). The labour market recorded further improvements. Job creation continued to increase (702,000; 2Q 2014: 800,000), while long-term unemployment and involuntary part-time workers declined. Headline inflation moderated to 1.8% (2Q 2014: 2.1%), amid lower cost of energy and medical services.

Recovery in the euro area was subdued in the third quarter. While overall demand conditions were supported by more accommodative monetary conditions, growth remained weak amid high unemployment, low capacity utilisation and ongoing balance sheet adjustments by both the private and public sectors. Business confidence was further affected by geopolitical developments in Eastern Europe, which in turn weighed down on private investment. Inflation moderated further to 0.3% (2Q 2014: 0.6%), due mainly to the lower cost of food and energy, and increased concerns on the risk of deflation.

Economic activity in the UK expanded by 3% in the third quarter (2Q 2014: 3.2%). The services sector remained the key contributor to growth, particularly the transport, and business services and finance sectors. The inflation rate moderated to 1.4% (2Q 2014: 1.7%), amid lower prices of food and transport.

In Japan, economic activity improved, although the strength of growth remained weak following larger-than-expected impact from the consumption tax increase in April. Private consumption was underpinned by higher retail sales amid better employment conditions. Investment was supported by improving business sentiments. In the external sector, exports expanded at a faster pace (3.2%; 2Q 2014: 0.1%), supported by higher shipments to Asia and the US. Inflation (excluding fresh food) moderated slightly (3.2%; 2Q 2014: 3.3%), as the effects of the consumption tax increase began to diminish. Core inflation (excluding food and energy), nevertheless, remained unchanged (2.3%; 2Q 2014: 2.3%).

Advanced Economies: Real GDP Growth

	2013		2014		
	3Q	4Q	1Q	2Q	3Q
	Annual Change (%)				
US[1]	4.5	3.5	-2.1	4.6	3.5[a]
UK	1.7[r]	2.7	2.9[r]	3.2[r]	3.0[p]

[1] Annualised basis
[a] Advance estimate
[p] Preliminary
[r] Revised

Source: National authorities

The overall monetary policy stance in the advanced economies remained highly accommodative across economies, despite continued divergence in monetary policy direction in the third quarter. In the US, the Federal Reserve (Fed) continued to reduce the pace of its asset purchases by USD10 billion following each meeting, ending the quantitative easing programme (QE-3) in October. In addition, latest official projections on the median policy rate indicated that the pace of interest rate increase could be faster than expected, with the federal funds rate reaching 1.4% by end-2015 (previous: 1.1%) and 2.9% in 2016 (previous: 2.5%). In the UK, the Bank of England (BoE) also signalled the potential for monetary policy normalisation to start in 2015 should economic activity and labour market conditions improve further.

In contrast, the ECB implemented further monetary easing in September and October, to support growth and reduce the risk of deflation in the euro area. The main refinancing operations (MRO) rate and deposit rate were reduced by 10 basis points (bps) each in September, to 0.05% and -0.20% respectively (previous: 0.15% and -0.10% respectively). The ECB also introduced new purchase programmes for asset-backed securities and covered bonds, beginning in October and lasting for at least two years. Meanwhile, the Bank of Japan (BoJ) increased its annual asset purchases to JPY80 trillion (previous target range: JPY60~70 trillion), amid continued disinflationary concerns.

In PR China, the economy grew by 7.3% (2Q 2014: 7.5%), driven mainly by growth in the tertiary industry (which includes, among others, hotel and catering, wholesale and retail trade, and financial intermediation) and the secondary industry (industry and construction). Inflation moderated to 2% (2Q 2014: 2.2%), attributable to the lower price of food, transport and housing.

In Asia, economic activity continued to expand, albeit at a more moderate pace in several economies. Growth in Indonesia moderated to 5% (2Q 2014: 5.1%), on account of lower exports and investment. In Korea, economic activity grew at a slower pace (3.2%; 2Q 2014: 3.5%) due mainly to weaker net exports. In Singapore, growth was sustained at 2.4% (2Q 2014: 2.4%), supported by the manufacturing and services sectors. In Chinese Taipei, the economy grew at a slightly faster pace (3.8%; 2Q 2014: 3.7%), underpinned by an improvement in domestic demand.

Regional Countries: Real GDP Growth

	2013		2014		
	3Q	4Q	1Q	2Q	3Q
	Annual Change (%)				
PR China	7.8	7.7	7.4	7.5	7.3
Indonesia	5.6	5.7	5.2	5.1	5.0
Singapore	5.0	4.9	4.8	2.4	2.4[a]
Korea	3.4	3.7	3.9	3.5	3.2[a]
Chinese Taipei	1.3	2.9	3.2	3.7	3.8[a]

[a] Advance estimate

Source: National authorities

Headline inflation moderated in most Asian economies on account of lower price increases in the food as well as transportation and communication sectors, particularly in Chinese Taipei, Indonesia, Korea, Singapore and Thailand. Nevertheless, inflation rose in Hong Kong and the Philippines due to higher cost of housing and utilities, and food respectively.

During the quarter, the direction of monetary policy decisions by regional central banks diverged. Bangko Sentral ng Pilipinas (BSP) raised its key policy rates in July and September by a total of 50 basis points, to 4.00% for the overnight borrowing or reverse repurchase facility and 6.00% for the overnight lending or repurchase facility. Inflationary pressures and inflation expectations were assessed to be elevated amid tight supply conditions and possible price adjustments in the energy and utilities sectors. In contrast, the Bank of Korea (BOK) lowered its base rate in August and October by 25 basis points each to 2.00%, amid tepid growth in investment and subdued inflationary pressures.

Brent crude oil prices moderated to an average of USD103 per barrel in the third quarter (2Q 2014: USD110 per barrel), amid higher global supply and subdued demand from several key economies, including PR China. During the quarter, the price premium on crude oil eased, as supply from the key oil-producing regions were not disrupted despite continued geopolitical developments. Meanwhile, non-OPEC countries contributed more to supply. The US, in particular, increased its supply of shale oil. Oil prices ended the quarter at USD94 per barrel, and declined further to USD86 per barrel as of 27 October 2014, the lowest level since November 2010.

Most major and regional currencies depreciated against the US dollar during the quarter due to weaker-than-expected data, expectations for a faster increase in US interest rates and ongoing geopolitical developments. In the advanced economies, the euro and Japanese yen were lower following weaker-than-expected economic activity. The announcement of additional monetary easing by the ECB also weighed down on the euro. Meanwhile, the pound sterling was affected by uncertainty surrounding the 2014 Scottish independence referendum. In Asia, investors' expectations for a more rapid increase in US interest rates, together with the escalation of street demonstrations in Hong Kong, weakened sentiments in the regional markets. Nevertheless, the Chinese renminbi remained on an appreciating trend, as investor confidence was supported by several policy announcements to support growth, including the easing of property-related measures.

Going forward, global growth is expected to remain moderate. Growth in the advanced economies is expected to remain uneven. In Asia, growth will be underpinned by a continued expansion in domestic demand and exports. Nevertheless, there remains considerable downside risks to global growth. These include prolonged weakness in domestic demand and low inflation in a number of major economies, uncertainty over monetary policy adjustments in the key advanced economies and persistent geopolitical tensions that could heighten financial market volatility.