DEVELOPMENTS IN THE SECOND QUARTER OF 2015

INTERNATIONAL ECONOMIC ENVIRONMENT

Moderate expansion in global economic activity

The global economy expanded at a moderate pace in the second quarter of 2015. In the major advanced economies, growth in the US and the UK continued to improve while the pace of economic activity in the euro area and Japan was more modest. Growth in most Asian economies moderated in the second quarter. Domestic demand continued to support growth in an environment of weak export performance. Several central banks in major and emerging economies lowered policy rates amid rising growth concerns and low inflation.

Global financial markets remained volatile in the second quarter. Investor sentiments were affected by uncertainties surrounding the timing and magnitude of interest rate normalisation by the US Federal Reserve (Fed) and adverse developments surrounding the Greek debt crisis. In Asia, equity markets were further weighed down by concerns over weaker-than-expected economic data releases in the region. In PR China, equity markets rose during the earlier part of the quarter supported by capital market liberalisation measures introduced since the fourth quarter of last year and continued easing measures by the government to support economic growth. Nevertheless, this trend reversed in mid-June following concerns over an overvaluation in Chinese stocks.

The US economy continued to expand at a more moderate pace (2.3%; 1Q 2015: 2.9%). On a seasonally adjusted annualised basis, the growth momentum strengthened to 2.3% (1Q 2015: 0.6%), as the temporary factors that weighed on growth in the first quarter, namely harsh winter conditions and port congestion, diminished. Private consumption activity was sustained in the second quarter as households continued to benefit from lower oil prices, stronger labour market conditions and improved household balance sheets. However, growth of fixed investment moderated, due mainly to the continued decline in oil and gas-related capital expenditure. Headline inflation registered flat growth in the second quarter of 2015 (1Q 2015: -0.1%), amid low oil prices.

Economic activity in the euro area continued to improve modestly in the second quarter. Domestic demand conditions were supported by low energy prices, accommodative monetary policy and better labour market conditions in a few key economies, including Germany. Despite the escalation of the Greek debt and economic crisis, business and consumer sentiments continued to improve during the quarter, with the manufacturing PMI increasing to 52.2 (1Q 2015: 51.4). Headline inflation turned around to register positive growth during the quarter (0.2%; 1Q 2015: -0.3%), due to an increase in the cost of food and services.

The UK economy grew at a more moderate pace in the second quarter (2.6%; 1Q 2015: 2.9%). The continued expansion of economic activity was driven mainly by the services sector, particularly the business services and finance sub-sector. Headline inflation registered 0% growth during the quarter (1Q 2015: 0.1%), amid lower prices of housing and household expenditures as well as clothing and footwear.

Economic activity in Japan expanded modestly in the second quarter. The improvement in indicators was, however, due in part to base effect arising from the consumption tax increase on 1 April 2014. Retail sales rebounded across a broad segment of goods (2.9%; 1Q 2015: -4.8%), while business sentiments improved during the quarter as reflected by the increase in the Tankan survey index for large manufacturers. On the external front, export growth moderated to 6.7% (1Q 2015: 9.1%) amid lower demand from Western Europe and the US. Inflation (excluding fresh food) experienced a broad-based moderation to 0.2% (1Q 2015: 2.1%). Core inflation (excluding food and energy) was also lower (0.5%; 1Q 2015: 2.1%).

Advanced Economies: Real GDP Growth

	2014		2015		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
US	2.6	2.2	2.9[r]	2.3[a]	2.6[a]
UK	3.0	2.8	2.9[r]	2.6[p]	2.7[p]

[a] Advance estimate
[p] Preliminary
[r] Revised

Source: National authorities

The stance of monetary policy in the advanced economies remained accommodative, despite continued divergence in direction of monetary policy across economies. Amid ongoing improvements in the US labour market, the Fed continued to signal that an increase in interest rates would be likely in the second half of the year.

Most central banks reaffirmed their commitment to maintain accommodative monetary conditions, with several central banks reducing policy rates, amid lower inflation and rising growth concerns. The European Central Bank (ECB) and the Bank of Japan (BOJ) maintained their asset purchase programmes during the quarter. The ECB reaffirmed its intention to purchase EUR60 billion of assets per month until end-September 2016 or until medium-term inflation is close to 2%. Likewise, the BOJ reiterated its commitment to increase the monetary base by JPY80 trillion annually. The Bank of England (BOE) also maintained the stock of its purchased assets at GBP375 billion. Meanwhile, the Reserve Bank of New Zealand reduced its key policy rate in June and July by a cumulative 50 basis points to 3.00%, while the Reserve Bank of Australia and Norway's Norges Bank lowered their key policy rates by 25 basis points each to 2.00% and 1.00%, respectively in the second quarter. In July, the Bank of Canada reduced its key policy rate by 25 basis points to 0.50%. Similarly, the Sveriges Riksbank (Swedish National Bank) lowered its key policy rate by 10 basis points to -0.35% and extended its purchase of government bonds by a further SEK45 billion.

In PR China, economic growth was sustained in the second quarter (7.0%; 1Q 2015: 7.0%). By industry, growth improvements in the primary (agriculture and mining) and tertiary (services) sectors offset the slower expansion across secondary (industry and construction) industries. During the quarter, the Chinese government announced a series of wide-ranging policy measures such as infrastructure investment and increased lending to targeted sectors to support economic momentum. In addition, further monetary policy easing measures were also introduced following the stock market correction towards the end of the quarter. Nevertheless, growth continued to face headwinds from ongoing reforms to rebalance the key drivers of the economy. Inflation increased to 1.4% in the second quarter (1Q 2015: 1.2%) amid higher prices of food as well as higher prices in the recreation, education and cultural sub-sector.

In Asia, most economies growth continued to expand, albeit at a more moderate pace. Growth in the Chinese Taipei economy slowed sharply to 0.6% in the second quarter (1Q 2015: 3.4%), due to a decline in exports which offset the improvement in domestic demand. Growth in Indonesia was sustained at 4.7% in the second quarter, as a moderation in investment activity was offset by an improvement in net exports, amid sustained private consumption growth. In Korea, growth moderated to 2.2% (1Q 2015: 2.5%), on account of weaker external demand amid a continued expansion in domestic demand. In Singapore, growth moderated to 1.8% (1Q 2015: 2.8%), due mainly to a contraction in manufacturing activity, particularly the biomedical engineering and transport engineering clusters.

Regional Countries: Real GDP Growth

	2014		2015		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
Chinese Taipei	3.9	3.6	3.4	0.6[a]	2.0[a]
Indonesia	5.0	5.1	4.7	4.7	4.7
Korea	3.4	3.7	2.5	2.2[a]	2.3[a]
PR China	7.4	7.4	7.0	7.0	7.0
Singapore	2.3	3.4	2.8[r]	1.8[p]	2.3[p]

[a] Advance estimate
[r] Revised
[p] Preliminary

Source: National authorities

Inflationary pressures remained subdued in most Asian economies, as prices continued to be weighed down by lower energy prices. Of note, Thailand, Singapore and Chinese Taipei experienced deflation in the second quarter. Nonetheless, inflation rose in Indonesia, primarily as the outcome of an increase in the price of fuel, following the fuel subsidy rationalisation.

Against this backdrop, monetary policy remained accommodative in the region with a few central banks lowering their policy rates during the quarter. Amid moderate domestic economic activity, the Bank of Thailand and the Reserve Bank of India lowered their key policy rates by 25 basis points each to 1.50% and 7.25%, respectively. Similarly, the Bank of Korea reduced its policy rate by 25 basis points to a record low of 1.50% as downside risks to growth increased following weak export growth and the outbreak of the Middle East Respiratory Syndrome (MERS) which dampened domestic demand. Meanwhile, the People's Bank of China (PBoC) eased monetary conditions further during the quarter to boost credit growth and support economic activity. The PBoC reduced the one-year benchmark lending and deposit rates to 4.85% and 2.00%, respectively (Previous: 5.35% and 2.50%, respectively). In April, the PBoC lowered the reserve requirement ratio by 100 basis points for all banks, and in June, the ratio was lowered further by 50 basis points for banks lending to small and medium enterprises as well as the agriculture sector.

Brent crude oil prices improved to an average of USD63 per barrel in the second quarter (1Q 2015: USD55 per barrel). This is due to a decline in US shale oil production and the Fed's decision to not raise interest rates in June, both of which helped improve sentiments in the oil market during the first two months of 2Q 2015. Price hit a year high of USD68 per barrel on 4 May 2015. However, the Fed's indication of a possible interest rate hike sometime in the second half of 2015 triggered a minor sell-off in the oil markets towards the end of the quarter, causing oil prices to moderate to USD62 per barrel on 29 June 2015.

Most major currencies appreciated against the US dollar in the second quarter. In the first two months of the quarter, the improvement in economic activity in the UK and the euro area provided some support to the pound sterling and the euro. However, the strength of these currencies was affected by higher uncertainty surrounding the Greek debt crisis during the quarter. The Japanese yen weakened amid BOJ's commitment to maintain accommodative monetary policy. In the rest of Asia, most regional currencies depreciated against the US dollar as better US economic data releases reinforced market expectations for the Fed to increase interest rates by end-2015. In addition, concerns over moderating economic activity in the region, including PR China and heightened uncertainty from the Greek debt crisis also weighed on the region's currency performance.

Going forward, the global economy is projected to remain on a moderate growth path, with diverging growth momentum across major economies. Overall global growth is expected to continue to benefit from low oil prices, but the impact will vary across economies. In Asia, with export growth remaining moderate, domestic demand is expected to remain the key driver of growth. Global growth, however, has become more vulnerable to increased downside risks. Any adverse developments in Europe, increased uncertainty over policy adjustments in the advanced and emerging economies and a re-emergence of geopolitical tensions could result in further international financial market volatility.