DEVELOPMENTS IN THE THIRD QUARTER OF 2009

INTERNATIONAL ECONOMIC ENVIRONMENT

Increasing signs of improvements in the global economy

Signs of improvements in the global economy became more pronounced in the third quarter of 2009. Global production, trade and retail sales revived, while conditions in the international financial markets continued to stabilise. In some of the major advanced economies, notably the US, Japan, Germany and France, economic activity gained momentum as evidenced by the positive growth on a quarterly basis. The rebound in economic activity was stronger in the emerging economies, particularly in Asia. However, the pace of recovery in the global economy continues to be uneven and remains dependent on policy support.

In the **US**, real GDP grew by an annualised rate of 3.5% in the third quarter (2Q 09: -0.7%), the first expansion after four consecutive quarters of contraction. This was driven mainly by positive growth in private consumption and residential fixed investment. Private consumption increased by 3.4% (2Q 09: -0.6%) due to strong purchases of motor vehicles as consumers took advantage of the 'cash for clunkers' programme. Private fixed investment expanded by 2.3% (2Q 09: -12.5%), with investment in the residential sector recording its first expansion in more than two years (3Q 09: 23.3%; 2Q 09: -23.2%). Lower drawdown in inventories and continued expansion in public sector spending provided further support to growth. On the inflation front, headline consumer prices declined at a faster pace of 1.6% during the quarter (2Q 09: -1.1%) due mainly to lower energy prices.

In **Japan**, the growth momentum continued with real GDP growing by an annualised rate of 4.8% (2Q 09: 2.7%) in the third quarter. Growth was supported by improvements in private consumption, capital spending in the non-residential sector and net exports. Exports recorded a slightly smaller decline of 34.4% (2Q 09: -38.6%), due to increased demand for E&E and steel from the Asian region. Meanwhile, government policies, particularly consumption-related measures, helped provide support to private consumption. Of significance, capital spending in non-residential sector rose by 6.6% (2Q 09: -15.6%), marking its first expansion after five consecutive quarters of contraction. On the inflation front, core consumer prices (excluding fresh food) declined by 2.3% (2Q 09: -1%), reflecting lower commodity prices from a year ago.

The **euro area** experienced a slower annual contraction of 4.1% (quarter-on-quarter growth of 0.4%) in the third quarter (2Q 09: -4.8%), as positive effects of fiscal measures and the improvement in external demand provided some support to the economy. On a quarterly basis, several economies including the two largest member economies, Germany and France, continued to register a quarter-on-quarter growth, due to the positive impact from the car scrapping schemes on car sales and consumer sentiment. On the inflation front, consumer prices in the euro area declined by 0.4% in the third quarter (2Q 09: 0.2%), due mainly to lower energy and food prices.

In the **UK**, real GDP declined by 5.2% year-on-year in the third quarter (2Q 09: -5.5%), which was the sixth quarter-on-quarter consecutive contraction, making this the longest economic recession on record. Meanwhile, inflation continued to edge downwards to 1.5% in third quarter (2Q 09: 2.1%).

Industrial Countries: Real GDP Growth

	2008		2009			Key contributing factors for 3Q growth
	3Q	4Q	1Q	2Q	3Q	
	Annual change (%)					
US[1]	-2.7	-5.4	-6.4	-0.7	3.5[a]	Positive growth in private consumption expenditure and residential fixed investment.
Japan[1]	-6.5	-11.5	-12.2	2.7[r]	4.8[p]	Due to positive contribution from private consumption, investment in non-residental sector and net exports.
Euro area	0.4	-1.8	-4.9	-4.8	-4.1[p]	Supported by improvements in Germany and France.
UK	0.3	-1.9	-5.0	-5.5	-5.2[p]	Broad-based contraction across all major economic sectors.

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

Source: National authorities

Central banks in the major advanced economies continued to maintain an accommodative monetary policy and the quantitative measures to ensure continued stability in the financial system. In the **US**, while the federal funds rate was maintained at 0 – 0.25%, changes were made with respect to several of the credit and lending programmes. In August, the Fed decided to gradually slow its purchases of USD300 billion worth of US Treasury securities by the end of October 2009 (previous deadline: September 2009). At the subsequent two meetings, the Fed announced that they would slow the pace of its purchases of both the agency debt and mortgage-backed securities by the end of the first quarter of 2010 (previous deadline: end-2009). The Fed also reduced the maximum amount of purchases of agency debt to USD175 billion (from USD200 billion) but maintained the maximum amount of mortgage-backed securities purchases at USD1.25 trillion. In Japan, the uncollateralised overnight call rate remained unchanged at 0.1%. However, the **Bank of Japan** extended its special lending facility to provide funds at 0.1% until March 2010 (previous deadline: December 2009). While maintaining the base lending rate at 0.5%, the **Bank of England** expanded the purchase of commercial paper, corporate bonds and gilts under the Asset Purchase Facility by another £50 billion and £25 billion in August and November respectively, bringing the total of this facility to £200 billion. Meanwhile, the **European Central Bank** had been purchasing covered bonds since July, while maintaining the refinancing rate at 1%.

In the third quarter, prices of **crude oil**[2] increased to a 10-month high of USD74 per barrel in mid-August, driven mainly by higher risk appetite among investors and expectations of a strong recovery in global demand. However, crude oil prices retreated to below USD70 per barrel in the latter half of the quarter, following concerns over the sustainability of the recovery. Crude oil prices averaged around USD68 per barrel during the quarter (2Q 09: USD60 per barrel).

In the **Asian region**, PR China and Indonesia continued to expand at a stronger pace of 8.9% (2Q 09: 7.9%) and 4.2% (2Q 09: 4%) respectively, while Hong Kong SAR registered a slower contraction of 2.4% (2Q 09: -3.6%). Meanwhile, Singapore and Korea recorded their first positive annual growth of 0.6% (2Q 09: -3.3%) and 0.6% (2Q 09: -2.2%) respectively following the strengthening of domestic demand and a broad-based improvement in exports. Domestic demand in the region has gathered pace, in particular private consumption, benefiting from the impact of fiscal measures, improving consumer confidence and stabilisation in labour market conditions. Stronger intra-regional trade also provided further support to growth in the regional economies. As the outlook for inflation remained benign and the recovery process was still at an early stage, most central banks in the region continued to maintain an accommodative monetary policy stance. **Bangko Sentral ng Pilipinas** reduced its policy rate by 25 basis points in July, while **Bank Indonesia** reduced its policy rate by 25 basis points each in July and August.

[2] Refers to WTI one-month futures on NYMEX

Regional Countries: Real GDP Growth

	2008		2009			Key contributing factors for 3Q growth
	3Q	4Q	1Q	2Q	3Q	
	Annual change (%)					
PR China	9.0	6.8	6.1	7.9	8.9	Supported by strong consumption and investment activities.
Singapore	0.0	-4.2	-9.5	-3.3[r]	0.6	Supported by continued expansion of biomedical and electronics output.
Korea	3.1	-3.4	-4.2	-2.2	0.6[a]	Supported by stronger domestic demand.
Indonesia	6.4	5.2	4.4	4.0	4.2	Supported by government spending and private consumption.
Hong Kong SAR	1.5	-2.6	-7.8	-3.6[r]	-2.4	Supported by improvement in domestic demand.

[a] Advance estimate
[r] Revised

Source: National authorities

In the **foreign exchange market**, all the major currencies except the pound sterling strengthened against the US dollar during the third quarter. The euro appreciated against the US dollar during the quarter on revival in global risk appetite following further signs of recovery taking place in the global economy. Meanwhile, the Japanese yen strengthened against the US dollar reflecting seasonal repatriation flows back to Japan, ahead of the end of the first half of their fiscal year. The repatriation was further motivated by firms taking advantage of the tax exemption on dividends received from overseas' subsidiaries which came into effect in April 2009. On the other hand, the pound sterling weakened against the US dollar on expectations that the recovery in the UK economy will lag other advanced economies. Regional currencies also appreciated against the US dollar in the third quarter following improved investor sentiments about the stronger growth prospects of the region vis-à-vis the advanced economies.

Going forward, global economic conditions are expected to improve further as most of the policy measures supporting demand are still in place. While the risks to growth have receded in recent months, the pace of recovery in the global economy is likely to be gradual and uneven as the outlook remains uncertain. A strong rebound will be constrained by problems in the advanced economies as financial, non-financial and household sectors continue to repair their balance sheets amidst tight financial conditions.