# DEVELOPMENTS IN THE SECOND QUARTER OF 2016

## INTERNATIONAL ECONOMIC ENVIRONMENT

### Moderate global growth

In the second quarter of 2016, the global economy expanded at a more moderate pace, with uneven growth momentum across economies. Growth remained modest in the advanced economies amid continued cyclical and structural weaknesses. In Asia, economic expansion was supported by domestic demand, but was weighed down by persistent weakness in export performance. While the initial impact from the result of the UK's EU referendum created uncertainty and heightened risk aversion, financial market volatility has since subsided. Amid continued growth concerns and low inflation, several major and regional central banks conducted further easing to support economic activity.

International financial market conditions became more volatile, particularly in June. During the first half of the quarter, equity markets declined due to the release of weaker Chinese economic data and the continued decline in oil prices. However, both major and regional equities rose from May onwards, following tentative signs of stabilisation in oil prices and the Federal Reserve (Fed)'s decision to keep its federal funds rate unchanged during the June FOMC meeting. Nevertheless, the unexpected outcome of the UK's EU referendum in June resulted in an initial financial market shock, with the British pound declining to a 31-year-low against the US dollar. In this environment of heightened risk aversion, the Japanese yen appreciated due to safe haven flows, while most regional currencies ended the quarter lower against the US dollar. Financial market volatility subsided in the week following the referendum, as concerns abated.

Brent crude oil price rose to an average of USD47 per barrel (1Q 2016: USD35 per barrel), the highest since 3Q 2015. The increase was broadly underpinned by improvements in market sentiments on expectations of a narrower gap between global oil supply and demand. Of significance, concerns over the global oversupply condition eased during the quarter as a result of a series of supply disruptions in oil producing countries such as Nigeria, Canada, Iraq and Libya, as well as a downtrend in US crude oil inventories. The global oil demand remained supported by oil consumption in the emerging economies, particularly in PR China and India. Towards the end of the quarter, however, price movements were highly volatile, reflecting mainly shifts in demand in the oil futures market. A weaker US dollar in early-June initially lifted Brent crude oil price to its highest level since mid-October 2015, at USD52 per barrel on 8 June. Subsequently, uncertainties surrounding the UK's EU referendum and its unexpected result led to a decline in Brent crude oil price. Nonetheless, as immediate concerns over the potential impact of the result waned, oil price increased, ending the quarter at USD50 per barrel.

The US economy grew at a more moderate pace in the second quarter (1.2%; 1Q 2016: 1.6%). However, on a seasonally adjusted annualised basis, growth momentum rose to 1.2% (1Q 2016: 0.8%). Economic activity was underpinned by private consumption amid sustained personal disposable income growth and steady labour market conditions. Headwinds remained for the corporate sector, particularly from weaker corporate profits. Additionally, inventories and net exports were a larger drag on growth. During the quarter, headline inflation remained steady at 1.1%, due mainly to increases in prices of shelter and transportation services.

According to preliminary estimates, growth in the euro area was relatively sustained (1.6%; 1Q 2016: 1.7%) during the second quarter, driven mainly by private consumption and investment activity. On a seasonally-adjusted quarter-on-quarter basis, growth moderated to 0.3%, from 0.6% in the previous quarter. Although external demand improved marginally (April - May 2016 average: 0.5%, 1Q 2016: -1.1%), it remained weak compared to last year's performance (2015: 5.4%). In spite of a highly accommodative monetary policy stance, deflationary pressures persisted, with headline inflation recording a decline of 0.1% (1Q 2016: +0.1%) and core inflation remaining subdued at 0.8%.

The UK economy grew at a faster pace in the second quarter (2.2%; 1Q 2016: 2.0%), as the weakness in the construction and agriculture sectors was offset by improvements in the services and manufacturing sectors. Nevertheless, household and business sentiments continued to be weighed down by uncertainty following the results of the UK's EU referendum. Growth in headline inflation was modest, at 0.3% (1Q 2016: 0.4%).

In Japan, overall economic activity remained subdued. Industrial production continued to decline (-1.9%, 1Q 2016: -3.2%), reflecting mainly contractions in the manufacturing, electricity and mining subcomponents. Exports contracted further (-9.5%, 1Q 2016: -7.9%), on account of slower demand from key trading partners. In addition, consumer spending remained in contraction amid a slower wage growth of 1.2% (1Q 2016: 1.4%). Headline inflation (excluding fresh food) declined further to -0.4% (1Q 2016: -0.1%) while core inflation (excluding food and energy) remained modest at 0.6% (1Q 2016: 0.7%).

**Advanced Economies: Real GDP Growth**

| | 2015 | | 2016 | | |
|---|---|---|---|---|---|
| | 2Q | 1H | 1Q | 2Q | 1H |
| | Annual change (%) | | | | |
| US | 3.0[r] | 3.1[r] | 1.6[r] | 1.2[a] | 1.4[a] |
| Euro area | 1.6 | 1.5 | 1.7 | 1.6[p] | 1.6[p] |
| UK | 2.4 | 2.6 | 2.0 | 2.2[p] | 2.1[p] |

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

Source: National authorities

Overall monetary policy stance in the advanced economies remained highly accommodative, with most central banks conducting further easing. Following the outcome of the UK's EU referendum, the Bank of England (BOE) reduced the bank rate by 25bps to a record low of 0.25% in August 2016. In order to further support growth and inflation, the BOE launched a new stimulus package, which includes a new Term Funding Scheme to reinforce the pass-through of the cut in bank rate, the purchase of up to GBP10 billion of UK corporate bonds and an expansion of the asset purchase scheme for UK government bonds of GBP60 billion, thereby taking the total stock of these asset purchases to GBP435 billion. The Reserve Bank of Australia (RBA) also lowered the cash rate by 25bps to 1.75% in May 2016 and then again to 1.50% in August 2016, following weaker-than-expected inflation. The RBA also noted that the price pressures in the housing market have abated, hence the potential risks of lower interest rates are less than they were a year ago. The Bank of Japan (BOJ) kept interest rates steady but decided to double the annual pace of the purchases of exchange-traded funds (ETF) to about 6 trillion yen. Against the backdrop of increased uncertainties surrounding the global economy, the BOJ increased the size of its lending program, which provides US dollars to Japanese companies in a bid to support their overseas activities. The European Central Bank (ECB) decided to keep its key policy rates and monthly asset purchase of EUR80 billion unchanged. Likewise, the Bank of Canada (BOC) maintained its target for the overnight rate at 0.5%. However, both the ECB and BOC have noted that headwinds to growth have increased following the result of the UK's EU referendum. Conversely, the Federal Reserve (Fed) kept the Federal Funds Rate unchanged in July, highlighting that the labour market has strengthened and near-term risks to the US economic outlook have diminished.

Growth in PR China was sustained at 6.7% in the second quarter (1Q 2016: 6.7%). By sector, the improvement in the industrial sector (6.3%, 1Q 2016: 5.8%) was offset by a more moderate expansion in the services sector (7.5%, 1Q 2016: 7.6%). During the quarter, the introduction of policy measures provided some support to investment activity. These include increased financing for infrastructure investment and the easing of house purchase restrictions. Nevertheless, the overall economy continued to face headwinds from weaker business sentiments, ongoing adjustments across sectors with excess capacity and a more modest external demand. Inflation was sustained at 2.1% (1Q 2016: 2.1%) as the increase in house prices was offset by more moderate growth in food and clothing categories.

In Asia, several economies registered moderate improvements. Economic activity in Korea expanded at a faster pace (3.2%; 1Q 2016: 2.8%), underpinned by stronger private consumption and a recovery in exports. Growth in Indonesia picked up to 5.2% (1Q 2016: 4.9%), supported mainly

by higher government spending and a smaller decline in export growth. Economic activity in Chinese Taipei registered a positive growth of 0.7% (1Q 2016: -0.7%), following a rebound in exports. Growth in Singapore was sustained at 2.1% (1Q 2016: 2.1%), as the improvement in the manufacturing sector, driven mainly by the biomedical manufacturing and electronic clusters, partially offset the weakness in the services sector during the quarter.

**Regional Countries: Real GDP Growth**

| | 2015 | | 2016 | | |
|---|---|---|---|---|---|
| | 2Q | 1H | 1Q | 2Q | 1H |
| | Annual change (%) | | | | |
| PR China | 7.0 | 7.0 | 6.7 | 6.7 | 6.7 |
| Indonesia | 4.7 | 4.7 | 4.9 | 5.2 | 5.1 |
| Korea | 2.2 | 2.3 | 2.8 | 3.2[a] | 3.0 |
| Singapore | 1.8 | 2.2 | 2.1[r] | 2.1 | 2.1 |
| Chinese Taipei | 0.6 | 2.3 | -0.7 | 0.7[a] | 0.0 |

[a] Advance estimate
[r] Revised

Source: National authorities

Inflation remained subdued in a number of Asian economies. Lower fuel prices contributed to a decline in transportation and utility costs, offsetting the higher rate of inflation for food items in a few economies. Following a period of deflation since 1Q 2015, Thailand recorded its first quarterly increase in inflation during the quarter, as the drought during the quarter caused food prices to increase at a faster pace than the decline in fuel pump prices.

Monetary policy remained accommodative in the region with a few central banks lowering their policy rates during the quarter. The Reserve Bank of India (RBI) and the Bank of Korea (BOK) lowered their key policy rates by 25 basis points to 6.50% and 1.25%, respectively, to support domestic economic activity. Additionally, the RBI also eased liquidity conditions by lowering the cash reserve ratio and increasing its reverse repo rate to support credit growth. The Central Bank of China (Taiwan) also lowered its key policy rate by 12.5 basis points to 1.375% in view of higher downside risks to economic growth. The Monetary Authority of Singapore (MAS) reduced the slope of the Singapore dollar nominal effective exchange rate (S$NEER) from a gradual appreciation path to zero percent, noting that economic activity is expected to expand at a more modest pace than previously projected.

Going forward, global economic activity is expected to remain subdued despite unprecedented easing of monetary conditions in major and regional economies. The pace of expansion in the advanced economies is expected to remain modest, while in Asia, domestic demand will continue to underpin growth. Further bouts of financial market volatility resulting from rising concerns on the US presidential elections and increased risks of political contagion following the UK's EU referendum could materially affect the markets through international capital flows. Overall global economic conditions have become increasingly challenging, with higher downside risks.