DEVELOPMENTS IN THE THIRD QUARTER OF 2012

INTERNATIONAL ECONOMIC ENVIRONMENT

Global growth moderated further amid improvement in financial market conditions

The world economic environment remained challenging in the third quarter of 2012. Growth in the advanced economies was uneven with the US economy experiencing an improvement while several other major advanced economies continued to experience weak growth, constrained by fiscal adjustments, sluggish labour markets and impaired financial intermediation. In Asia, economic activity moderated as spillover effects of the external uncertainties on domestic demand became more apparent. A number of countries implemented policy measures to support economic growth.

Conditions in the international financial markets improved following policy actions in the crisis-affected economies to ease uncertainties in the market. At the beginning of the third quarter, volatility in the financial markets receded from its peak as the outcome of the European Summit in June provided clearer policy directions on the future of the currency union. In addition, central banks in the euro area, US and Japan undertook further unconventional monetary easing, relieving some pressures in financial markets. Nevertheless, there were periods of heightened volatility in the financial markets as developments in the euro area led to a temporary rise in risk aversion. These events include the USD125 billion funding request by the Spanish government to recapitalise the banking sector, causing yields on the Spanish 10-year sovereign bond to increase to a record high of around 7.5%. Market sentiments deteriorated further following the downgrades of sovereigns and banks by several credit ratings agencies such as the Spanish sovereign rating downgrade by Fitch and the downgrade of banks in Germany and Austria by Moody's. In November, volatility in the financial markets rose as delays over the release of the next tranche of financial aid to Greece led to renewed uncertainty. In the US, investors refocused their attention to the impending fiscal cliff issue after the presidential election.

The US economy grew at an annual rate of 2.3% in the third quarter (2Q 12: 2.1%). On a seasonally adjusted annualised basis, the economy grew at 2.0% (2Q 12: 1.3%). Private consumption improved, particularly in demand for automobiles and non-durable goods. Household spending was sustained by the increase in credit and withdrawal in personal savings amid higher consumer confidence. Job creation remained positive, registering a stronger gain of 521,000 during the quarter (2Q 12: 200,000). Private fixed investments grew by 6.4% (2Q 12: 9.9%), as the tentative improvement in housing market led to higher residential investment. Federal government expenditures rose due to the larger-than-expected increase in defence spending. The annual rate of inflation was lower at 1.7% (2Q 12: 1.9%).

Growth in the euro area remained weak amid continued recession in several crisis-affected economies. Domestic demand was affected by negative sentiments in the private sector arising from austerity measures and the ongoing sovereign debt crisis. Consumption, particularly in the crisis-affected economies, fell due to weak labour markets and tight financing conditions. The eurozone unemployment rate rose to 11.5%, with youth unemployment exceeding 50% in Greece and Spain. Headline inflation remained steady at 2.6% (2Q 12: 2.5%).

The UK economy recorded flat growth in the third quarter (2Q 12: -0.5%). On a quarter on quarter basis, real GDP expanded by 1.0% (2Q 12: -0.4%), reversing three quarters of consecutive contraction. The services sector was a key contributor to growth, supported by the hosting of the Olympic Games. Nevertheless, overall economic performance remained weak, attributable mainly to a decline in the construction sector. The protracted weakness reflected the negative impact of ongoing fiscal consolidation and declining exports to the euro area. Inflation maintained a steady downward trend due to smaller increases in energy prices (2.4%, 2Q 12: 2.8%).

In Japan, the pace of economic recovery has slowed to 0.1% (2Q 12: 3.3%), reflecting the fading effect of reconstruction-related demand amid continued weakness in the external environment. On a seasonally adjusted annualised basis, the economy contracted by 3.5% (2Q 12: 0.3%). Export growth declined significantly during the quarter (-4.9%, 2Q 12: 9.2%). On the domestic front, household spending remained resilient amid last minute purchases of energy-efficient cars as the subsidies programme came to an end. Deflationary pressures continued to persist as core consumer prices (excluding fresh food) declined in the third quarter (-0.2%, 2Q 12: 0.0%) following broad-based weakness in prices across all categories and slower increases in energy prices.

Advanced Economies: Real GDP Growth

	2011		2012		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
US[1]	1.3	4.1	2.0	1.3	2.0[a]
UK	0.7	0.7	-0.1	-0.5	0.0
Japan[1]	9.5[r]	-1.2[r]	5.2[r]	0.3[r]	-3.5[p]

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

Source: National authorities

Monetary policy remained accommodative in the advanced economies, with more unconventional measures undertaken amid increasing signs of weakening growth prospects. In the US, the Federal Open Market Committee (FOMC) maintained the federal funds rate at a historic low of 0-0.25%. In addition, the FOMC expanded its quantitative easing measures by increasing its purchase of agency mortgage-backed securities at a pace of USD40 billion per month. The European Central Bank (ECB) decreased its policy rate by 25 basis points to 0.75% and cut the overnight deposit rate to 0%. The ECB also expanded the range of eligible assets to be used as collateral from euro area banks to support bank lending activity in the region. In view of the weak economic recovery, the Bank of England (BoE) expanded its quantitative easing measures by increasing the size of its asset purchase programme in July by a total of £50 billion to £375 billion while keeping its policy rate at 0.5%. In addition, the BoE and the British government jointly unveiled a £100 billion lending plan for households and businesses. The Bank of Japan (BoJ) decided to enhance an existing loan scheme by ¥2 trillion through the Growth-Supporting Funding Facility. The funding facility was introduced early this year in an effort to support funding to prospective growth industries. The BoJ also expanded the total size of the Asset Purchase Programme by ¥10 trillion to ¥80 trillion for the purchase of Japanese government bonds and treasury discount bills.

Regional Countries: Real GDP Growth

	2011		2012		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
PR China	9.1	8.9	8.1	7.6	7.4[p]
Singapore	6.0	3.6	1.6[r]	2.5[r]	0.3[p]
Korea	3.6	3.3	2.8	2.3	1.6[a]
Chinese Taipei	3.5	1.9	0.4	-0.2	1.0[a]
Indonesia	6.5	6.5	6.3	6.4	6.2

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

Source: National authorities

Most economies in Asia continued to expand at a slower pace due mainly to further weakness in external demand. In several economies, there were also increasing signs that the adverse spillover effects from the external sector had begun to affect domestic demand. Nevertheless, many ASEAN economies continued to register relatively robust growth rates, partly supported by higher government spending (Thailand, Malaysia and the Philippines) and resilient domestic demand (Malaysia and Indonesia). Growth in PR China's economy moderated to 7.4% (2Q 12: 7.6%), on account of slower activity in the primary and secondary sectors. In Singapore, growth slowed to 0.3% (2Q 12: 2.5%) due to a deceleration in manufacturing and construction activities. The Korean economy also expanded at a slower rate of 1.6% (2Q 12: 2.3%) due mainly to weaker investment and export activity. The Chinese Taipei economy improved to 1.0% (2Q 12: -0.2%) following a rebound in investment growth. Economic activity in Indonesia grew by 6.2% (2Q 2012: 6.4%), on account of sustained consumption and investment.

In line with the weaker economic activity and slower increases in global commodity prices, headline inflation moderated in several economies during the quarter with the exception of the Philippines and Chinese Taipei, where prices rose on account of higher cost of food. India's headline inflation accelerated towards the end of the quarter as the government hiked subsidised fuel prices to rein in the budget deficit. With inflation becoming less of a policy concern in the region, several monetary authorities eased monetary policies to support growth amid heightened risks from the external environment. In July, the Bank of Korea (BoK) and Bangko Sentral ng Pilipinas (BSP) lowered their key policy rates by 25 bps each to 3.00% and 3.75% respectively. Similarly, the People's Bank of China reduced its benchmark one-year lending rate by 31 bps to 6.00% after lowering the rate by 25 bps in June. In October, BoK and BSP further reduced their key policy rates by 25 bps each to 2.75% and 3.50%, while the Bank of Thailand also lowered its benchmark policy rate by a similar magnitude to 2.75%. On the fiscal front, several economies, including PR China, Korea, Thailand and Chinese Taipei, have undertaken fiscal measures to boost domestic demand. These policies include the acceleration of approvals and implementation of infrastructure projects in PR China, and lower consumption taxes and an expansion of social-welfare programmes in Korea. In Thailand, in addition to the ongoing spending on flood-prevention measures, the government has announced plans to speed up investments in railway infrastructure and water management projects. Chinese Taipei's government has also unveiled stimulus to support the economy, which includes regulatory easing of foreign investments and implementing infrastructure projects to boost private investment.

Since reaching a trough of USD90.9 per barrel in late June, the price of crude oil[1] has been rising steadily during the third quarter, averaging USD109.5 per barrel (2Q 12: USD108.8 per barrel). The ascent was due mainly to a series of supply-side events, arising from a strike by workers in major Norwegian oil companies, lower production in the North Sea, and ongoing geopolitical tensions in the Middle East. The upward trend briefly reversed in late September following weaker Chinese economic data and Saudi Arabia's pledge to moderate prices. As at 28 September 2012, crude oil price closed at USD112.2 per barrel.

Foreign exchange markets were buoyed by market optimism emanating from further monetary easing by the monetary authorities. As a result, most major and Asian currencies appreciated against the dollar. Early in the quarter, the euro and Asian currencies depreciated against the US dollar, following Spanish regions' requests for financial aid from the federal government, which led to a re-intensification of the European sovereign debt crisis and subsequently heightened risk aversion. Weaker prospects for global growth also weighed down on investor confidence. In September, however, unconventional monetary easing measures undertaken by the US Federal Reserve, the BOJ and the ECB lifted sentiments in the market. Consequently, most currencies appreciated during the quarter as an expansion in liquidity spurred investors to seek higher yielding assets. Movements in the Japanese yen largely reflected safe-haven demand, with the appreciation during periods of risk aversion offsetting a marginal decline in August caused by weak domestic economic data.

Recent economic indicators suggest some stabilisation in growth performance going forward. Nevertheless, risks remain arising from continued policy uncertainties in several major economies. In particular, policymakers in those economies face a challenging task of weighing crucial decisions on issues related to fiscal consolidation and key reforms to address the underlying structural weaknesses that impedes economic recovery.

[1] Refers to Brent one-month futures on the Intercontinental Exchange (ICE).