DEVELOPMENTS IN THE THIRD QUARTER OF 2016

INTERNATIONAL ECONOMIC ENVIRONMENT

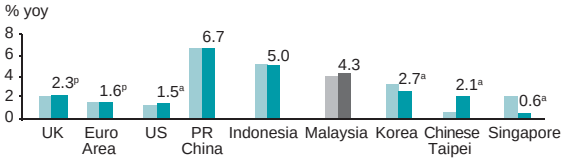
In the third quarter of 2016, the global economy continued to experience moderate growth. While volatility in the international financial markets receded following major central banks' easing actions, a number of important policy issues in major economies, such as the US monetary policy normalisation and election as well as UK-EU negotiations timeline following the UK's EU referendum, continued to pose uncertainties to global growth prospects. Amid a subdued growth outlook and low inflation, several major and regional central banks increased the degree of monetary accommodation.

Moderate growth in the global economy

The latest data pointed to modest economic activity in the advanced economies. In Asia, domestic demand remained an important source of growth amid persistent weakness in external demand.

Economic activity in the US and the UK expanded by 1.5% and 2.3%, respectively in the third quarter (2Q 2016: 1.3% and 2.1%, respectively). On a quarter-on-quarter seasonally adjusted annualised basis, growth momentum in the US economy rose to 2.9% (2Q 2016: 1.4%). The improvement came from better exports as well as inventory investment following a sizeable reduction in the previous quarter. The US economy continued to be characterised by two-speed growth, whereby sustained growth in private consumption was partially offset by weaker growth in private fixed investments. Private consumption remained the key driver of growth, underpinned by stronger labour market conditions and improving wage growth. In the UK, the immediate impact from the UK's EU referendum remained limited, as a faster expansion in the services sector more than offset a more moderate growth in the manufacturing and construction sectors. Nevertheless, uncertainty persisted, as indicated by weaker business sentiments. The depreciation in pound is expected to feed into inflation, hence affecting households' real income. The adverse impact of the UK's EU referendum is likely to be more evident when there is greater clarity on UK's upcoming post-EU referendum negotiations.

Global Real GDP Growth (Annual Change, %)



a Advance
p Preliminary

Source: National authorities

In the euro area and Japan, economic indicators pointed to subdued economic activity. While growth in the euro area was supported by domestic demand amid better credit conditions, business sentiments were weaker reflecting the uncertainty surrounding the UK-EU negotiations, which are expected to begin next year when the UK government invokes Article 50 of the Treaty on European Union. On the external front, exports remained in contraction due to lower shipments of raw materials and manufactured products. In Japan, consumption activity moderated following lower wage growth. Underscoring a decline in corporate profits amid the continued appreciation of the yen, Japan's largest manufacturers maintained their pessimistic business outlook. Similar to the euro area, export growth contracted, on account of lower shipments of car, electronics parts and steel.

Economic activity expanded at a moderate pace in emerging Asia amid persistent weakness in external demand. The Chinese economy registered a steady growth of 6.7%. While growth in the primary and services sectors were higher at 4.0% and 7.6%, respectively (2Q 16: 3.1% and 7.5%, respectively), this was offset by lower growth in the industrial sector (6.1%, 2Q 16: 6.3%). The

stabilisation in overall growth was due mainly to monetary and fiscal stimulus by the Chinese Government. In particular, investment activity was supported by post-flood reconstruction activity, as well as increased financing for the infrastructure and property sectors. In the ASEAN economies, growth continued to be underpinned by domestic demand amid some policy support.

Global financial market volatility decreased during the quarter

In July, global equities trended higher as the fallout from the UK's EU referendum appeared to be contained. The Bank of England (BOE) and the European Central Bank's commitment to mitigate any adverse spillovers from the UK's EU referendum also lifted sentiments in the financial markets. In the second half of the quarter, while global equity markets declined as sentiments were affected by expectations of an imminent interest rate increase by the US Federal Reserve (Fed), most major and regional equity markets resumed their upward trend after the Fed left interest rates unchanged on 18 September. Against this environment, most currencies ended the quarter slightly higher against the US dollar. The pound sterling, however, depreciated towards the end of the quarter due to renewed concerns about the UK's exit from the EU.

Although the average Brent crude oil price remained steady during the quarter at USD47 per barrel (2Q 2016: USD47 per barrel), price movements during the quarter were volatile, reflecting news-driven shifts in market sentiments. At the beginning of the quarter, Brent crude oil price trended lower, as concerns of a global market oversupply re-emerged. This was triggered primarily by selected data releases in the US, which indicated unusually high gasoline inventory levels during the summer driving season and rising shale oil rig counts. Subsequently, Brent crude oil price increased, supported mainly by the expectations, and eventual announcement, of a tentative agreement to cut oil production amongst the OPEC member countries.

Subdued inflation in the advanced and Asian economies

During the quarter, while there were slight improvements to headline inflation in the US, UK and euro area, price pressures were relatively subdued. Of significance, prices in these economies continued to be weighed down by weak energy prices. In Japan, headline inflation (excluding fresh food) contracted further following a sharper decline in prices of housing.

Likewise, inflationary pressures remained subdued in most Asian economies. In Indonesia, PR China, Thailand and Chinese Taipei, inflation was weighed down by lower food prices, while an overall decrease in the cost of utility led to lower inflation in Korea. In Singapore, inflation contracted at a slower pace, due mainly to higher costs of transportation.

Global monetary policy stance remained accommodative

Overall monetary policy stance in the advanced economies remained highly accommodative, with several central banks conducting further easing measures. Following the outcome of the UK's EU referendum results, the BOE reduced the bank rate by 25 bps to a record low of 0.25% in August 2016. The BOE also launched a new stimulus package, which includes a new Term Funding Scheme, 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. The Reserve Bank of Australia (RBA) also lowered the cash rate by 25 bps to 1.50% in August 2016, following weaker-than-expected inflation. In September, the Bank of Japan (BOJ) announced a new monetary policy framework called the "Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control" as it seeks to achieve the price stability target of 2% at the earliest possible time. The new policy framework consists of controlling the yield curve and an inflation-overshooting commitment. The framework will entail the BOJ setting short-term as well as long-term interest

rates as operating targets and conducting purchases of Japanese Government Bonds to achieve the target levels. The BOJ has also committed to maintaining an increase in the monetary base until inflation exceeds the target of 2%.

In the region, a few central banks lowered policy rates during the quarter. In September, Bank Indonesia (BI) cut its key policy rate, the seven-day reverse repo rate from 5.25% to 5.00% as domestic inflationary pressures eased. BI also reduced the lending facility rate and the deposit facility rate by 25 bps each to 5.75% and 4.50%, respectively. Similarly, the Reserve Bank of India (RBI) cut its key policy rate in October, from 6.50% to 6.25%, citing a marked slowdown in global growth. This was the first decision by the recently appointed monetary policy committee, which pushed policy rates to a five-year low. All other central banks across the region maintained key policy rates.

Global growth prospects continue to be challenging going forward

Looking ahead, overall global economic conditions will likely continue to be challenging, with subdued growth prospects 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. Downside risks remain high, arising from the uncertainty over the post-referendum future of the UK in the EU, persistence of low energy and commodity prices as well as possible disorderly market conditions arising from policy shifts in major economies. In this regard, international financial market conditions will likely continue to be vulnerable to setbacks and changes in sentiments.