DEVELOPMENTS IN THE THIRD QUARTER OF 2015

INTERNATIONAL ECONOMIC ENVIRONMENT

Moderate global economic expansion

The global economy continued to expand at a moderate pace in the third quarter of 2015, with diverging growth momentum across economies. While the US and the UK economies registered moderate growth, economic activity in the euro area and Japan improved at a more gradual pace. In Asia, growth was supported by the continued expansion of domestic demand amid weak export performance. Against a backdrop of moderate growth and low inflation, several major and regional central banks lowered policy rates. In addition, a number of economies in the region have also announced fiscal measures to support domestic demand activity.

Global financial market volatility increased during the quarter, arising mainly from heightened investor concerns over global growth prospects and financial sector volatility, particularly in PR China. Early in the quarter, global equity markets were affected by adverse developments related to the Greek debt crisis. This subsequently improved following the tentative approval of Greece's third bailout programme in mid-July. This trend, however, reversed as investor sentiments were affected by stock market corrections in PR China and an unexpected move by the People's Bank of China (PBoC) to lower the central parity rate of the Renminbi (RMB). Correspondingly, the CBOE Volatility (VIX) index increased to a four-year high on 24 August, as a sharp decline in Chinese equities triggered heightened global investor risk aversion. During the quarter, global equity markets were also affected by weaker-than-expected economic data releases in the region, continued uncertainty surrounding the US Federal Reserve's (Fed) first interest rate increase since June 2006 and further declines in global oil prices.

The US economy continued to expand, although at a more moderate pace, in the third quarter (2.0%; 2Q 2015: 2.7%). On a seasonally adjusted annualised basis, the growth momentum slowed to 1.5% (2Q 2015: 3.9%), due mainly to a sharper decline in inventories. During the quarter, growth was driven mainly by private consumption, as households continued to benefit from lower oil prices, further strengthening of the labour market and improved household balance sheets. Growth of fixed investment was sustained as stronger investment in the services sector offset more moderate manufacturing investment growth and a sharper decline in oil and gas-related capital expenditure. Of significance, capital expenditure in the real estate sub-sector was underpinned by the gradual improvement in housing starts and existing home sales. Headline inflation rose marginally in the third quarter (0.1%; 2Q 2015: 0%), due mainly to higher prices of shelter and transportation services.

Economic activity in the euro area continued to improve at a gradual pace in the third 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. Amid lower concerns over the Greek debt crisis during the quarter, business and consumer sentiments remained steady, while the expansion in manufacturing PMI was sustained (52.2; 2Q 2015: 52.2). Headline inflation moderated slightly during the quarter (0.1%; 2Q 2015: 0.2%), due to a sharper contraction in the cost of energy.

Economic activity in the UK expanded at a more moderate pace in the third quarter (2.3%; 2Q 2015: 2.4%). The mining and quarrying as well as services sectors remained the key contributor to growth, particularly the business services and finance sub-sector. Headline inflation growth remained flat (2Q 2015: 0%), as an increase in the prices of clothing and footwear were offset by lower costs of housing and household expenditures.

The Japanese economy expanded at a modest pace in the third quarter, due in part to a low base effect arising from the consumption tax increase in 2014. Retail sales moderated across a broad segment of goods (0.9%; 2Q 2015: 3.0%), while business sentiments

declined during the quarter, as reflected by the decrease in the Tankan survey index for large manufacturers (12; 2Q 2015: 15). On the external front, export growth moderated to 3.7% (2Q 2015: 6.7%), due to lower demand from China and other Asian economies. Inflation (excluding fresh food) turned around to register a negative growth of 0.1% (2Q 2015: 0.1%), while core inflation (excluding food and energy) was higher at 0.8% (2Q 2015: 0.4%).

Advanced Economies: Real GDP Growth

	2014		2015		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
US	2.9	2.5	2.9	2.7	2.0[a]
UK	2.9	3.0	2.7	2.4	2.3[p]

[a] Advance estimate
[p] Preliminary

Source: National authorities

The overall monetary policy stance in the advanced economies remained accommodative during the quarter given rising growth concerns and lower inflation. Most central banks reaffirmed their commitment to maintain accommodative monetary conditions by keeping policy rates unchanged. In the US, the Federal Open Market Committee (FOMC) left its Federal Funds Rate unchanged in September and October. In September, the FOMC highlighted that recent global economic and financial developments could restrain economic activity and pose downside risks to the inflation outlook. The FOMC members also reduced their median estimates for the Federal Funds Rate, indicating that the pace of interest rate normalisation will be more gradual. Similarly, the European Central Bank (ECB), Bank of Japan (BOJ) and Bank of England (BOE) 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%. However, it also announced its intention to re-examine the degree of monetary accommodation in December, particularly should downside risks to inflation and growth materialise. The BOJ reiterated its commitment to increase the monetary base by JPY80 trillion annually, while the Bank of England (BOE) maintained the stock of its purchased assets at GBP375 billion.

Meanwhile, the Bank of Canada and Sveriges Riksbank (Swedish National Bank) reduced their key policy rates by 25 and 10 basis points each to 0.50% and -0.35%, respectively, in July. Similarly, Norway's Norges Bank lowered its key policy rate by 25 basis points in September to 0.75%, while the Reserve Bank of New Zealand cut its key policy rate by a cumulative 50 basis points in July and September to 2.75%.

In PR China, growth moderated slightly to 6.9% in the third quarter (2Q 2015: 7.0%). By industry, the slower expansion across secondary (industry and construction) industries was partially offset by improvements in the tertiary (services) sector. During the quarter, the Chinese government implemented a series of wide-ranging policy measures, including infrastructure investment and increased lending to targeted sectors to support domestic economic activity. In addition, further monetary policy easing measures were also introduced following the sharp decline in the stock markets. Nevertheless, growth continued to face headwinds arising from excess capacity in heavy industries, the property market and weaker sentiments after the adjustments in the Chinese equity markets. Inflation increased to 1.7% (2Q 2015: 1.4%) following higher prices in the food, housing and alcoholic beverages and tobacco sub-sectors.

In Asia, economic activity continued to expand, supported by improvement in domestic economic activity. Growth in the Korean economy picked up in the third quarter (2.6%; Q2 2015: 2.2%), underpinned by a rebound in investment and private consumption after the MERS outbreak. However, net exports constituted a larger drag to growth in the third quarter. Growth in Indonesia was sustained at 4.7% (2Q 2015: 4.7%), as the improvement in domestic demand offset weaker external demand. However, the Chinese Taipei economy contracted by 1.0% (2Q 2015: +0.5%), due to weaker exports and a moderation in domestic demand growth. Singapore's growth moderated to 1.4% in the third quarter (2Q 2015: 2.0%), due mainly to a sharper contraction in the manufacturing sector. This was in turn attributed to a decline in the output of electronics, biomedical and transport engineering. In addition, both the services and construction sectors expanded at a slower pace during the quarter.

Regional Countries: Real GDP Growth

	2014		2015		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
Singapore	2.8	2.1	2.6[r]	2.0[r]	1.4[a]
PR China	7.2	7.2	7.0	7.0	6.9
Korea	3.3	2.7	2.5	2.2[p]	2.6[a]
Chinese Taipei	4.3	3.5	3.8[r]	0.5[p]	-1.0[a]
Indonesia	4.9	5.0	4.7	4.7	4.7

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

Source: National authorities

During the quarter, inflationary pressures remained subdued in most regional economies given the low energy prices. Of note, Thailand, Singapore and Chinese Taipei remained in deflation during the quarter. In Indonesia, however, inflation remained elevated due mainly to higher fuel prices following the reductions in government fuel subsidies.

In this environment, monetary policy remained accommodative in the region with a few central banks lowering their key policy rates during the quarter. The Reserve Bank of India (RBI) lowered its policy repo rate by 50 basis points to 6.75% to support domestic investment activity. Similarly, the Central Bank of the Republic of China (CBC) reduced its discount rate by 12.5 basis points to 1.75%, amid slowing domestic economic activity and weak exports. Meanwhile, in August and October, the People's Bank of China (PBoC) reduced its one-year benchmark lending rate by a total of 50 basis points to 4.35% (Previous: 4.85%) and lowered the reserve requirement ratio for large depository financial institutions by a total of 100 basis points to 17.5%. The PBoC also removed the ceiling on deposit rates, improving market-oriented interest rate formation in the Chinese economy. The Monetary Authority of Singapore (MAS) also reduced slightly the rate of appreciation of the Singapore dollar nominal effective exchange rate (S$NEER) policy band in October, following a weaker-than-expected growth outlook.

Brent crude oil prices declined sharply to an average of USD51 per barrel in the third quarter (2Q 2015: USD63 per barrel), due mainly to expectations of worsening oversupply in the oil market in the next few quarters following the successful conclusion of the Iranian nuclear agreement. This was further exacerbated by the Chinese equity market sell-off in July, which led to heightened risk aversion in the oil futures market. Sentiments remained bearish throughout the quarter with prices hitting a 6-year low of USD42 per barrel on 24 August 2015. However, prices recovered somewhat towards the end of the quarter, as the FOMC's decision to maintain its policy interest rate boosted investor sentiments. As a result, oil prices ended the quarter at USD48 per barrel on 30 September 2015.

The euro and the yen appreciated against the US dollar during the quarter. The euro was supported by better economic data releases and an improvement in investor sentiments following the approval of Greece's third bailout programme. The Japanese yen strengthened, benefitting from safe haven flows due to heightened investor risk aversion during the quarter. In the rest of Asia, however, most currencies depreciated against the US dollar, as concerns over stock market corrections and moderating economic activity in PR China affected investor sentiments in the region. In addition, regional currencies continued to be weighed down by high uncertainty over the timing of the Fed's first interest rate increase.

Going forward, global growth is expected to remain moderate. While the major advanced economies continue to improve, the pace of recovery will be modest. In Asia, domestic demand is expected to continue to support growth. Downside risks to global growth remain high arising from the moderating growth momentum in a number of major economies, uncertainty surrounding energy and commodity prices and possible disorderly market conditions arising from policy shifts in major economies.