INTERNATIONAL ECONOMIC ENVIRONMENT

Mixed growth performance in the global economy

Global economic activity was mixed in the third quarter with moderating growth in the US, continued recovery in Europe and sustained expansion in the Asian region.

Following the cooling of the housing market, the **US** economy recorded a growth of 1.6% in the 3Q, largely due to the sharp decline in residential property investment (-17.4%). In addition, the less favourable trade performance continued to affect growth largely due to the high cost of imported oil. Nevertheless, the underlying strength of the broader US economy remained intact as overall consumption spending and investment activity remained favourable, sustained by the more favourable labour market conditions and the strong growth in non-residential property investment, as well as high imports of capital and consumer goods. In **Japan**, the economy continued to expand by 2.0% in the 3Q. Exports provided more support to the growth, against the background of sustained demand from People's Republic of China (PR China) and the US, while capital spending increased by 2.9%. Positive business sentiment has also been a contributory factor with big manufacturers planning to increase capital spending, as reported in the latest Tankan survey. The **euro area** economy sustained its growth momentum at 2.6% in the 3Q, driven mainly by strong exports and domestic demand. The economy remained on a steady course as the PMI index improved in October. Meanwhile, Germany's 3Q GDP growth was more broad-based with contributions from both domestic and foreign demand. Similarly in the **United Kingdom (UK)**, GDP for 3Q expanded by 2.8%, mainly supported by expansion in the services and manufacturing sectors. Meanwhile, rising housing prices and buoyant stock markets continued to underpin consumer confidence in October.

The need for **monetary policy** tightening became less for several countries in the global economy. In the US, with future inflation risks expected to abate, following the moderating economic performance and the decline in oil prices, the Federal Open Market Committee (FOMC) maintained the Fed funds rate at 5.25% for the third consecutive time on 25 October. The **Bank of Japan** maintained the uncollateralised overnight call rate at 0.25% on 31 October, after ending its zero interest rate policy in July. The **European Central Bank** continued to increase its key refinancing rate by 25 bps to 3.25% on 5 October, due to upside risks to price stability following strong money and credit growth in the economy. The **Bank of England** increased its interest rate to 5% on 9 November, which is the highest level recorded in five years.

Global **crude oil prices** averaged USD71 per barrel for the quarter. After having peaked at USD78.40 on 14 July, oil prices have declined. In October, crude oil prices experienced the biggest correction in over 15 years, falling by nearly 20% from its mid-July peak to hover around USD58–61 p/b. The decline

Industrial countries: Real GDP Growth

	2005		2006			Key contributing factors for 3Q growth
	3Q	4Q	1Q	2Q	3Q	
	Annual change (%)					
US[1]	4.2	1.8	5.6	2.6	1.6[a]	Slower growth following decline in residential property investment and a larger trade deficit. Nevertheless, private consumption, non-residential property investment and government spending remained positive.
UK	1.8	1.9	2.3	2.6	2.8	Stronger growth supported by an expansion in the services sector and manufacturing production.
Euro zone	1.7	1.8	2.2[r]	2.7[r]	2.6[p]	Sustained growth supported by both domestic and foreign demand, particularly in Germany.
Japan[1]	2.0[r]	4.1[r]	3.2[r]	1.5[r]	2.0[p]	Steady recovery following rebound in residential property investment while exports continued to underpin growth in the 3Q. However, private consumption recorded a decline.

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

Source: National authorities

in prices was supported by easing geopolitical concerns, rising inventories, the milder-than-expected hurricane season in the US and expectations of moderating demand following the slowdown in the US economy.

In the **Asian region**, economic growth was sustained in the third quarter, albeit at a slower pace, compared to the second quarter. Growth was supported by strong performance in PR China, recovery in the electronics sector amid strengthening of domestic demand. Regional exports remained resilient, performing better than initial expectations despite concerns of a potential slowdown in US demand.

Inflation rates in most regional countries showed a downward trend. Of significance, in Thailand, inflationary pressures began to subside, reflecting the fading effect of the floating of diesel price in late June 2006 and the lower energy, transportation and communication prices. In terms of **monetary policy** stance, India, Korea and PR China have raised interest rates during the quarter while Singapore reaffirmed its policy of a 'modest and gradual appreciation' of the Singapore dollar nominal effective exchange rate (S$NEER) policy band. Meanwhile, Indonesia continued to lower rates in early November.

In the **foreign exchange market**, the dollar weakened against most major currencies during the quarter. The depreciation of the dollar was driven mainly by increased expectations of an end to the tightening US monetary policy stance. The Japanese Yen and Swiss franc were two exceptions as both currencies depreciated due to carry-trade activities. Yen slipped to an all-time low against the euro on 19 September. Meanwhile, the performance of regional currencies was generally mixed. The Philippine peso, Thai baht, Chinese yuan, Indonesian rupiah and Korean won strengthened during the third quarter compared to the end of the second quarter, while the other regional currencies weakened slightly. The peso recorded the strongest appreciation, buoyed by positive economic data and remittances from overseas workers.

Regional Countries: Real GDP Growth

	2005		2006			Key contributing factors for 3Q growth
	3Q	4Q	1Q	2Q	3Q	
	Annual change (%)					
PR China	9.8	9.9	10.3	11.3	10.4	Driven by investment and exports.
Singapore	7.6	8.7	10.7	8.2	7.2	Supported by manufacturing and the wholesale and retail trade sector.
Hong Kong	8.2	7.5	8.0	5.5	6.8	Supported by investment and exports.
Indonesia	5.6	4.9	4.8	5.1	5.5	Supported by private consumption and net exports.
Korea	4.5	5.3	6.1	5.3	4.6	Supported by government consumption and facility investment.

Source: National authorities