DEVELOPMENTS IN THE SECOND QUARTER OF 2009

INTERNATIONAL ECONOMIC ENVIRONMENT

Increasing signs of stabilisation in the global economy

The global economy showed increasing signs of stabilisation in the second quarter following improvements in the international financial markets. In the major advanced economies, while overall economic conditions continued to remain weak, the pace of decline in economic activity has slowed. A similar trend has also been observed in most regional economies following stabilisation in exports and production. To a large extent, the gradual improvement in economic conditions in the global economy could be attributed to policy measures undertaken to stabilise the financial systems in the advanced countries as well as the cumulative effects of fiscal and monetary stimulus for most economies.

In the **US**, real GDP contracted in the second quarter, but at a slower annualised rate of 1% (1Q 09: -6.4%), making it the fourth consecutive quarter of contraction and the longest economic contraction since 1947. While increased public sector spending and improvements in net exports provided support to growth, the decline in overall GDP was due to the continued contraction in private consumption expenditure and private fixed investment as well as inventory drawdown. Private consumption expenditure declined by 1.2% (1Q 09: +0.6%) as unemployment continued to rise, reaching a 26-year high of 9.5% at the end of the second quarter. Meanwhile, the contraction in private fixed investment moderated to 13.5% (1Q 09: -39%) due to slower declines in investment in both the residential and non-residential sectors. Private inventory drawdown accounted for nearly fourth-fifth of the GDP decline in the second quarter, as businesses continued to scale down inventories. On the inflation front, headline consumer prices declined by 0.9% during the quarter (1Q 09: -0.2%) due mainly to lower energy prices and transportation costs.

In **Japan**, after four consecutive quarters of economic contraction, real GDP grew by an annualised rate of 3.7% in the second quarter (1Q 09: -11.7%) following improvements in net exports and private consumption. The slower rate of decline of 27.9% in industrial production in the second quarter (1Q 09: -34.5%) reflected improvement in net exports largely stemming from inventory normalisation as well as slower pace of decline in exports to PR China. In spite of rising unemployment (2Q 09: 5.2%; 1Q 09: 4.4%) and weak sentiment, private consumption received a boost from cash payouts and subsidies in the fiscal stimulus package. On the inflation front, core consumer prices (excluding fresh food) declined by 1% (1Q 09: 0%), reflecting sharply lower commodity prices and sluggish demand conditions.

The **euro area** experienced a slightly slower annual contraction of 4.6% in the second quarter (1Q 09: -4.9%), due to the positive impact of stimulus measures on economic activities in Germany and France. On a quarterly basis, both Germany and France recorded a quarter-on-quarter growth of 0.3% in the second quarter (1Q 09 quarter-on-quarter: Germany -3.5%; France: -1.3%). The sentiment-based indicators such as the Purchasing Managers Index and Economic Sentiment Indicator, have also showed signs of stabilisation in the second quarter. On the inflation front, consumer prices moderated further to 0.2% in the second quarter (1Q 09: 1.0%) due to falling commodity prices. Meanwhile, in the **UK**, real GDP contracted 5.6% year-on-year in the second quarter (1Q 09: -4.9%), its worst contraction since 1955. Growth was affected by the sharp decline in the services sector on weaker activity in the business and financial services sub-sectors as well as continued contraction in the manufacturing sector. On the inflation front, consumer prices moderated to 2.1% in the second quarter (1Q 09: 3%) due to lower prices in food and non-alcoholic beverages.

Industrial Countries: Real GDP Growth

	2008		2009			Key contributing factors for 2Q growth
	2Q	1H	1Q	2Q	1H	
	Annual change (%)					
US[1]	1.5	1.8	-6.4[r]	-1.0[a]	-3.6[a]	Declines in private consumption and investment activities, as well as continued inventory drawdown. However, net exports and public sector spending contributed positively to growth.
UK	1.8	2.2	-4.9[r]	-5.6[p]	-5.3[p]	Broad-based decline in all sectors especially services sector.
Euro area	1.5	1.8	-4.9	-4.6[p]	-4.8[p]	Due to improvement in economic activities in Germany and France.
Japan[1]	-4.3	1.0	-11.7[r]	3.7[p]	-7.6[p]	Due to improvements in private consumption and net exports.

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

Source: National authorities

Central banks in the major advanced economies continued to maintain an accommodative monetary policy stance and implemented measures to strengthen the financial system during the quarter. In the **US**, with the federal fund rate rates maintained at 0 – 0.25%, several changes were made with respect to measures to support the financial sector. These include an extension of the Primary Dealer Credit Facility and Commercial Paper Funding Facility until February 2010 to support short-term funding, as well as the scaling down of the Legacy Securities Program of the *Public-Private Investment Program* (that is aimed at removing bad assets) from the original size of USD500 billion – USD1 trillion to USD30 billion. In Japan, while the uncollateralised overnight call rate was maintained at 0.1%, the **Bank of Japan** extended its emergency corporate funding support measures until December 2009. The **Bank of England** also maintained its base lending rate at 0.5% during the quarter while expanding the *Asset Purchase Facility* twice by £50 billion in May and another £50 billion in August to £175 billion. Meanwhile, the **European Central Bank** reduced its refinancing rate to 1% in May 2009 and started its €60 billion covered bond purchase programme in early July to inject liquidity into the financial system.

In the second quarter, **global crude oil prices**[2] increased to a 9-month high of USD72 per barrel in mid-June, driven largely by improved risk appetite among investors while the fundamental demand-supply conditions remained weak. Despite the spike in prices in June, crude oil prices averaged around USD60 per barrel during the quarter (1Q 09: USD40 per barrel).

In the **Asian region**, several regional economies such as Korea, Singapore, Chinese Taipei, Hong Kong SAR and Thailand recorded smaller declines in annual real GDP growth in the second quarter following stabilisation in production and exports. On a quarter-on-quarter basis, Singapore, Chinese Taipei, Hong Kong SAR and Thailand recorded positive growth of 20.7%[3], 20.7%[3], 3.3%[4] and 2.3%[4] respectively. Regional growth continued to be led by PR China, which posted a stronger-than-expected annual growth of 7.9% (1Q 09: 6.1%), due mainly to the higher contribution from investment, which gained support from the impact of the sizeable fiscal stimulus. With most regional countries such as Thailand, Chinese Taipei, PR China, Singapore and Hong Kong SAR experiencing technical deflation, central banks across Asia continued to maintain accommodative monetary policy. During the quarter, Thailand reduced the policy interest rate by 25 basis points while Indonesia and Philippines reduced interest rates by 75 basis points each to support economic activity.

[2] Refers to WTI one-month futures on NYMEX
[3] Seasonally adjusted annualised quarter-on-quarter rate
[4] Seasonally adjusted quarter-on-quarter rate

Regional Countries: Real GDP Growth

	2008		2009			Key contributing factors for 2Q growth
	2Q	1H	1Q	2Q	1H	
	Annual change (%)					
PR China	10.1	10.4	6.1	7.9	7.0	Supported by investment which was driven by the large fiscal and monetary stimulus.
Indonesia	6.3	6.4	4.4	4.0	4.2	Supported by consumption and goverment spending.
Korea	4.3	4.9	-4.2	-2.5[a]	-3.4	Supported by improvement in exports growth and household spending.
Singapore	2.5	4.6	-9.5[r]	-3.5	-6.5	Supported by slower contraction in the manufacturing sector due to the sharp increase in biomedical output.
Hong Kong SAR	4.1	5.7	-7.8	-3.8	-5.8	Supported by slower contraction in exports.
Thailand	6.0	5.7	-7.1	-4.9	-6.0	Supported by government spending and private consumption.
Chinese Taipei	4.6	5.4	-10.1	-7.5[p]	-8.8	Supported by positive contribution from private consumption with smaller drag from gross fixed capital formation.

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

Source: National authorities

In the **foreign exchange market**, all major currencies appreciated against the US dollar during the quarter due to improved risk appetite among global investors following the rally in the global equity markets. However, towards the end of the quarter, the US dollar began to strengthen slightly against the euro and the Japanese yen on concerns over the relatively weak economic conditions in these economies vis-à-vis the US. Similarly, regional currencies appreciated against the US dollar during the second quarter due mainly to improved investor sentiments amid stabilisation in regional exports and production. Of significance, the Indonesian rupiah strengthened considerably against the US dollar due to the favourable economic conditions and political developments.

Going forward, with increasing signs of stabilisation in economic indicators for most economies in July and early August, global economic conditions are expected to improve further in the second half of the year. Nonetheless, the sustainability of growth prospects will depend crucially on the recovery in private sector demand in the advanced economies, which in turn is conditional on the resumption of lending activities by the financial institutions. This will, to some extent, influence the growth outlook for the Asian region.