

## DEVELOPMENTS IN THE SECOND QUARTER OF 2010

### INTERNATIONAL ECONOMIC ENVIRONMENT

#### Uneven recovery in the global economy as the sovereign debt crisis in the euro area escalated

The recovery in the global economy continued to be uneven in the second quarter as the sovereign debt crisis in the euro area escalated. Major advanced economies sustained a moderate recovery due to improvements in private demand but consumer and business sentiments eased towards the latter part of the quarter on the prospects of impending fiscal austerity measures in several economies. After registering an exceptional growth performance in the first quarter, most regional economies continued to sustain strong growth in the second quarter, due to robust domestic and external demand. Conditions in the international financial markets deteriorated as several euro area economies faced difficulties in refinancing their sovereign securities in late April. The crisis culminated in a €750 billion European Financial Stability Facility mechanism and the European Central Bank's emergency measures in early May. However, persistent concerns on the health of the banking sector in the euro area led the authorities to conduct stress tests on 91 banking institutions in the euro area in July. Inflationary pressures across most economies remained moderate during the quarter.

The **US** economy grew at a slower rate of 2.4% in the second quarter (1Q 10: 3.7%). While growth continued to be supported by private consumption, fixed investment, and government spending, the moderation was due to a bigger decline in net exports and lower contribution in inventory build-up. Private consumption showed continued growth as households were supported by higher income and improving labour market conditions as hiring rose by 621,000 in the second quarter (1Q 10: +261,000). However, consumer confidence had begun to trend downwards towards the end of the quarter, reflecting the cautious outlook of households on the economy. The drag to growth also came from higher imports of capital goods which rose in

tandem with private investment. Inflation grew at a slower rate of 1.8% (1Q 10: 2.4%) due to lower energy prices.

The **Japanese** economy expanded at a more moderate pace of 0.4% in the second quarter (1Q 10: 4.4%), supported by strong external demand while domestic demand remained weak. Exports grew by 33.4% in the second quarter (1Q 10: 43.2%), due primarily to robust shipments to Asia. On the domestic side, household spending declined by 0.3% (1Q 10: 1.9%) as government stimulus waned while the unemployment rate rose to 5.2% (1Q 10: 4.9%). On the inflation front, core consumer prices (excluding fresh food) declined by 1.2% (1Q 10: -1.2%), due mainly to government measures which lowered education costs.

**Euro area** experienced a strong growth of 1.7% on an annual basis (1Q 10: 0.6%) as the expansion in external demand in core economies, especially Germany, outweighed the deterioration in domestic demand in the peripheral economies. Exports rose by 22.6% (1Q 10: 12.1%) on the strength of demand from Asia. On the domestic demand, private consumption indicators remained weak following moderating consumer confidence and deteriorating retail sales growth, particularly in those countries implementing fiscal austerity measures. On the inflation front, consumer prices increased by 1.5% (1Q 10: 1.1%) following higher import prices due to the depreciation of the euro.

In the **UK**, real GDP increased by 1.6% in the second quarter (1Q 10: -0.2%), the first positive annual growth since the second quarter of 2008. The improvement was broad-based across all sectors, supported by continued rebound in both production and exports. In addition, domestic demand gained momentum during the quarter as indicated by higher growth in retail sales as well as improvement in the labour market. Nonetheless, consumer sentiments weakened following concerns over the near-term impact from the announcement of fiscal austerity measures. Meanwhile, inflation rose slightly to 3.4% during the quarter (1Q 10: 3.3%), due to the restoration of the standard rate of Value

### Advanced Countries: Real GDP Growth

	2009		2010		Key contributing factors for 2Q growth	
	2Q	1H	1Q	2Q		1H
	Annual change (%)					
US <sup>1</sup>	-0.7 <sup>r</sup>	-4.0 <sup>r</sup>	3.7 <sup>r</sup>	2.4 <sup>a</sup>	2.8 <sup>a</sup>	Moderation in growth due to bigger decline in net exports and lower contribution in inventory investment.
Japan <sup>1</sup>	10.4 <sup>r</sup>	-7.3 <sup>r</sup>	4.4 <sup>r</sup>	0.4 <sup>p</sup>	3.2 <sup>p</sup>	Moderation in growth due to lower contribution of private consumption and net exports and a larger drawdown in inventory.
Euro area	-5.6	-5.5	0.6	1.7 <sup>a</sup>	1.2 <sup>a</sup>	Growth led by expansion in external demand in core economies.
UK	-5.9	-5.7	-0.2	1.6 <sup>p</sup>	0.7 <sup>p</sup>	Growth mainly due to increases in business services and construction activities.

<sup>1</sup> Annualised basis  
<sup>r</sup> Revised  
<sup>a</sup> Advance estimate  
<sup>p</sup> Preliminary

Source: National authorities

Added Tax to 17.5% in January and to some extent, the effect of the depreciation of the pound sterling on import prices.

Central banks in major advanced economies have responded swiftly to the escalation of the sovereign debt crisis in the euro area since late April. On the 9 and 10 May, as the global financial markets came under intense pressure and volatility, the **European Central Bank (ECB)**, in co-ordination with the €750 billion European Financial Stability Facility mechanism, announced three measures to restore confidence in the financial markets. First, the ECB will intervene in the euro area public and private debt securities secondary market to restore the functioning of the affected markets. During the quarter, ECB purchased €60 billion of securities. Second, the ECB will provide emergency liquidity to banks in the form of unlimited three- and six-month funds at a fixed rate. Third, the ECB reactivated the US dollar swap lines with the **Federal Reserve (the Fed)**, **Bank of Japan (BoJ)**, **Bank of England (BoE)**, Bank of Canada and Swiss National Bank to maintain US dollar liquidity in the financial markets. Meanwhile, other advanced economies such as Australia, Canada, Sweden and Norway continued to raise their policy rates during the quarter to normalise monetary conditions.

Global **crude oil prices**<sup>2</sup> declined to an eight-month low of USD68 per barrel on 20 May, weighed down by increased inventory level and concerns over the prospects of global growth which would dampen demand for oil. Nevertheless, the trend reversed in the latter

part of the quarter due to expectations of strong demand from the emerging economies as well as the possibility of adverse weather conditions that may cause supply disruption in the Gulf of Mexico. Global crude oil prices ended the quarter at USD76 per barrel. For the whole quarter, crude oil prices averaged USD78 per barrel (1Q 10: USD79 per barrel).

In **Asia**, most economies in the region continued to sustain strong growth in the second quarter, underpinned by resilient domestic and external demand. Private consumption remained robust, supported by improved labour market conditions and lending activities. The strength in investment and export activities was sustained by continued demand from within the region and the advanced economies. **Singapore's** economy recorded a stronger-than-expected growth of 18.8% in the quarter (1Q 10: 16.9%), due mainly to strong growth in the manufacturing sector, particularly in the electronics and biomedical sub-sectors. In **Indonesia**, the economy grew stronger by 6.2% in the quarter (1Q 10: 5.7%) supported by stronger consumption and investment. **PR China's** economy expanded at an annual pace of 10.3% in the second quarter (1Q 10: 11.9%), as all sectors recorded moderating growth following policy tightening measures by the authorities to cool down the economy. **Korea's** real GDP grew by 7.2% in the quarter (1Q 10: 8.1%), supported by continued expansion in exports and manufacturing activities. In **Hong Kong SAR**, the economy registered a growth of 6.5% in the quarter (1Q 10: 8%) supported by exports and domestic demand.

<sup>2</sup> Refers to West Texas Intermediate one-month futures on NYMEX.

### Regional Countries: Real GDP Growth

	2009		2010			Key contributing factors for 2Q growth
	2Q	1H	1Q	2Q	1H	
	Annual change (%)					
Singapore	-1.7	-5.6	16.9	18.8	17.9	Stronger growth in the manufacturing sector due to biomedical and electronics sub-sectors.
PR China	7.9	7.4	11.9	10.3	11.1	Moderate growth in all sectors following policy tightening measures to tighten bank lending and cool the property market.
Korea	-2.2	-3.2	8.1	7.2 <sup>a</sup>	7.6	Continued expansion in manufacturing activity and exports.
Hong Kong SAR	-3.8	-5.7	8.0	6.5	7.3	Growth supported by exports and domestic demand.
Indonesia	4.1	4.3	5.7	6.2	5.9	Growth supported by private consumption and investment activities.

<sup>a</sup> Advance estimate

Source: National authorities

Amid robust growth and a gradual rise in inflationary pressures, more central banks in Asia moved towards normalising their policy interest rates. The **Central Bank of the Republic of China (Taiwan)** increased its discount rate by 12.5 basis points to 1.375% in June following accelerating economic recovery and rising consumer and property prices. The **Bank of Korea** raised its base rate by 25 basis points to 2.25% in July to contain inflation. Similarly, the **Bank of Thailand** increased its 1-day repurchase rate by 25 basis points to 1.50% in July in view of a more entrenched economic recovery amid modest inflationary pressures. The **Reserve Bank of India** also raised its repurchase rate to 5.75%, by 25 basis points each in two separate meetings in July, to contain rising inflation.

In the **foreign exchange markets**, most major currencies depreciated against the US dollar during the second quarter following the escalation of the sovereign debt crisis in the euro area. Both the euro and pound sterling weakened against the dollar, with the euro reaching its lowest level since March 2006, due to rating downgrades, concerns over the impact of fiscal austerity measures

and questions over the health of the banking sector in the euro area. The heightened investor risk aversion also benefited the yen, which strengthened broadly against the US dollar in the last two months of the quarter. Meanwhile, regional currencies appreciated against the US dollar in the first month of the quarter, supported by optimism over better growth prospects for the region. However, the trend reversed in the latter part of the quarter following renewed sovereign debt problems in the euro area. Most regional currencies had reacted positively albeit temporarily to PR China's move to increase the flexibility of the yuan's exchange rate but the situation in the euro area continued to dictate the trend in regional currencies against the US dollar.

Going forward, downside risks to global growth have increased in view of the ongoing sovereign debt concerns and the planned fiscal consolidation in several advanced economies. The strength of the global recovery will hinge critically on the credibility of fiscal austerity measures being implemented in many advanced economies and market confidence on a swift resolution to the sovereign debt problems in the euro area.