

DEVELOPMENTS IN THE SECOND QUARTER OF 2008

INTERNATIONAL ECONOMIC ENVIRONMENT

Slower global growth with concerns of inflationary pressures

Economic expansion in the major industrialised economies continued to weaken in the second quarter. Growth in the Asian economies, while remaining favourable, also recorded some moderation. Meanwhile, inflationary pressures increased in most countries following higher energy and food prices.

In the **United States (US)**, real GDP expanded by a better-than-expected annualised 3.3% in the second quarter (1Q 08: 0.9%). Private consumption increased by 1.7% (1Q 08: +0.9%), while net exports contributed about 3.3 percentage points to growth. Growth was supported by a sustained expansion in consumer spending and greater contribution from net exports. Nonetheless, investment activity weakened, due mainly to a continued decline in residential investment which contracted for the tenth consecutive quarter. Revised data also showed that the US economy contracted by 0.2% in the fourth quarter of 2007 (previous estimate: +0.6%), with a sharper decline in the housing market than previously estimated. In terms of inflation, consumer prices rose by 4.3% (1Q 08: 4.2%) largely on account of higher energy and food prices.

In **Japan**, real GDP declined by an annualised 2.4% in the second quarter (1Q 08: +3.2%), as private consumption, investment and exports contracted on a quarterly basis. Private consumption decreased by 0.5% quarter-on-quarter (q-o-q) as consumers were affected by the rising inflationary pressures and weak labour market conditions. Meanwhile, residential investment and capital spending declined by 3.4% and 0.2% q-o-q respectively. Exports, which was the main driver of growth for the previous few quarters, fell by 2.3% q-o-q as the decline in exports to the US and Europe offset firm export growth to emerging markets. On the inflation front, prices rose by 1.4% (1Q 08: 1.0%), with core prices remaining within positive territory for the ninth consecutive month.

In the **euro area**, economic activity contracted in the second quarter by 0.2% q-o-q from an expansion of 1.3% q-o-q in the first quarter. Meanwhile, the year-on-year growth slowed for the third consecutive quarter to 1.5% (1Q 08: 2.1%). Growth was mainly affected by a slowdown in the major euro area economies. Germany, France and Italy contracted in the second quarter due to weak consumption activity and slowing exports, while Spain grew at a slower pace as the once booming construction industry continued to moderate. Meanwhile, in the

Industrial countries: Real GDP Growth

	2007		2008		Key contributing factors for 2Q growth	
	2Q	1H	1Q	2Q		1H
	Annual change (%)					
US ¹	1.8	1.6	0.9 ^r	1.9 ^a	0.9	Supported by growth in consumer spending and greater contribution from net exports.
Japan ¹	-1.7	2.5	3.2	-2.4 ^p	1.6 ^p	Declined due to weakening private consumption, investment and exports.
Euro area	3.2	2.9	2.1	1.5 ^p	1.9 ^p	Weak consumption activity in Germany, France and Italy and a construction slump in Spain.
UK	3.1	3.2	2.3	1.6 ^p	2.5 ^p	Slower growth due to decline in construction activity and industrial production.

¹ Annualised basis

^a Advanced estimate

^r Revised

^p Preliminary

Source: National authorities

UK, economic growth in the second quarter slowed significantly to 1.6% (1Q 08: 2.3%), due mainly to weakness in the construction sector and weaker growth in manufacturing activity. Headline inflation in both the euro area and UK rose by 3.6% and 3.3% respectively in the second quarter, due mainly to rising energy and food prices.

In the **US**, the **Federal Open Market Committee** (FOMC) lowered the Federal Funds rate by 25 b/p to 2.0% on 30 April. Thereafter, the rate was maintained on concerns of slowing growth despite higher inflation. Headline inflation in July recorded an increase of 4.9%, the fastest pace since 1991. However, the FOMC emphasised that economic growth in the coming quarters would be affected by the continued deterioration in the housing market and high energy prices.

Increased concerns over the two government-sponsored housing mortgage enterprises (GSEs), namely Fannie Mae and Freddie Mac, prompted the US Congress to approve the Housing and Economic Recovery Act of 2008 in July 2008. The bill contains provisions to support the GSEs, including allowing temporary authority for the US Treasury to purchase debt

securities and stocks issued by the GSEs and increased credit lines.

During the second quarter, interest rates were maintained in other industrial economies. The **Bank of Japan** kept interest rates at 0.5% despite rising consumer prices as weaker external demand conditions had increased the risks to economic growth. The **European Central Bank** (ECB) maintained interest rate at 4%, but later raised rates by 25 basis points to 4.25% in July as inflation breached 4% in June, 2% above the ECB target. The **Bank of England** (BoE) continued to maintain interest rates at 5%, balancing concerns over rising inflation against the increasing risk of a sharper economic slowdown.

In the commodities market, global **crude oil prices**¹ rose significantly, and averaged USD123.93 per barrel (1Q 08: USD97.70 per barrel) in the second quarter. Oil prices reached a new intra-day record high of USD147.12 on 11 July following a weak US dollar as well as concerns over supply disruptions in Iran, Nigeria and Brazil. Oil prices since have begun to retreat, falling below USD120 per barrel by early August, weighed down by a stronger US dollar, proposed measures to curb speculative activities and signs of slower global growth.

Regional Countries: Real GDP Growth

	2007		2008			Key contributing factors for 2Q growth
	2Q	1H	1Q	2Q	1H	
	Annual change (%)					
PR China	12.6	12.2	10.6	10.1	10.4	Lower growth due to declining contribution from net exports.
Indonesia	6.3	6.1	6.3	6.4	6.4	Strong growth in exports due to high commodity prices.
Thailand	4.2	4.3	6.1	5.3	5.7	Lower growth due to weak consumption and investment.
Korea	4.9	4.5	5.7	4.8 ^a	5.3	Strong expansion in exports despite a weaker domestic demand.
Philippines	7.0	7.7	4.7	4.6	4.7	Growth supported by strong investments.
Chinese Taipei	5.2	4.7	6.3	4.3	5.3	Driven mainly by strong exports demand from emerging markets.
Hong Kong SAR	6.4	6.0	7.3	4.2	5.8	Moderation in growth due to weaker external and domestic demand.
Singapore	9.1	8.0	6.9	2.1	4.5	Lower growth due to sharp contraction in biomedical manufacturing.

^a Advanced estimate
Source: National authorities

¹ Refers to WTI one-month futures on NYMEX

In the **Asian region**, economic growth in several regional economies moderated in the second quarter due to softer domestic demand and slower exports. Regional growth continued to be led by PR China, which posted a strong, albeit lower growth of 10.1% (1Q 08: 10.6%), due mainly to lower contribution from net exports. During the quarter, several national authorities in the region had responded to the significant rise in crude oil prices by raising domestic retail fuel prices. Thus, while growth in most regional economies moderated, regional inflationary pressures remained high due to rising fuel and food prices. Amidst these developments, several regional authorities have also announced measures to alleviate the burden of rising prices, particularly on the lower income group. To counter inflation, a number of Asian central banks shifted towards a tightening cycle.

In the **foreign exchange market**, the US dollar ended the quarter stronger against the euro and Japanese yen, but depreciated slightly against the pound sterling following heightened expectations for interest rate hike by BoE. Meanwhile, regional currencies displayed a mixed performance, with most Asian currencies recording a modest depreciation as high food and fuel prices raised concerns over the impact of inflation on growth. Beginning the third quarter, the US dollar has begun to show a broad-based strengthening.

While the global economy performed better-than-expected in the first half of 2008, global growth is expected to slow in the second half 2008. Downside risks to growth will continue to persist amidst signs of sharper slowdown in industrial economies as well as the prevailing uncertainties in the global commodities and financial markets.