

DEVELOPMENTS IN THE THIRD QUARTER OF 2008

INTERNATIONAL ECONOMIC ENVIRONMENT

Global recession as global financial crisis intensified

The global economy deteriorated considerably as several major industrial economies contracted in third quarter sliding into a recession as the effects of the financial crisis spilled over across the real economy. This is despite extraordinary measures taken by the authorities in their attempt to restore the functioning of financial markets to contain the impact on the real economy. Regional economies were impacted with the Singapore and Chinese Taipei economies contracting for the first time since 2003. The financial de-leveraging and weaker global growth conditions triggered a sharp decline in oil and commodity prices. There are signs of significant easing of inflation pressures in most countries.

In the **US**, real GDP contracted by an annualised 0.5% in the third quarter (2Q 08: 2.8%). Private consumption expenditure declined by 3.7%, marking the end of more than a decade long sustained expansion of consumer spending. Fixed investment contracted by 5.6% (2Q 08: -1.7%) due to a sharper decline in residential investment, its eleventh consecutive quarter of decline. Nevertheless, net exports contributed 1.1 percentage points to growth (2Q 08: 2.9 percentage points). Inflation peaked at 5.3% in the quarter (2Q 08: 4.3%), and has since trended downwards in recent months in line with

the declining commodity prices and significant across-the-board softening in global demand.

Japan's real GDP declined by an annualised 0.4% in the third quarter (2Q 08: -3.7%), its first recession since 2001. While consumer spending slowed sharply, fixed investment declined further on falling corporate profits and impact of a strong yen on exports and overseas revenue. On the inflation front, prices rose by 2.2% (2Q 08: 1.4%) while core consumer prices remained positive since fourth quarter of 2007.

The **euro area** entered into a technical recession for the first time since its formation in 1999, after the economy declined by 0.2% quarter-on-quarter in the third quarter (2Q 08: -0.2%). Germany and Italy contracted quarter-on-quarter for the second consecutive quarters, reflecting rapid deterioration in exports following weaker global and domestic demand. France, being an exception, avoided the recession due to the cushion provided by domestic demand. Inflation in the euro area was 3.8% in the third quarter (2Q 08: 3.6%), reaching its peak in July before moderating towards the end of the quarter. Meanwhile, in the **UK**, real GDP slowed sharply to 0.3% in the third quarter (2Q 08: 1.5%) and registered a contraction quarter-on-quarter, its first contraction in 16 years. The slowdown in the economy was broad-based with services, manufacturing and construction sectors recording quarterly declines. Inflation continued to edge

Industrial Countries: Real GDP Growth

	2007		2008			Key contributing factors for 3Q growth
	3Q	4Q	1Q	2Q	3Q	
	Annual change (%)					
US ¹	4.8	-0.2	0.9	2.8 ^r	-0.5 ^p	Contraction in consumer spending and residential investment.
UK	3.3	2.9	2.3	1.5	0.3 ^p	Broad-based slowdown in services, manufacturing and construction sectors.
Euro area	2.6	2.1	2.1	1.4	0.7 ^p	Slowdown due to weak exports and domestic demand.
Japan ¹	2.3	1.8	2.5	-3.7 ^r	-0.4 ^p	Significant weakness in consumption, investment and exports.

¹ Annualised basis
^r Revised
^p Preliminary

Source: National authorities

upwards to 4.8% in third quarter (2Q 08: 3.4%), lagging the economic cycle.

As the global financial crisis intensified, authorities across the world have taken extraordinary measures both at national and international levels to restore the functioning of financial markets and providing stimulus to the rapidly contracting real economy. On the monetary front, seven major central banks announced coordinated interest rate cuts on 8 October, with the **US Federal Reserve** cutting its Fed funds rate by 50 basis points to 1.5%, the **European Central Bank (ECB)** reducing its overnight rate by 50 basis points to 3.75% and **Bank of England (BoE)** cutting its base lending rate by 50 basis points to 4.5%. The Fed funds rate was also reduced further to 1% on 31 October while a currency swap of USD30 billion each with Korea, Singapore, Brazil and Mexico was entered into with the US Fed to ease US dollar financing shortages in global money markets.

On the financial front, the US authorities announced several measures including supporting financial institutions that were in difficulties to thaw the freeze in the credit markets. On 7 September, the US Treasury put two government-sponsored mortgage finance enterprises under conservatorship to restore market confidence following continued decline in their capital base. Following the bankruptcy of a major investment bank on 15 September, the US Treasury

introduced USD700 billion Troubled Assets Relief Program (TARP) to inject capital into financial institutions and provide support to the ailing securitised consumer debt markets. The US Treasury has so far injected about USD180 billion into several financial institutions. Besides widening the types of collaterals accepted under its existing liquidity facilities, the US Fed also introduced the Commercial Paper Funding Facility (CPFF) to ease liquidity shortage in the commercial paper market as US companies struggled to meet their short-term funding needs.

In response to the deteriorating conditions, the **Bank of Japan** cut interest rate for the first time in 7 years by 20 basis points to 0.3% on 31 October as Japanese yen surged to a 13-year high and Nikkei slumped to its lowest level in 26 years. Similarly, on 7 November, the ECB reduced its overnight rate by 50 basis points to 3.25% while the BoE cut its base lending rate by a record 150 basis points to 3%, its lowest since 1955. On the fiscal front, Japan, Germany, Spain and UK have announced fiscal stimulus ranging from USD30 billion to USD50 billion to mitigate the impact of the financial crisis while the US and other economies are expected to follow suit.

In the commodities market, global **crude oil prices**¹ declined to an average of USD91.15 per barrel (2Q 08: USD118.59 per barrel) in the third quarter. After the peak at USD145.29

Regional Countries: Real GDP Growth

	2007		2008			Key contributing factors for 3Q growth
	3Q	4Q	1Q	2Q	3Q	
	Annual change (%)					
PR China	11.5	11.2	10.6	10.1	9.0	Growth supported by fixed asset investment and retail sales.
Indonesia	6.5	6.3	6.3	6.4	6.1	Growth supported by strong domestic demand.
Philippines	7.1	6.4	4.7	4.4'	4.6	Growth led by household spending, exports and construction activities.
Thailand	5.1	5.7	6.0	5.3	4.0	Moderation in growth due to weaker growth in exports and domestic demand.
Korea	5.1	5.7	5.8	4.8	3.9 ^a	Lower growth due to slowdown in construction and services sector.
Hong Kong SAR	6.8	6.9	7.3	4.2	1.7	Sharp moderation due to weaker exports and domestic demand.
Singapore	9.5	5.4	6.9	2.3	-0.6	Contraction due to decline in biomedical manufacturing.
Chinese Taipei	7.0	6.4	6.3'	4.6'	-1.0 ^a	Contraction due to decreasing private consumption and weak external trade.

^a Advanced estimate

' Revised

^p Preliminary

Source: National authorities

¹ Refers to WTI one-month futures on NYMEX

per barrel in July, the oil prices declined sharply to below USD100 per barrel due mainly to the global unwinding of speculative positions as de-leveraging continued to accelerate and expectations of weaker global demand heightened. The price of oil hit a three-and-a-half-year low below USD50 per barrel in late November.

In the **Asian region**, economic growth in most regional economies moderated in the third quarter while export performance was mixed. Although regional growth continued to be led by the People's Republic of China (PR China), its growth also moderated further to 9% in the third quarter (2Q 08: 10.1%). Of significance, Singapore's and Chinese Taipei's third quarter growth contracted by 0.6% (2Q 08: 2.3%) and 1% (2Q 08: 4.6%) respectively. To mitigate the downside risks to growth, several Governments announced fiscal stimulus packages to support domestic demand. With inflationary pressures easing, monetary policy has also been biased toward supporting growth. Most central banks

in Asia moved towards easing. Interest rates declines were initiated in all regional economies except Indonesia, Thailand and Philippines, while Singapore shifted its monetary policy stance to a zero appreciation of its currency.

In the **foreign exchange market**, the US dollar ended the quarter slightly stronger against the euro and the pound sterling due to the de-leveraging process and the repatriation of funds back to the US. The Japanese yen, however, appreciated against the US dollar and all major currencies following the unwinding of carry trades. Similarly, regional currencies were also affected by the de-leveraging process and depreciated against the US dollar. This trend has persisted into the start of the fourth quarter.

Going forward, the downside risks to global growth is expected to persist amidst signs of a deeper recession in industrial economies and further moderation in growth in the regional economies.