

## DEVELOPMENTS IN THE SECOND QUARTER OF 2007

### INTERNATIONAL ECONOMIC ENVIRONMENT

#### *Sustained growth in most major regions*

Global economic growth strengthened in the second quarter of 2007. Growth momentum was sustained in most major economies including the United States, euro area, Japan and People's Republic of China (PR China).

In the **US**, consumption growth moderated to 1.3% (1Q: 3.7 %) amid slowing housing market and higher gasoline prices. Nevertheless, the US economy expanded by 3.4% in the second quarter of 2007 (1Q: 0.6%), driven by strong non-residential property investment, higher government spending and better trade performance. The trade deficit narrowed, driven by broad-based growth in exports, including industrial supplies, consumer goods and capital goods. Imports contracted for the first time since the first quarter of 2003. The more recent turmoil in the subprime mortgage and credit markets has however resulted in some uncertainty on the impact it might have on consumption and the overall growth prospects.

In **Japan**, the economy grew at a moderate pace of 0.5% in the second quarter (1Q: 3.2%). The moderation was due mainly to the slowdown in the private consumption activity, after a robust performance in the first quarter. In addition, the slower growth also reflected lower exports particularly to the US. Nevertheless, in the latest Tankan survey released in July, Japanese businesses remain optimistic with plans to increase capital spending. The economy of the **euro area** expanded by 2.5% in the second quarter, supported by spending on capital equipment and robust net trade in Germany. In addition, continued improvement in the labour market and high levels of confidence

among consumers suggest continued income formation and rising consumer demand. In the **UK**, growth was sustained at 3% in second quarter, supported mainly by consumer spending and the services sector. Meanwhile, the manufacturing sector continued to register positive growth.

#### Industrial countries: Real GDP Growth

	2006		2007		Key contributing factors for 2Q growth	
	2Q	1H	1Q	2Q		1H
Annual change (%)						
US <sup>1</sup>	2.4	3.3	0.6	3.4 <sup>a</sup>	1.7	Growth rebounded on higher fixed investment, government spending, exports and inventories.
UK	2.7	2.4	2.9 <sup>r</sup>	3.0 <sup>a</sup>	3.0	Supported mainly by the services sector and a rebound in the manufacturing sector.
Euro zone	2.9	2.8	3.1	2.5	2.8	Supported by trade and strong spending on capital equipment in Germany.
Japan <sup>1</sup>	1.7	2.4	3.2 <sup>r</sup>	0.5 <sup>a</sup>	2.5	Moderate growth due to the slowdown in private consumption and export activity.

<sup>1</sup> Annualised basis  
<sup>a</sup> Advance estimates  
<sup>r</sup> Revised

Source: National authorities

In the **US**, the **Federal Open Market Committee (FOMC)** maintained interest rates at 5.25% at its meeting on 28 June and 7 August 2007. Inflation remains a concern given the high level of resource utilisation. On 17 August however, the discount rate was reduced by 50 basis points to 5.75%. The **European Central Bank (ECB)** kept its interest rate unchanged at 4% for a second consecutive month at its policy meeting in August. Current rapid growth in money supply and lending has remained the main concern for the ECB. The **Bank of England** also kept its policy rate steady at 5.75%, although inflation had remained above target level of 2%. Similarly, the **Bank of Japan** maintained interest rates at 0.5% on 23 August.

Global **crude oil** prices edged up towards the end of second quarter, closing at USD70.69 per barrel on 29 June amid concerns over supplies in Nigeria and lower

US inventories level. Oil prices recorded a new high at USD78.77 per barrel on 1 August spurred by speculative purchase following strong economic data.

In the **Asian** region, economic activity remained strong despite the adjustment in the electronics and electrical (E&E) sector. Growth was supported by sustained domestic demand and non-E&E exports. The current moderation in regional E&E exports is projected to bottom out during the second half of the year as inventory continues to adjust and the growth in unit shipments of semiconductors mitigates the effects of lower average selling prices (ASPs).

Inflationary trends were mixed. The ASEAN-4<sup>1</sup> economies recorded lower inflationary pressures, while inflation rates were higher in PR China, Korea and Singapore due to a combination of higher food and asset prices. In terms of monetary policy, Indonesia, Thailand and the Philippines reduced interest rates in view of lower inflationary pressures and to spur domestic demand, while PR China, Korea and Chinese Taipei raised interest rates.

In the **foreign exchange market**, the US dollar ended the quarter weaker against major currencies. Interest rate differentials remained the major factor influencing the US dollar performance. In July, the pound reached a 26-year high against the US dollar, while the euro traded near record high against the dollar. This development was driven by expectations for a rate cut by the Federal Open Market Committee and prospects of further rate increases in Europe. Meanwhile, most regional currencies ended the quarter stronger compared with the first quarter, due to continued strong trade, and portfolio equity inflows. Subsequently, there was contagion from the volatile global capital markets in the foreign exchange markets in August.

#### Regional Countries: Real GDP Growth

	2006		2007			Key contributing factors for 2Q growth
	2Q	1H	1Q	2Q	1H	
	Annual change (%)					
PR China	11.5	11.0	11.1	11.9	11.5	Driven by exports and investment.
Singapore	8.0	9.1	6.4	8.6	7.5	Supported by the financial services and construction sectors.
Hong Kong SAR	5.5	6.8	5.7	6.9	6.3	Driven by investment, exports and private consumption.
Indonesia	5.1	5.0	6.0	6.3	6.1	Supported by investment and exports.
Chinese Taipei	4.6	4.7	4.2	5.1	4.6	Supported by strong private investment.
Korea	5.1	5.7	4.0	4.9 <sup>a</sup>	4.5 <sup>a</sup>	Supported by manufacturing and investment.

<sup>a</sup> Advanced estimates

Source: National authorities

<sup>1</sup>ASEAN-4 refers to Indonesia, Malaysia, the Philippines and Thailand