DEVELOPMENTS IN THE THIRD QUARTER OF 2007

INTERNATIONAL ECONOMIC ENVIRONMENT

Sustained economic growth in most major regions despite moderation in housing-related activity in US

Growth in the global economy was sustained at a relatively strong pace in the third quarter of 2007. In the **US,** despite the continued slowdown in housing-related activity, preliminary estimates showed that economic growth expanded at an annualized rate of 4.9%. Consumer spending expanded by 2.7% (2Q: 1.4%) as job creation supported income growth. Growth was also supported by the trade sector (which contributed 1.4 percentage points to GDP growth) and non-residential investment.

In **Japan,** the economy grew at an annualised rate of 2.6%, supported mainly by the strong export performance during the quarter. Business investment rebounded, after contracting in the second quarter, as companies purchased more general industrial machinery. However, private residential investments fell by 7.8% in the third quarter, the third consecutive quarter of decline in 2007, due to tighter building regulations. Favourable weather conditions supported increased consumption spending.

In the **euro area,** real GDP expanded by 2.6% in the third quarter, supported by stronger business investment and also consumer spending. Growth also picked up in Germany, France and Italy in the third quarter. Meanwhile in the **UK,** the economy remained resilient, expanding by 3.2% in the third quarter. Economic expansion benefited from strong services sector activity which grew by 4%. As in the previous quarters, growth was particularly strong in business services and finance. However, industrial output slowed due mainly to weaker manufacturing output growth.

Industrial countries: Real GDP Growth

	2006		2007			Key contributing factors for 3Q growth
	3Q	4Q	1Q	2Q	3Q	
	Annual change (%)					
US[1]	1.1	2.1	0.6	3.8[r]	4.9[p]	Growth was supported by higher net exports and non-residential investment.
UK	3.0	3.2	3.1	3.1[r]	3.2[r]	Supported mainly by the services sector especially in business services and finance.
Euro zone	2.9	3.3	3.2	2.5	2.6[p]	Supported by stronger business investment and consumer spending.
Japan[1]	-0.2	5.5	2.6	-1.6[r]	2.6[p]	Supported by a rebound in investment, healthy consumer spending and strong export performance.

[1] Annualised basis
[r] Revised
[p] Preliminary

Source: National authorities

In the **US,** the **Federal Open Market Committee** (FOMC) cut interest rates by 50 basis points at the 18 September meeting, and another 25 basis points at the 31 October meeting. The interest rate cuts were to forestall the effects on the broader economy from the risks of financial market disruptions.

The **European Central Bank** (ECB) maintained policy rates during the quarter, pausing to evaluate the impact of the recent credit turmoil on the economy. However, medium-term inflation risk stemming from increased capacity constraints, tightening of labour markets, strong money-supply growth, and elevated oil and food prices remain a concern for the ECB. The **Bank of England** also kept rates steady at 5.75% in its November meeting despite concerns arising from the recent credit market problems as growth data in the third quarter remained strong.

Similarly, the **Bank of Japan** maintained interest rates at 0.5% on 31 October, constrained by the recent developments in prices. Recent data showed that core inflation excluding fresh foods continued to fall in September, the eighth consecutive month of decline.

In the third quarter, global **crude oil prices** recorded a high of USD83.32 per barrel on 20 September spurred by the report of the US Energy Department showing an unexpected drawdown of crude inventories in the US and concerns over bad weather. Oil prices increased further to exceed USD90 per barrel by end-October 2007 and reached a new high of USD98.03 on 20 November 2007 due to concerns ahead of the Northern Hemisphere winter and a steady reduction in inventories in recent weeks.

In the **Asian** region, economic activity remained strong despite the increased uncertainties concerning the US economy and the global debt market turmoil. Growth was supported by sustained domestic demand and gradual recovery in E&E exports. The moderation in regional E&E exports in the first half of the year has begun to recover as reflected in improved global sales of semiconductor since July and the decline in inventories in the third quarter.

Most regional economies recorded higher inflationary pressures, mainly due to higher food prices. PR China and Korea raised interest rates to contain inflation. However, Indonesia, Thailand and the Philippines, the moderation in inflationary pressures have led to cuts in interest rates to stimulate domestic demand.

In the **foreign exchange market,** the US dollar ended the quarter weaker against major currencies. Dollar performance was mainly affected by the concern over the strength of the US economy and also interest rate differentials. In November, the pound sterling reached a 26-year high (USD2.1074) versus the dollar on 8 November 2007. Meanwhile, the US dollar also fell to record lows against the euro and a basket of six major currencies due to expectations of rate cuts by the Federal Reserve. Regional currencies also appreciated against the US dollar due to continued strong trade and portfolio inflows.

Regional Countries: Real GDP Growth

	2006		2007			Key contributing factors for 3Q growth
	3Q	4Q	1Q	2Q	3Q	
	Annual change (%)					
PR China	10.6	10.4	11.1	11.9	11.5	Driven by strong exports and investment.
Singapore	7.0	6.6	6.5	8.7	8.9	Supported by growth in the manufacturing, construction and financial services sectors.
Indonesia	5.9	6.1	6.0	6.3	6.5	Due to strong investment and exports.
Hong Kong SAR	6.4	6.9	5.6	6.6	6.2	Supported by exports and private consumption.
Korea	4.8	4.0	4.0	5.0	5.2	Supported by manufacturing and services sectors.

Source: National authorities