

## HIGHLIGHTS & OUTLOOK

### STRENGTHENING INFLATION: A SUPPLY-SIDE STORY

**Headline CPI inflation** came in higher at **1.3%** year-on-year (y-o-y) in January, nearly twice the rate registered in December (0.7%). This was much higher than private analysts' expectations of 0.8% (median forecast), according to a Reuters poll.<sup>1</sup> The jump in the inflation number partly reflected the effect of the Chinese New Year (CNY) celebrations falling in January 2004, compared to the month of February last year. The MAS underlying inflation – which excludes accommodation and private road transport – also came in markedly higher at 1.7% y-o-y, as compared to 1.1% a month ago.

The seasonally adjusted index rose by 0.8% (m-o-m SA) sequentially in January, after creeping up by 0.2% in the previous month. The rise in the overall index largely reflected **supply-side factors** including the increase in medical treatment charges, the upward adjustment in newspaper prices, and the second phase of the GST increase. World oil and non-oil commodity price developments including price shocks from food-related diseases continued to underpin some of the price increases in January.

### GST EFFECT APPEARS TO BE MUTED

January's consumer prices were boosted by the second phase of the GST hike, with prices of several goods and services experiencing one-off increases. For consumer goods, the impact of GST appeared to be more muted this time round, with several items experiencing smaller price increases compared to the first phase last year. (Table 1.) Given the improvement in the economic climate, we would have expected more firms to pass-on the GST increase to customers. One possible explanation for this could be the proximity between Christmas and CNY this year, which did not allow retailers to unwind the earlier Christmas discount sales, thus contributing to the lower sequential price increase in January this year.

**Table 1**  
**Sequential Price Increase of Selected Consumer Goods (%)**

Items	Jan 2003	Jan 2004
Ready-made clothing & accessories	1.7	1.3
Footwear	-0.3	-2.5
Personal effects	0.5	0.4
Personal care	1.0	0.5
Recreation	0.7	0.2
Household durables	-0.4	0.2
Cooked food	0.2	0.3

Prices of consumer services, however, saw more significant increases in January compared to those in the goods sector, particularly communication costs, health and education costs, as well as some utility tariffs such as electricity and water.

### SIGNIFICANT INCREASES IN SOME HEALTH AND EDUCATION COSTS

Apart from the GST increase, which had a broad-based effect on prices, there were several other supply-side price adjustments that contributed to the sequential CPI increase in January. In particular, prices of healthcare services rose sharply on account

<sup>1</sup> Source: The Business Times on 20 February 2004, "Singapore inflation seen up after tax hike".

of more expensive medical and dental treatment. The former saw a 7.6% increase – the highest ever recorded – mainly due to the hike in Chinese physician charges, as production costs of Chinese medicine rose significantly.<sup>2</sup> In addition, overall education costs picked up visibly following SPH's upward price adjustment for its news-stand copies of nine of its newspapers – its first price adjustment since 1995 – ranging from 10 cents to 20 cents. This has led prices of the newspapers, magazines & other books subcategory to spike up by 12%. Reasons cited for the price increase were the significant rise in manpower and production costs over the years, which SPH has been absorbing, including the series of GST increases.

#### **CONTINUED UPWARD PRESSURE FROM RISING WORLD COMMODITY PRICES**

Supply-side factors, including higher world oil prices, continued to put upward pressure on domestic consumer prices.<sup>3</sup> Petrol prices, which were already raised by five cents in mid-December, rose further as pump operators unwound earlier discounts. Singapore Power raised electricity tariffs by an average of 1.1% in January.

In addition, food-related commodities also experienced price increases in the month. While this may be due to some GST increases, it could possibly be reflecting the initial impact of the partial supply disruptions caused by the bird-flu. Apart from some price increases in chicken and eggs, the substitution of chicken for other forms of meat may have led to rising prices of these items as well.

#### **MEANWHILE, DOMESTIC DEMAND FOR BIG-TICKET ITEMS HELD UP**

Meanwhile, prices of travel-related items continued to strengthen in January on the back of buoyant demand. This was reflected in the sixth straight month of increase in prices of "other miscellaneous" items (comprising largely holiday & tour packages) by 1.1%. With the improvement in consumer sentiment, many Singaporeans took advantage of the festive CNY and Hari Raya Haji holidays to travel abroad.

COE premiums fell further to around \$24,000 in Jan, reflecting the increased supply in COEs rather than weakening demand for cars. The more competitive car prices and easy financing continued to sustain buying interest for the past few months.

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#### **HEADLINE INFLATION TO RISE HIGHER IN 2004 AFTER A MILD 0.5% IN 2003**

Going forward, headline CPI inflation in 2004 is expected to rise higher than the 0.5% recorded in 2003, and to come in within the **0.5-1.5%** range. The higher headline figure expected is underpinned by the turnaround in consumer sentiments following the improvement in the economic and employment outlook. This year's inflation outcome will be influenced by a combination of both external and domestic price developments. Some changes in indirect taxes as announced in the FY04 Budget will also impact consumer prices.

#### **COMMODITY PRESSURES SET TO CONTINUE**

Commodity price developments could be a key factor, posing upside risks to domestic consumer prices. Our Dec 2003 issue of the Inflation Monthly had looked at this issue in detail, including the impact of food-related diseases (e.g. mad cow disease and bird flu). In particular, food prices could see more pronounced increases. Already, NTUC Fairprice has started to bring in supplies of eggs from Australia, which cost more than twice as much as local ones.

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<sup>2</sup> Source: The Straits Times on 3 March 2004, "Seeing the sinseh costs more as Chinese medicine prices rise"

<sup>3</sup> OPEC oil prices hovered around the US\$30 per barrel mark for most of December 2003 and January 2004.

In the international commodity markets, prices of a wide range of soft commodities have been trending up, supported by fears of shortages and a general pickup in demand as the global economy strengthens. This will eventually trickle in as higher import prices and subsequently into consumer prices. In addition, oil prices are widely expected to stay above the mid-20s levels for this year. Already, oil prices have spiked up again above US\$30 in late February on worries that US gasoline inventory was seasonally low. OPEC's announcement to reduce production quotas, on the basis of lower demand as the winter season drew to an end, added further to supply-side concerns. In addition, political unrest in Venezuela led to threats by president Hugo Chavez to reduce oil supplies. Nonetheless, some moderation in oil prices is expected towards the later part of the year with the eventual return of Iraqi oil production. Oil futures also indicate that current prices of above US\$30 levels are unsustainable, with expectations of more subdued oil prices towards the later part of the year.

### **MORE PRICE INCREASES EXPECTED WITH PICKUP IN ECONOMIC ACTIVITY**

On the domestic front, some demand-side inflationary pressures can be expected as the economy recovers and consumer confidence strengthens. Some firms may also be encouraged to increase prices to cover some of the cost increases that they have been absorbing during the period of economic weakness. After increasing its news-stand prices of newspapers in January, SPH increased its prices of subscription copies as well in February. In addition, the impact of the GST increase on consumer prices may become more apparent in the following months with the end to the sales season.

### **INCREASING PROMINENCE OF TAX CHANGES ON CONSUMER PRICES**

The recently announced FY2004 Budget is expected to have some impact on the prices of selected consumer items. With the lowering of the Additional Registration Fee (ARF) from 130% to 100%, car dealers have responded immediately by reducing car prices by up to 10%, with price discounts of as much as \$17,000 for bigger cars.<sup>4</sup>

This year's budgetary measures also included the usual increase in tobacco taxes, which has led to an immediate increase in cigarette prices. Tobacco taxes were raised by 15% compared to 21% last year. Although there were also some tax changes for liquor duties, the overall impact is not clear at this stage, as there were both increases and reductions in taxes according to the type of liquor.

In recent years, indirect taxes especially on the above two items – tobacco & alcoholic drinks and motor vehicles – have had a significant influence on CPI inflation, and this is likely to continue going forward. This is particularly so for tobacco and alcohol taxes, which led to price increases of at least 4% p.a. since 2000<sup>5</sup>, contributing an average of around 20% of annual CPI inflation over the same period.<sup>6</sup> (Chart 1.) These duties are largely regarded as "sin" taxes, and are part of the government's efforts to discourage consumption of these products for health reasons. At the same time, various motor vehicle taxes have been adjusted downwards over the past few years, and these have been reflected in lower car prices. Other indirect taxes that fall into this category include the GST, which reflects the move from direct to indirect taxation.

However, it is often not possible to obtain a precise quantitative estimate of the impact of some of these indirect taxes beforehand for our inflation forecast, as very little information is available about the planned changes in advance. In addition, it may not be clear what the pass-through of the tax changes may be given the complex pricing structure. For example, the recent 20% cut in car taxes is not likely to lead to a proportional decline in car prices, given that car dealers may only pass on a fraction of the cost savings to consumers, depending on the strength of demand for cars.

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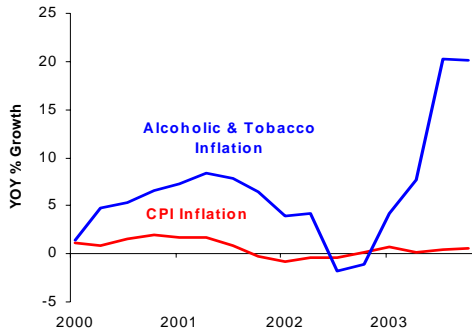
<sup>4</sup> Source: The Straits Times on 1 March 2004, "Car dealers cut prices after drop in vehicle tax"

<sup>5</sup> This is with the exception of 2002 when prices of tobacco and alcoholic drinks rose by 1.3%, as keen competition in the tobacco industry led to a price war, offsetting the effect of the taxes.

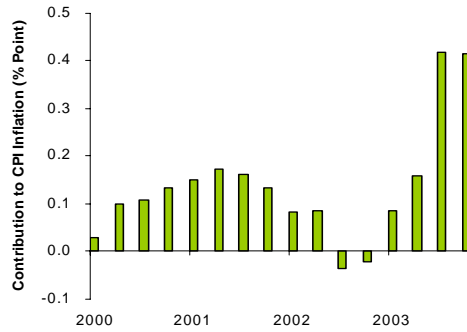
<sup>6</sup> Please note that this calculation has not taken into account the negative contributions of various categories in the CPI basket over the period.

Chart 1

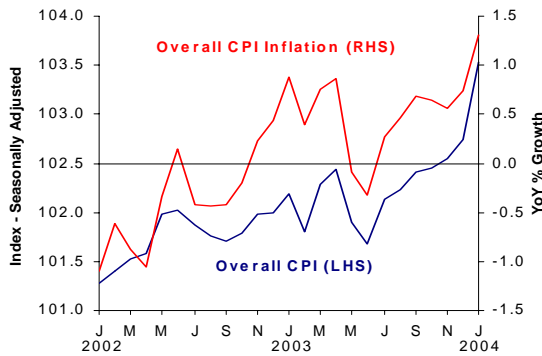
a) Tobacco and Alcoholic Drinks and Overall CPI Inflation



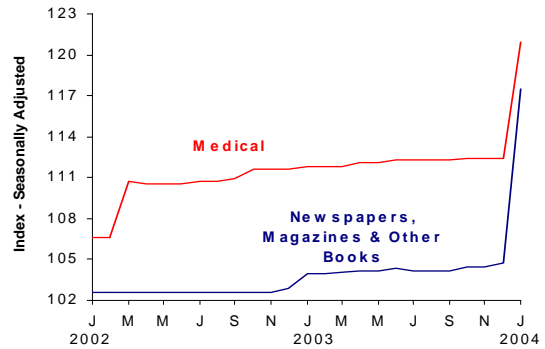
b) Contribution of Tobacco & Alcoholic Drinks to Overall CPI Inflation



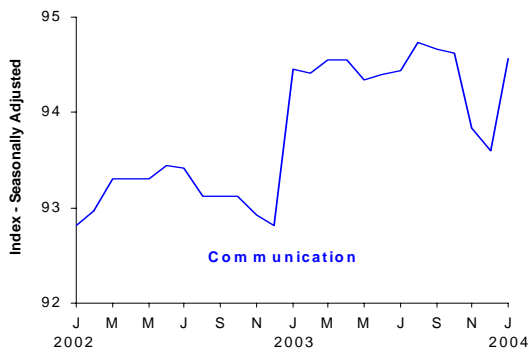
Headline CPI inflation strengthened to 1.3% y-o-y in January, nearly twice that recorded in the previous month. The seasonally adjusted index rose by 0.8%, after inching up 0.2% in December.



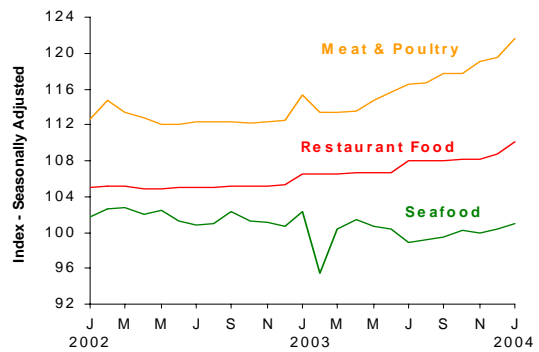
Healthcare costs rose noticeably in January, largely on the back of higher medical treatment while the hike in newspaper prices pushed up education costs.



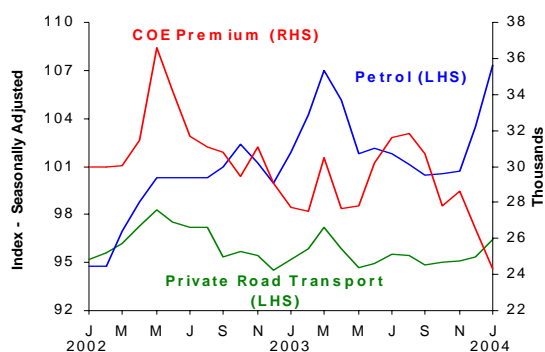
Other service-related costs such as communication costs increased in January as well.



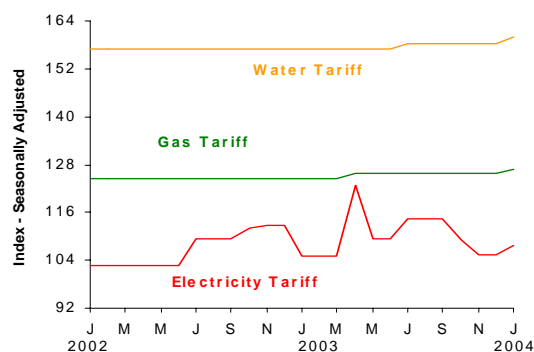
The higher prices of non-cooked food items such as meat & poultry and seafood, as well as more expensive restaurant meals, which contributed to the higher food prices, were due to the GST hike and food-related disease shocks.



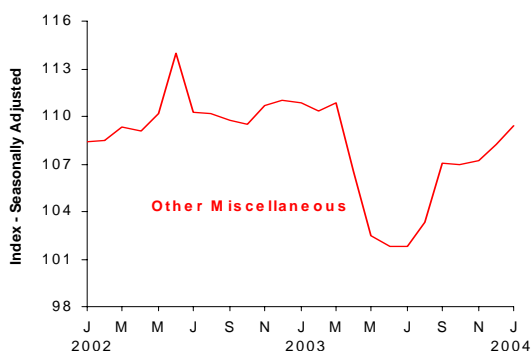
Petrol prices continued to rise in January, although the overall increase in transport cost was moderated by the fall in COE premiums due to the glut of COEs.



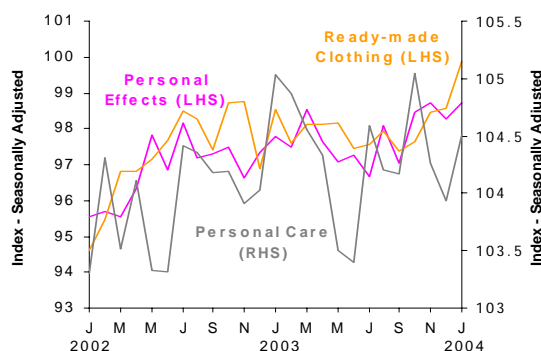
The high global oil prices in recent months also sparked an increase in the tariffs of electricity and gas. The water tariff was also raised as well.



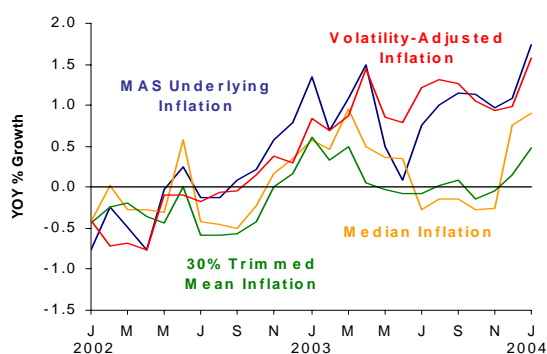
Prices of "other miscellaneous" items (comprising mainly packaged tours) continued to strengthen for the sixth straight month.



Meanwhile, prices of several retail-related items including clothing, personal effects and personal care picked up reflecting the GST hike.



All measures of core inflation came in higher for January, as compared to the previous month.



Note: CPI SA series are used only when seasonality is detected. Otherwise, non-SA series are used.

**MONETARY POLICY DIVISION  
ECONOMIC POLICY DEPARTMENT**

CONSUMER PRICE INDEX								
Period	All Items	Food	Clothing	Housing	Tpt & Comm	Education	Health	Misc
Weights	10000	2752	443	2292	1803	729	305	1676
	INDEX – SEASONALLY ADJUSTED							
2001 Jan	102.4	102.9	97.2	102.7	100.6	103.9	104.7	103.6
Feb	102.0	101.4	98.3	103.1	100.3	104.0	104.8	103.3
Mar	102.5	101.9	98.1	103.1	100.8	104.2	104.8	104.4
Apr	102.7	101.9	98.1	103.2	100.6	104.7	105.3	105.0
May	102.3	101.9	98.1	101.8	100.1	104.8	105.5	105.3
Jun	101.9	101.8	98.0	102.0	98.1	104.9	105.8	105.6
Jul	102.3	101.9	98.0	101.5	99.2	105.3	106.0	106.2
Aug	102.2	102.0	97.2	101.3	99.2	105.4	106.0	106.1
Sep	102.1	101.8	98.5	101.0	99.2	105.6	106.1	106.1
Oct	102.0	101.9	97.3	101.0	98.7	105.9	106.2	105.9
Nov	101.7	102.0	96.6	100.6	98.1	106.1	106.4	105.4
Dec	101.6	101.6	97.1	100.6	97.7	106.3	106.6	105.2
2002 Jan	101.3	101.6	95.7	99.9	97.9	106.0	106.4	104.9
Feb	101.4	102.1	96.5	99.5	98.1	106.2	106.5	105.1
Mar	101.5	101.9	97.5	99.5	98.3	106.4	109.1	105.0
Apr	101.6	101.8	97.5	99.3	98.6	106.3	109.1	104.7
May	102.0	101.9	97.8	99.6	99.0	106.4	109.1	106.0
Jun	102.0	101.9	98.2	99.7	98.7	106.6	109.3	107.4
Jul	101.9	101.8	98.9	99.8	98.8	106.3	109.5	105.3
Aug	101.8	101.7	98.8	99.6	98.7	106.5	109.5	105.4
Sep	101.7	102.2	98.5	99.5	97.9	106.7	109.8	105.2
Oct	101.8	101.9	99.0	99.6	98.2	106.8	110.2	105.4
Nov	102.0	102.0	99.0	99.9	98.5	107.1	110.4	105.7
Dec	102.0	102.1	97.5	99.8	98.4	107.3	110.6	106.0
2003 Jan	102.2	102.3	98.7	99.4	99.1	107.6	110.7	106.4
Feb	101.8	101.4	97.9	99.1	99.2	107.7	110.8	106.2
Mar	102.3	101.9	98.3	99.1	99.6	107.8	110.8	107.4
Apr	102.4	102.4	98.4	100.4	98.7	108.0	110.8	105.9
May	101.9	102.4	98.5	99.4	98.0	108.1	110.8	104.6
Jun	101.7	102.3	97.8	99.5	98.2	108.3	111.0	104.6
Jul	102.1	102.5	98.0	99.4	98.1	109.7	111.4	105.6
Aug	102.2	102.6	98.4	99.3	98.1	109.7	111.5	106.2
Sep	102.4	102.8	98.0	99.2	98.0	110.0	111.7	107.1
Oct	102.4	103.0	98.0	98.6	98.2	110.2	111.7	107.5
Nov	102.6	103.1	98.7	98.4	98.5	110.4	112.0	107.7
Dec	102.7	103.4	98.8	98.3	98.9	110.6	112.0	108.0
2004 Jan	103.5	103.6	99.3	99.0	99.5	112.5	117.3	108.6

## SELECTED INFLATION INDICATORS

Period	CPI	Import Price Index	Non-fuel Primary Commodities	Opec Oil Price
	YOY% Growth			
2001 Jan	2.0	0.9	-2.1	-2.4
Feb	1.3	0.3	-2.9	-5.2
Mar	1.8	-0.5	-3.0	-12.3
Apr	2.0	1.3	-2.3	7.7
May	1.9	1.2	-1.7	-2.9
Jun	1.2	-0.1	-1.3	-10.5
Jul	1.3	-0.9	-1.6	-14.1
Aug	0.7	-1.4	-2.1	-14.5
Sep	0.5	-3.2	-7.0	-22.7
Oct	0.2	-3.9	-9.3	-36.0
Nov	-0.2	-3.5	-7.2	-43.2
Dec	-0.6	-2.3	-8.4	-26.5
2002 Jan	-1.1	-2.8	-8.7	-24.4
Feb	-0.6	-2.8	-7.6	-25.6
Mar	-0.9	-2.3	-4.6	-4.4
Apr	-1.1	-2.7	-5.2	0.5
May	-0.3	-3.2	-6.3	-5.8
Jun	0.1	-3.7	-2.8	-8.9
Jul	-0.4	-3.2	0.2	6.0
Aug	-0.4	-2.0	1.4	5.7
Sep	-0.4	-1.3	7.9	13.8
Oct	-0.2	-0.5	13.5	40.2
Nov	0.2	-1.1	11.1	37.2
Dec	0.4	0.0	11.3	59.6
2003 Jan	0.9	1.0	11.8	65.5
Feb	0.4	2.5	11.4	66.7
Mar	0.8	2.1	7.2	30.4
Apr	0.9	0.0	7.1	1.9
May	-0.1	-1.2	6.8	3.6
Jun	-0.3	-0.3	3.9	12.7
Jul	0.3	0.1	1.3	9.3
Aug	0.5	0.6	4.0	10.7
Sep	0.7	-0.9	3.1	-4.7
Oct	0.6	-1.0	6.7	3.8
Nov	0.6	0.4	9.7	17.4
Dec	0.7	0.2	12.5	4.8
2004 Jan	1.3	0.7	16.1	-0.3