

## HIGHLIGHTS & OUTLOOK

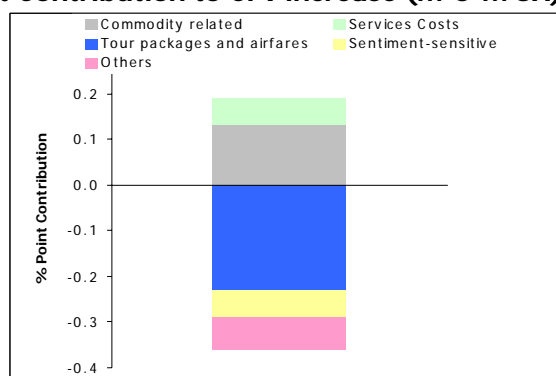
### CONSUMER PRICES PULL BACK AS COMPETITION HEATS UP

#### HEADLINE INFLATION LOWER AFTER EARLIER SARS BOOST

**Headline CPI inflation** retreated to 1.6% year-on-year (y-o-y) in July, down from 2.3% in June, as the effect from a low base during Sars last year dissipated. This brought average inflation for the first seven months of this year to 1.6%. The MAS underlying inflation – which excludes private road transport costs and accommodation – also came in lower, from 2.7% in June to 1.8% in July.

On a month-on-month, seasonally adjusted (m-o-m SA) basis, consumer prices fell by 0.2% in July, after remaining unchanged in June. The bulk of the decline can be attributed to the sharp fall in airfares and tour package prices due to on-going structural changes in the airline industry, even as higher prices from commodity-related items continued to support consumer prices. (Chart 1.)

**Chart 1**  
**% Point Contribution to CPI increase (m-o-m SA) in July**



#### COMPETITION DAMPENS AIRFARES AND TOUR PACKAGE PRICES...

With several new low-cost entrants in the airline industry recently, consumers benefited from the price war in airfares that erupted in July. Although the latest low-cost carrier (LCC) to enter the market, Tiger Airways, is only expected to begin operations by the fourth quarter of this year, its impending entry reportedly triggered some pre-emptive price-cuts by incumbent market players during the month.<sup>1</sup> This followed an earlier episode of price cuts by several full-service carriers earlier in the year when Valuair, another LCC, began operations. Then, Singapore Airlines, Cathay Pacific and United Airlines had slashed prices, with fares for some popular routes falling by more than half.

#### ...AS WELL AS RETAIL PRICES

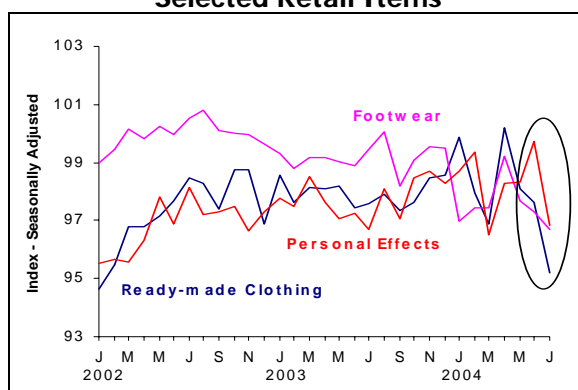
Retail prices fell further during the month, as retailers offered deeper discounts towards the end of the Great Singapore Sale (GSS). The GSS ended on 25<sup>th</sup> July – an extension of two weeks from the usual six-week duration, which held down retail prices for longer.

The fall in prices of some retail items appeared to be sharper than during past GSS. For example, ready-made clothing prices fell by 2.5% to levels not seen since Jan

<sup>1</sup> Source: The Business Times on 22 July 2004, "Tiger Airways' plan to undercut by 40% may spark fresh price war".

2002. (Chart 2.) Recent anecdotal evidence from retailers after the conclusion of the GSS suggested that the improvement in consumer spending was not particularly broad-based. While several upmarket retailers reported better sales compared to the past two years, this was largely attributed to tourist spending, especially from Indonesia and Australia, on the back of the aggressive promotions by the Singapore Tourism Board. In comparison, domestic consumer spending appeared to have remained fairly soft. In particular, several lower-end retailers such as the heartland shops did not receive much boost from the GSS.<sup>2</sup> Apart from lingering uncertainties in the labour market, Singaporeans may have been traveling to other cheaper shopping destinations in the region, particularly with the increasing popularity of budget airlines. This could have posed some competition for the consumer dollar in Singapore, thus weighing down on overall retail prices.

**Chart 2  
Selected Retail Items**



#### UPWARD PRESSURE ON OIL-RELATED ITEMS AS CRUDE OIL PRICES STRETCH TO NEW HIGHS

Nonetheless, even as these structural changes have been exerting some downward pressure on consumer prices, commodity-related developments continued to push up food and oil items in the CPI basket. West Texas Intermediate (WTI) oil prices rose to above US\$40 in July. This partly reflected market reactions to warnings by the US that terrorists were scheming to disrupt their elections, which heightened security fears and added a premium to prices. These developments in the world oil markets sent domestic petrol prices and electricity tariffs higher as well.

Food prices also recorded increases, with more expensive vegetables, rice and meat & poultry. However, NTUC's decision to continue absorbing the hike in the GST for 400 essential items has helped to stabilise prices of these key consumer items.

#### PRICES OF CONSUMER SERVICES TRENDED UP WITH RISING HEALTH AND EDUCATION COSTS

Prices of consumer services also trended up, reflecting higher health and education costs in the month. Healthcare costs were pushed up by more costly proprietary medicines & supplies. Similar to earlier months, the increase in this category was largely attributed to more expensive vitamins and health food. Dental treatment charges saw a pickup as well, although the increase was more moderate compared to earlier hikes. Education costs rose with an upward adjustment in foreign university tuition fees, even as local tertiary fees remained unchanged.

<sup>2</sup> Source: Channel NewsAsia on 26 July 2004, "Great Singapore Sale ends, organisers hope to rake in S\$1.8b in sales".

## **VOLATILE OIL PRICES LIKELY TO HAVE CONTINUING IMPACT ON CONSUMER PRICES**

Global oil prices have been fairly volatile recently, and will continue to impact domestic consumer prices going forward. West Texas Intermediate (WTI) crude oil prices raced towards the US\$50 per barrel threshold in August due to concerns that oil supplies were already dangerously stretched by the strong demand. This was exacerbated by various developments, which threatened to disrupt supplies further. First, the series of pipeline attacks at Iraq, which cut the country's oil exports by half to around 900,000 bpd, raised fears of further supply shortages if attacks persisted. Second, the possibility of bankruptcy at Russia's largest oil company, Yukos, could cut off exports. Third, there were concerns that Venezuela's political troubles may interrupt shipments from the country. Nonetheless, global oil prices subsequently receded to around US\$43 later in the month, as several of these supply fears dissipated. Looking ahead, uncertainty in Iraqi supply could continue to loom over oil prices, with the intermittent pipeline attacks plaguing the country. This, together with strong demand growth as the winter month approaches, could provide some support for oil prices in the near term.

## **RESURFACING OF BIRD FLU COULD SPIKE UP FOOD PRICES**

Other commodity-related shocks include the recent ban of poultry products from Malaysia by the Agri-food Veterinary Authority (AVA) due to the bird flu case at Kelantan. The AVA has reported that there is sufficient supply of frozen poultry, and prices have remained stable as importers increased their orders from the United States, Brazil and the Netherlands. However, prices could rise if a shortage occurs, forcing importers to source from more expensive countries. This may in turn lead to some substitution effects, with consumers switching consumption of chicken to other forms of meat. Already, some poultry sellers in wet markets and hawkers in food centres have reported a fall in sales of as much as 70%, with some Singaporeans avoiding chicken consumption. In response, some chicken rice sellers at hawker centres started offering discounts to entice consumers.

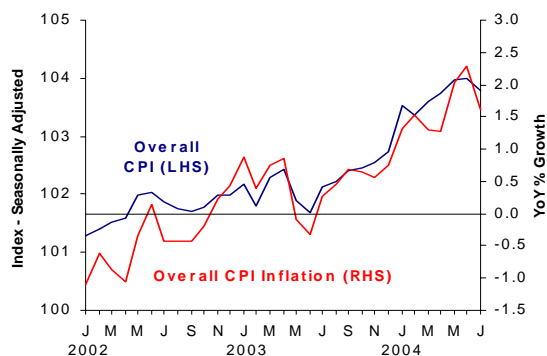
The impact of the poultry ban is more significant on eggs, as two-thirds of Singapore's egg supply is from Malaysia. Local eggs, which used to cost around 13-19 cents before the ban, have seen two rounds of price increases of around 5 cents in each instance. Although supermarket retailers have recently turned to Australian eggs to ease the shortage, these are more expensive at a hefty 40 cents each. However, there could be some respite for high food prices – the AVA is currently studying the possibility of an earlier resumption of poultry exports from bird flu-free zones in Malaysia, even as it extended the poultry ban in affected areas due to a new outbreak of bird flu in Kelantan recently.

## **COMPETITION IN SOME DOMESTIC SECTORS DAMPEN PRICE INCREASES**

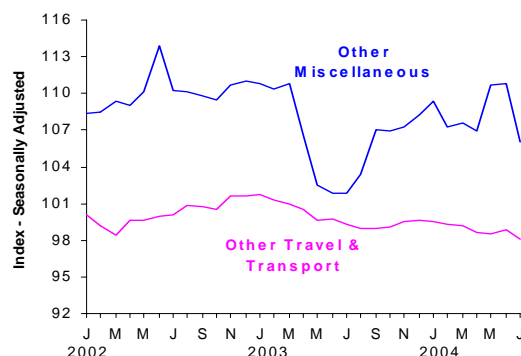
Meanwhile, several sectors in the economy, which have traditionally been domestic-oriented and "non-tradable" in nature, have become increasingly "tradable", leading to downward pressure on domestic prices in these sectors. These sectors include not just the air travel segment, from budget airlines, but also in medical services, from regional countries. For example, the Raffles Medical Group recently announced that it will slash 20-30% off the cost of ten common procedures from September to attract more foreign patients. This followed moves by both private and restructured hospitals weeks earlier, to cut rates for common procedures such as Lasik and baby delivery bills.

These developments will help hold down consumer prices, even as several cost increases, which were held back during the period of economic weakness, filter through going forward. Taking these factors into account, the headline CPI inflation forecast for 2004 remains unchanged at **1.5-2.0%**.

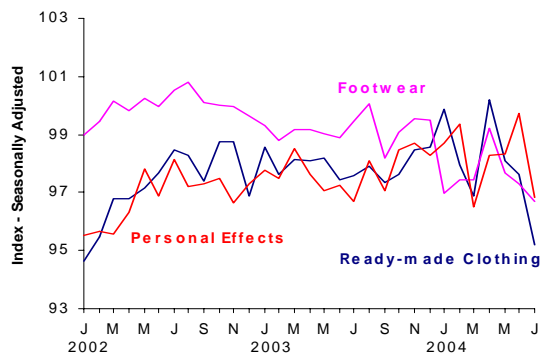
Headline CPI inflation dipped to 1.6% in July, down from 2.3% in June. The seasonally adjusted index also declined by 0.2% from the previous month.



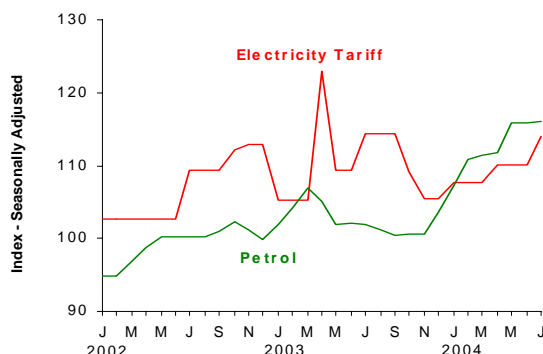
The fall in the index reflected the price war in the airline industry, which pushed down airfares (included in other travel and transport costs) and tour package prices (other miscellaneous items).



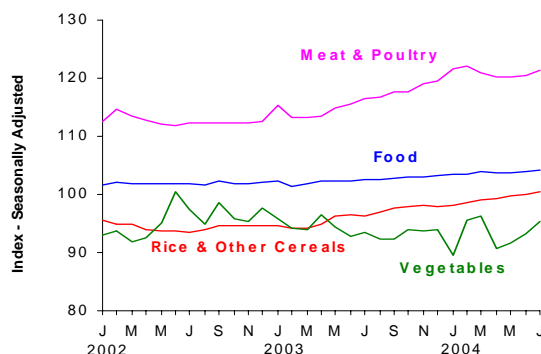
Retail items also fell further in July, with the extension of the GSS by another two weeks. Regional competition may have further dampened prices of these items.



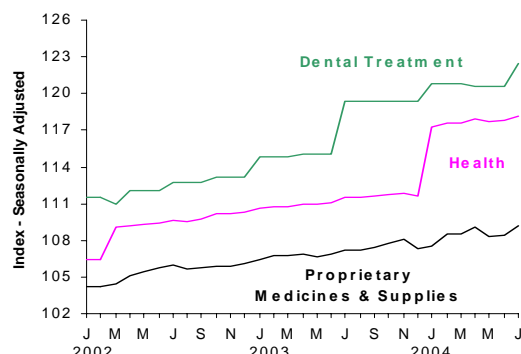
However, escalating global oil prices to above US\$40 sent prices of petrol and electricity tariffs higher during the month.



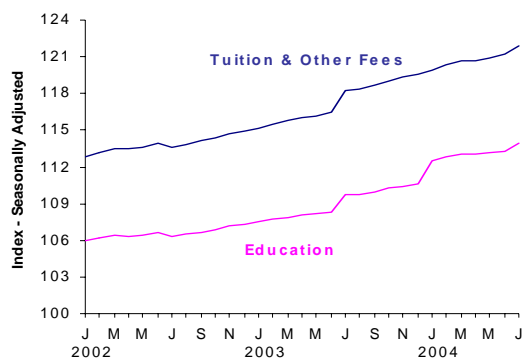
Food prices rose as well with more expensive vegetables, rice and meat & poultry.



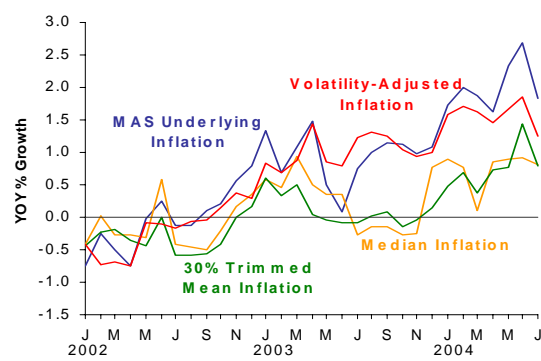
Consumer services saw some pickup with higher cost of dental treatment, as well as more expensive vitamins and health food.



Education costs rose on the back of a rise in foreign university tuition fees.



All core inflation measures came in lower, with the MAS underlying inflation at 1.8%.



*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							
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
Feb	103.4	103.6	97.9	98.8	99.8	112.9	117.7	108.3
Mar	103.6	104.0	97.0	98.7	99.4	113.1	117.6	109.5
Apr	103.7	103.7	100.0	98.9	99.2	113.0	117.7	109.0
May	104.0	103.6	97.9	99.2	99.9	113.2	117.6	110.0
Jun	104.0	104.0	97.4	99.3	99.9	113.3	117.7	110.4
Jul	103.8	104.3	95.6	99.1	99.6	114.0	118.0	108.9

Source: Department of Statistics

SELECTED INFLATION INDICATORS				
Period	CPI	Import Price Index	Non-fuel Primary Commodities	Opec Oil Price
	YOY% Growth			
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	-2.7	-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	11.3	37.2
Dec	0.4	0.0	11.4	59.6
2003 Jan	0.9	1.0	11.8	65.5
Feb	0.4	2.5	11.5	66.7
Mar	0.8	2.1	7.3	30.4
Apr	0.9	0.0	7.2	1.9
May	-0.1	-1.2	6.9	3.6
Jun	-0.3	-0.3	3.9	12.7
Jul	0.3	0.1	1.4	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	6.8	3.8
Nov	0.6	0.4	9.6	17.4
Dec	0.7	0.2	12.2	4.8
2004 Jan	1.3	0.3	15.8	-0.3
Feb	1.5	-2.0	19.2	-6.4
Mar	1.3	-1.9	23.7	9.3
Apr	1.3	-0.3	24.7	27.8
May	2.0	2.6	21.8	41.9
Jun	2.3	2.9	21.6	28.9
Jul	1.6	3.0	22.3	32.0

Source: Department of Statistics, IMF and Bloomberg