HIGHLIGHTS & OUTLOOK

A YEAR ON AFTER SARS

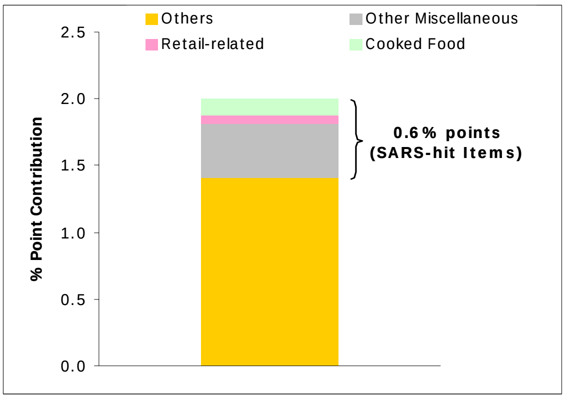
Headline CPI inflation came in at **2.0%** year-on-year (y-o-y) in May, considerably higher than the 1.3% recorded in April, bringing average inflation for the first five months of the year to 1.5%. The headline inflation figure was in line with market expectations, with analysts forecasting a median estimate of 2.0%.[1] The MAS underlying inflation – which excludes accommodation and private road transport – also rose to 2.3% y-o-y, from 1.6% in April. On a seasonally adjusted, month-on-month (m-o-m, SA) basis, consumer prices trended up by 0.2% in May, after rising by 0.1% a month ago.

JUMP IN HEADLINE INFLATION RATE REFLECTED LOW BASE EFFECTS DUE TO SARS OUTBREAK A YEAR AGO

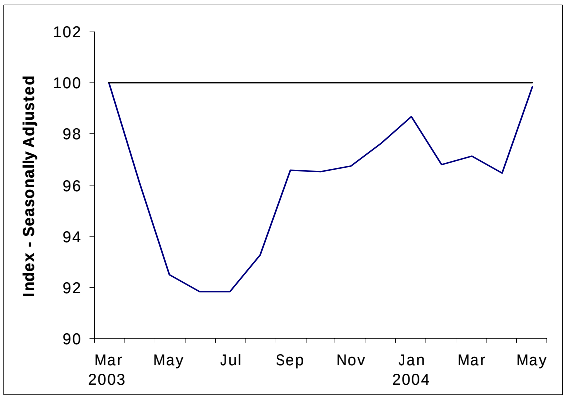
The rise in the y-o-y headline figure could be partly attributed to low base effects, when consumer prices plunged a year ago following the outbreak of SARS. In particular, prices of travel-related items (comprising largely tour packages), which bore the brunt of the SARS impact last year, rebounded, resulting in prices of "other miscellaneous" items rising by 8% y-o-y in May. Prices of other SARS-hit items that received a y-o-y boost included cooked food and some retail items. Our estimates suggest that prices of these items contributed approximately 0.6% points to May's headline inflation rate. (Chart 1a)

Chart 1

(a) Contribution of SARS-hit Items to Headline CPI Inflation



(b) Profile of "Other Miscellaneous" Items



DIVERGENCE BETWEEN PRICES OF BIG-TICKET AND MASS-MARKET RETAIL ITEMS

Despite the higher y-o-y headline inflation number in May, the sequential rise in the overall price index was fairly modest at 0.2%. A significant portion of the sequential increase in the CPI was due to the turnaround in prices of the "other miscellaneous" category, which rose by 3.5% in May. It is however still premature to conclude that the sharp increase in prices of tour packages (in both y-o-y and in m-o-m SA terms) is indicative of some demand-side inflationary pressures - prices of these items have only just recovered to their pre-SARS level in Mar 2003. (Chart 1b)

Car prices have started to trend up, with COE premiums rising above $27,000 in May, after averaging $24,000 in the first few months of the year. There were a few reasons behind the increase in premiums this time round. First, fewer COEs were allocated on

[1] Source: The Business Times on 22 June 2004, "May inflation seen hitting three-year high".

a monthly basis in the new quota year beginning in Apr 2004.[2] Second, there was a longer time lag between bidding exercises in April (a three week gap instead of the usual two), which resulted in an extra week's build-up in order collection.[3] Thus, car dealers had to bid for a larger number of orders, with a lower supply of COEs. Third, improved consumer sentiment, coupled with aggressive promotions by car dealers and banks through schemes such as free-installment plans, could have also helped to boost demand.[4] According to the Motor Traders Association, the number of cars sold in H1 2004 was around 25% higher than the same period last year.[5]

In comparison, the earlier rebound in prices of several mass-market retail items was not sustained into May. In particular, prices of ready-made clothing and footwear fell, with several major retailers offering early bird discounts of up to 50% in the run-up to the Great Singapore Sale (GSS) at end-May.

SWELLING WORLD OIL PRICES CONTINUED TO BOOST CONSUMER PRICES

Domestic pump prices were raised by another five cents in mid-May, with OPEC oil prices staying high at around US$36 per barrel. Electricity tariffs, however, remained unchanged after the quarterly upward adjustment earlier in April.

Meanwhile, food prices edged downwards on the back of lower prices of non-cooked food items, which have fallen for three consecutive months. While prices of some foodstuff such as rice and dairy products continued to trend up, these increases were more than offset by the price declines in meat and poultry and seafood. Cooked food prices fell slightly as well.

RISK OF HIGH OIL PRICES TO PERSIST, EVEN AS NON-OIL COMMODITY PRICES SEEMED TO HAVE ABATED SOMEWHAT

Given the lingering uncertainty in world oil markets, commodity prices are expected to pose some upside risks to consumer prices in the near term. Although OPEC oil prices seemed to have receded from their earlier highs of around US$37 in late May, they continued to hover at the US$33-34 range in recent weeks. While the increased production by OPEC and the recent handover to the new Iraqi government from the US-led administration have provided some relief for the markets, fears of further attacks continue to plague the oil market. As recently as mid-June, there was another pipeline sabotage attack in Iraq, which halted oil exports from the country temporarily. Indeed, forward price indicators such as the West Texas Intermediate (WTI) crude oil futures have risen substantially since end-2003, suggesting that expectations of oil prices remain fairly high for the rest of the year. (Chart 2a) In the upcoming months, domestic prices of oil-related items are likely to experience further upward adjustments, with electricity tariffs to increase by another 3.5% for the period July to September. However, some temporary relief for petrol prices can be expected with pump operators cutting prices by three cents in early June.

2 Although the overall number of COEs available in this quota year is larger than the last, there are fewer COEs available a month-on-month basis, as compared to the Oct 2003 to Mar 2004 period. LTA released 30% more COEs for the remaining six months during its mid-year review in Sep 2003, when it had significantly underestimated the number of cars scrapped last year.

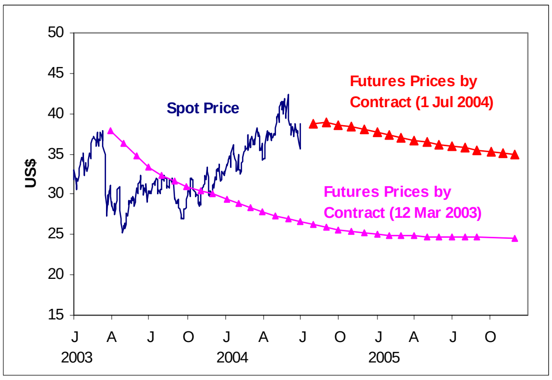
3 COE premiums bid in a particular month are reflected in overall car prices in the following month, given that car dealers need to secure the certificates before the cars are eventually sold.

4 While the number of cars sold is dependent to some extent on the COE quota for a particular month, car dealers have some leeway to "roll over" COEs obtained in the Open category from earlier bidding exercises to fulfill sales orders.

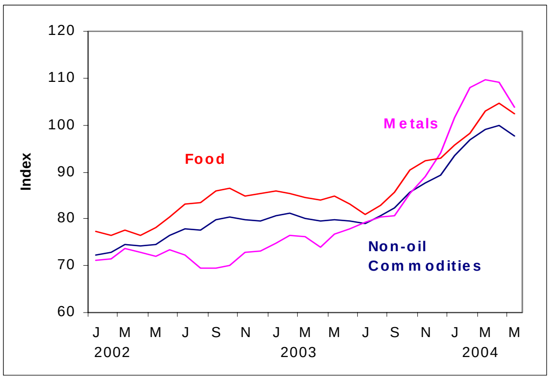
5 Source: The Straits Times on 1 July 2004, "Car sales set to hit all-time high".

Chart 2

(a) West Texas Intermediate (WTI) Crude Oil Spot and Futures Prices



(b) Prices of Non-oil Commodities



In comparison, prices of non-oil commodities seemed to have abated more recently. (Chart 2b) In particular, prices of various hard commodities such as metals appeared to have moderated, with rising concerns of a fall-off in Chinese demand following the recent government's credit-tightening measures. Although metals may not see significant price increases going forward, a sharp pullback is unlikely as well, given the synchronised upturn in global economic activity. Likewise, prices of soft commodities have eased somewhat more recently, with the unwinding of speculative positions.

Nonetheless, domestic food prices, particularly seafood, may experience some increases in the near term, as supplies were reported to have fallen by around 40% due to strong sea currents in nearby waters. This was further compounded by the Agri-food and Veterinary Authority of Singapore's (AVA) decision to destroy nine batches of seafood, which were found to contain cancer-causing agents.[6]

DEMAND-SIDE FACTORS TO BE ONE OF THE KEY DETERMINANTS OF PRICE DEVELOPMENTS IN H2 2004

On the demand side, prices of various sentiment-sensitive items are likely to strengthen further in the second half of the year, alongside the firmer recovery in the domestic economy and improved labour market conditions. Nevertheless, some softening in prices of retail items can be expected at least till end-July, with this year's GSS extending to eight weeks, instead of a usual six-week period. The two-week extension is timed to coincide with the end-of-season sales of various upmarket labels, which will offer price discounts of up to 70%.

With the rebound in travel demand, there could be further strengthening in prices of tour packages, which had turned around more recently. While rising competition from low-cost carriers in the airline industry[7] are likely to dampen price increases somewhat, the recent tie-ups between these budget airlines and travel agents offering innovative-themed tours may help support prices. For example, Valuair has recently tied up with several tour operators to offer medical-themed tours such as Lasik treatments in Bangkok.[8] Given the increasing popularity of Lasik treatments among Singaporeans, such tours may boost the growth of medical tourism.

At the same time, the recent rebound in car prices following the rise in COE premiums may not be sustainable. With the number of cars that have been scrapped in the first five months of the year exceeding that of the same period last year (8%), most motor

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6 Source: ChannelNewsAsia on 21 June 2004, "AVA destroys seafood found to contain cancer-causing agents".

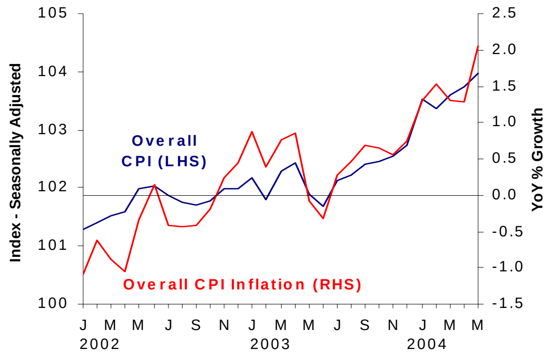
7 At least two more discount operators are set for launch in Singapore later this year: Tiger Airways, backed by full service flag-carrier SIA, and a rival supported by Australia's Qantas Airways. Source: The Business Times on 18 June 2004, "Low-cost airlines set for explosive growth in Asia".

8 Source: Streats on 29 June 2004, "Medical themed tours for Valuair".

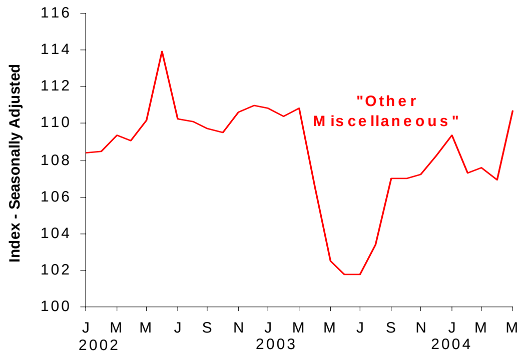
traders expect an upward adjustment in the COE quota in the mid-quota year review in October. This could result in lower COE premiums in the later part of this year.

Taking all these factors into account, the headline CPI inflation could come in within our forecast range of **1.5-2.0%** for 2004 as a whole.

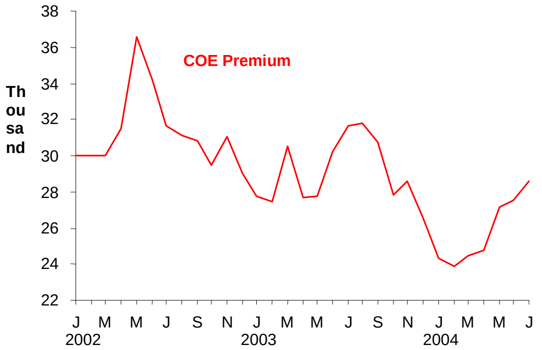
Headline CPI inflation rose to 2.0% in May, after coming in at 1.3% in the previous month. The seasonally adjusted index trended up by 0.2%, after rising by 0.1% in April.



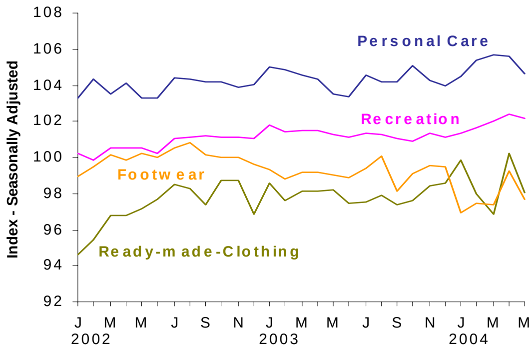
The rebound in prices of "other miscellaneous" items was the main contributor to the sequential rise in consumer prices.



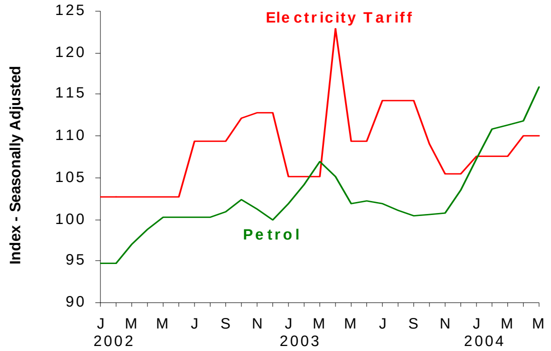
Car prices rose with COE premiums rising above $27,000 for the first time since Nov 2003.



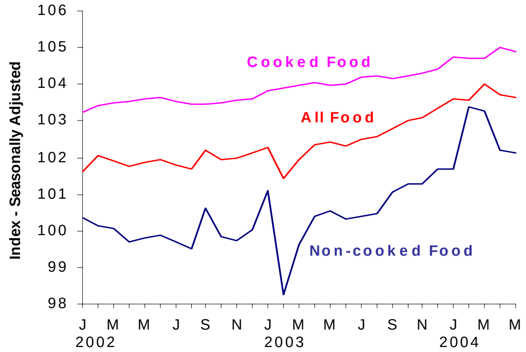
However, prices of several mass-market retail items such as ready-made clothing, footwear, recreation and personal effects moderated, after a rebound in April.



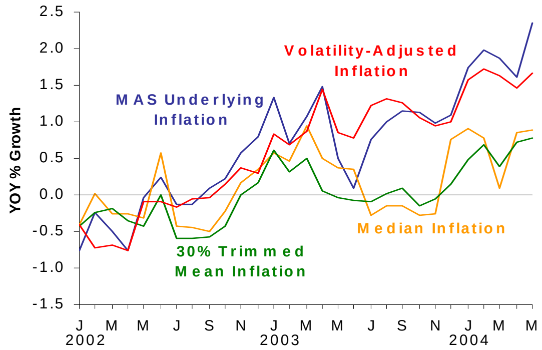
Petrol prices were hiked by five cents, while electricity tariffs remained unchanged after an earlier quarterly adjustment in April.



Food prices edged downwards with lower prices of both non-cooked food and cooked food.



Except for the median inflation, which came in unchanged at 0.9% from the previous month, all other measures of core inflation rose in May.



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	100.1	103.9	104.7	103.6
Feb	102.0	101.4	98.3	103.1	99.8	104.0	104.8	103.3
Mar	102.5	101.9	98.1	103.1	100.4	104.2	104.8	104.4
Apr	102.7	101.9	98.1	103.2	100.5	104.7	105.4	105.0
May	102.3	101.9	98.1	101.8	100.2	104.8	105.6	105.3
Jun	101.9	101.8	98.0	102.0	98.3	104.9	105.9	105.6
Jul	102.3	101.9	98.0	101.5	99.7	105.3	106.1	106.2
Aug	102.2	102.0	97.2	101.3	99.7	105.4	106.0	106.1
Sep	102.1	101.8	98.5	101.0	99.6	105.6	106.0	106.1
Oct	102.0	101.9	97.3	101.0	98.9	105.9	106.3	105.9
Nov	101.7	102.0	96.6	100.6	97.9	106.1	106.3	105.4
Dec	101.6	101.6	97.1	100.6	97.2	106.3	106.4	105.2
2002 Jan	101.3	101.6	95.7	99.9	97.4	106.0	106.4	104.9
Feb	101.4	102.1	96.5	99.5	97.7	106.2	106.4	105.1
Mar	101.5	101.9	97.5	99.5	98.0	106.4	109.0	105.0
Apr	101.6	101.8	97.5	99.3	98.6	106.3	109.2	104.7
May	102.0	101.9	97.8	99.6	99.1	106.4	109.3	106.0
Jun	102.0	101.9	98.2	99.7	98.8	106.6	109.4	107.4
Jul	101.9	101.8	98.9	99.8	99.3	106.3	109.6	105.3
Aug	101.8	101.7	98.8	99.6	99.2	106.5	109.5	105.4
Sep	101.7	102.2	98.5	99.5	98.3	106.7	109.7	105.2
Oct	101.8	101.9	99.0	99.6	98.4	106.8	110.2	105.4
Nov	102.0	102.0	99.0	99.9	98.3	107.1	110.2	105.7
Dec	102.0	102.1	97.5	99.8	97.8	107.3	110.3	106.0
2003 Jan	102.2	102.3	98.7	99.4	98.6	107.6	110.6	106.4
Feb	101.8	101.4	97.9	99.1	98.9	107.7	110.7	106.2
Mar	102.3	101.9	98.3	99.1	99.5	107.8	110.7	107.4
Apr	102.4	102.4	98.4	100.4	98.8	108.0	111.0	105.9
May	101.9	102.4	98.5	99.4	98.1	108.1	110.9	104.6
Jun	101.7	102.3	97.8	99.5	98.3	108.3	111.1	104.6
Jul	102.1	102.5	98.0	99.4	98.5	109.7	111.6	105.6
Aug	102.2	102.6	98.4	99.3	98.6	109.7	111.6	106.2
Sep	102.4	102.8	98.0	99.2	98.3	110.0	111.6	107.1
Oct	102.4	103.0	98.0	98.6	98.3	110.2	111.8	107.5
Nov	102.6	103.1	98.7	98.4	98.2	110.4	111.9	107.7
Dec	102.7	103.4	98.8	98.3	98.3	110.6	111.6	108.0
2004 Jan	103.5	103.6	99.3	99.0	99.1	112.5	117.3	108.6
Feb	103.4	103.6	97.9	98.8	99.5	112.9	117.6	108.3
Mar	103.6	104.0	97.0	98.7	99.3	113.1	117.6	109.5
Apr	103.7	103.7	100.0	98.9	99.4	113.0	118.0	109.0
May	104.0	103.6	97.9	99.2	100.0	113.2	117.8	110.0

Source: Department of Statistics

ANNEX 2

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	-3.0	-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	-2.7	-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	25.7	27.8
May	2.0	2.6	22.5	41.9

Source: Department of Statistics, IMF and Bloomberg