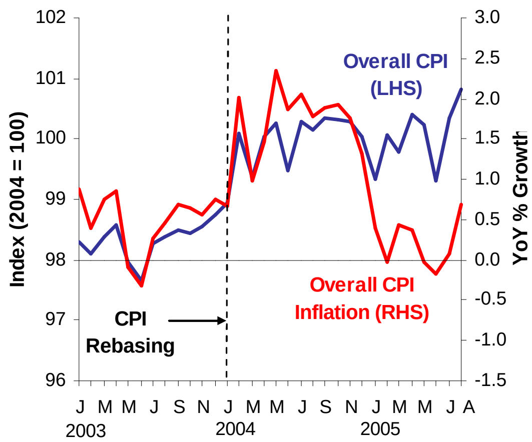
Inflation Monthly
Aug 2005

CPI Inflation Picks Up

CPI (2004 = 100)		
% Growth / Level	Jul 05	Aug 05
y-o-y	0.1	**0.7**
m-o-m	1.1	**0.5**
Index	100.4	**100.8**



- **Headline CPI inflation rose to 0.7% in August**
  The MAS underlying inflation measure increased to 1.5% from 1.1% in the previous month.

- **On a m-o-m basis, CPI went up 0.5% due to higher private road transport costs and more expensive retail sales items**
  Petrol prices jumped almost 14% in August as pump quotes were hiked twice while discounts stabilised at lower levels. Meanwhile, prices of retail items such as clothing and footwear came in higher following the end of the Great Singapore Sale in July.

- **Pass-through of oil prices expected to firm, but car prices to drag down headline inflation**
  Going forward, greater pass-through of oil prices to energy components is expected, with the indirect filter-through to other goods and services also picking up. However, car prices could continue trending downwards following the recent LTA quota review.

- **CPI inflation projected to be around 0-0.5% in 2005 before rising to 0.5-1.5% in 2006**
  Meanwhile, the MAS underlying inflation measure is forecast at around 1% this year and to rise to 1.5-2% in 2006.

Recent Developments

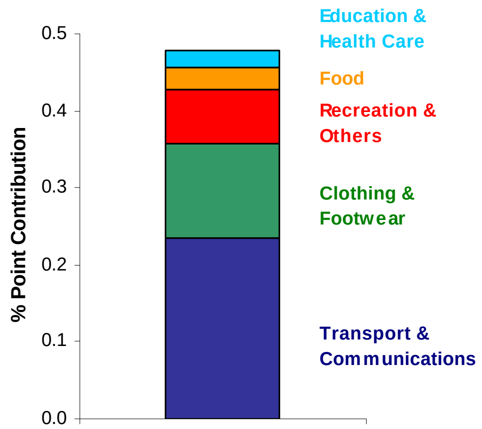
Headline CPI Inflation Picks Up

Headline CPI inflation rose to 0.7% year-on-year (y-o-y) in August, after coming in at 0.1% in July. This brought average inflation for the first eight months of the year to 0.2%. The MAS underlying inflation measure – which excludes private road transport and accommodation costs – came in at 1.5% y-o-y, up from 1.1% in the previous month. It averaged 1.0% over the period Jan-Aug 2005.

Higher Private Road Transport Costs and Dearer Retail Sales Items Boosted CPI

On a month-on-month (m-o-m) basis, the CPI increased 0.5% in August mainly due to higher private road transport costs (subsumed under Transport & Communications) and more expensive retail sales items such as clothing, footwear and personal effects (Clothing & Footwear and Recreation & Others). (Chart 1)

Chart 1
% Point Contribution to CPI Change (m-o-m), Aug 2005



Double Hike in Pump Quotes along with Withdrawal of Discounts Led to Higher Private Road Transport Costs

The rise in private road transport costs was mainly due to higher petrol prices, which contributed 0.3% point to the overall increase in CPI. Petrol prices rose almost 14% in August – the largest month-on-month increase – as pump quotes for all petrol grades were hiked twice in the month, by a total of 17 cents per litre, while discounts were reduced from 25% at one stage in early July to 10%. (Chart 2a) These price adjustments came on the back of mounting product costs, with the WTI crude oil and wholesale petrol prices rising 11% and 13% respectively during the month. (Chart 2b)

Chart 2a
Petrol Pump Quotes and Petrol CPI

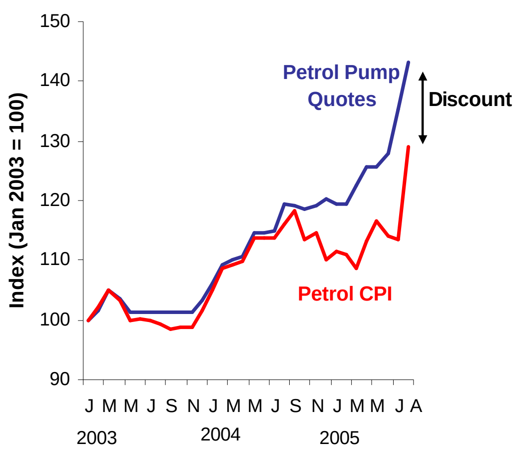
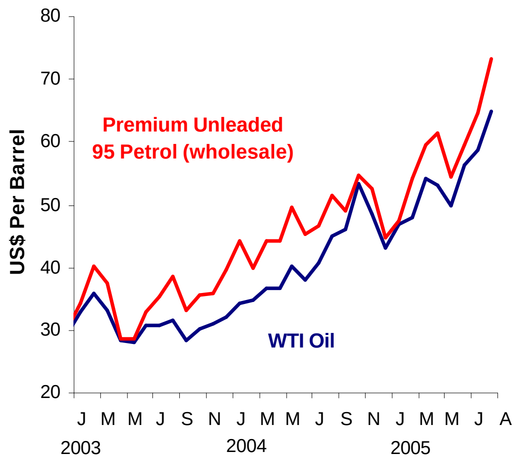


Chart 2b
WTI Oil and Wholesale Petrol Prices



Source: Bloomberg and International Energy Agency

The upward movement in global oil prices was underpinned by the emergence of numerous risk factors including unfavourable geopolitical developments in the Middle East as well as the devastation of oil production and refinery facilities in the Gulf of Mexico. In particular, Hurricane Katrina forced operators to shut down more than a tenth of US' refining capacity (1.9 million barrels per day (bpd)) and a quarter of its crude oil output. This led to the price of WTI soaring to a record US$70.85 per barrel on 30 August, while average retail gasoline prices in the US touched an all time high of US$3.069 per gallon. In anticipation of stronger impending import demand by the US to make up for domestic shortfalls, the spike in gasoline prices triggered similar upswings in the prices of wholesale petrol globally. For instance, the price of the wholesale Singapore 95 unleaded petrol shot up by US$8 to US$87.70 per barrel on the day of the disaster, compelling petrol companies to hike pump prices for the second time in the month.

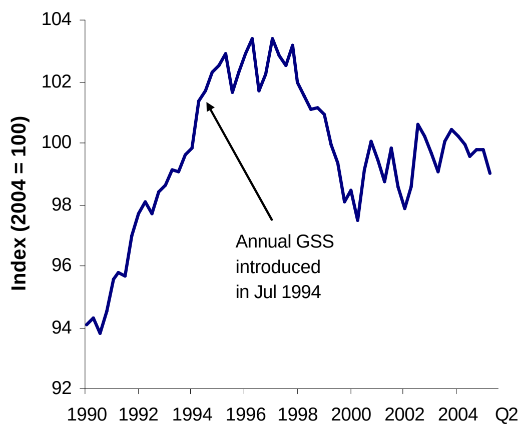
Apart from rising product costs, the hike in domestic petrol prices also reflected the withdrawal of price discounts. The cut-throat price war based on huge discounts amidst rising product costs proved to be unsustainable for petrol companies, with operators reportedly suffering daily losses of up to S$230,000 at the peak of the price war. As a result, operators unwound the discounts gradually to a more sustainable level of 10% in mid-August. This withdrawal of discounts is estimated to have contributed about 8% points of the total rise in petrol prices in August.

Prices of Clothing, Footwear and Personal Effects Rebounded Following the End of the Great Singapore Sale

As expected, prices of retail sales items such as clothing & footwear and personal effects rebounded by 4% following the end of the Great Singapore Sale (GSS) in July. The post-GSS rebound in prices this year was stronger than the average of 1.7% during the last two years. As noted in the June and July 2005 issues of the *Inflation Monthly*, this could have partly reflected the wider participation and deeper discounts offered by retailers, with prices falling by a cumulative 5.7%, as compared to an average of 2.3% during the similar sales period in 2003 and 2004.

Taking a longer-term perspective, prices of retail sales items have generally trended up since 2000, although the rise in prices has been more gradual than that seen in the early 1990s (as highlighted by the blue regions in Chart 3a). While the seasonal effect of the annual GSS event since 1994 would have contributed to the greater fluctuation in prices, there are other factors that are responsible for the more benign price increases in more recent years.

Chart 3a
Clothing, Footwear and Personal Effects CPI



First, the economy has been hit by a series of negative external shocks in more recent years, which has led to more volatile GDP growth and retail sector performance. In comparison, prices of retail items were on a steady rise during the early 1990s, as sturdy consumer demand on the back of the robust economic performance fuelled the expansion of the retail sector. (Chart 3b)

Chart 3b
Real GDP and Retail Sales Index

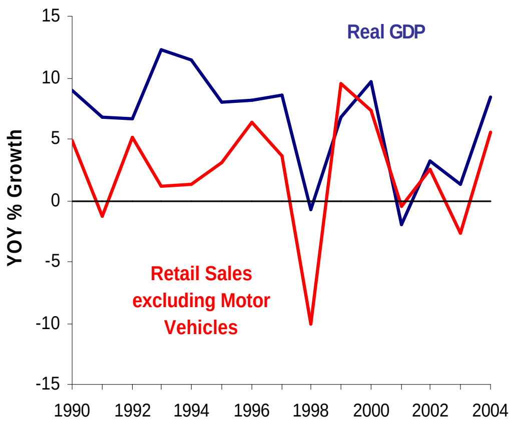
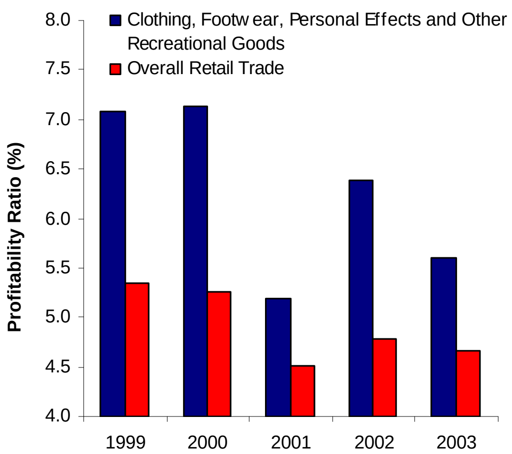


Chart 3c
Profitability Ratio* of the Retail Sector



* Defined as the ratio of operating surplus to operating receipts.
Source: Economic Survey Series, Retail Trade

Second, local retailers are facing more intense domestic and regional competition. Locally, competition has tightened and margins have narrowed, as more players entered the local retail scene. (Chart 3c) For instance, the Economic Development Board introduced a new warehouse retail scheme in April 2004, while the number of suburban shopping malls has increased steadily. Moreover, the rise of the Internet has facilitated greater access by consumers to competing product sources, which could potentially lead to a more efficient price discovery process. Retailers are also facing increasing competition from regional countries like Malaysia, Thailand and Hong Kong who are racing to capture tourists' spending.

Third, the increasing share of more price competitive imports from countries like China and Vietnam would also have kept a lid on price increases. As depicted in Chart 3d, the share of total clothing imports from China has increased from a mere 5% in 1995 to about 29% in

2004, while the proportion of footwear imports from China and Vietnam has more than doubled during the same period.

Fourth, rental costs are lower as retail rentals have declined by more than 50% since 1990, leading to some pass-through of these cost savings. (Chart 3e)

Chart 3d
Country Share of Imports

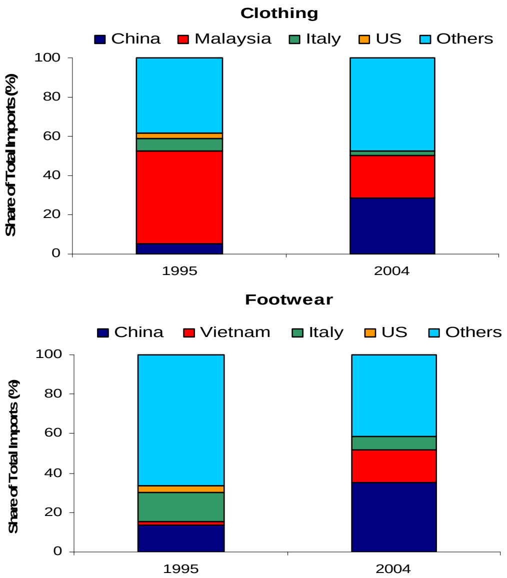
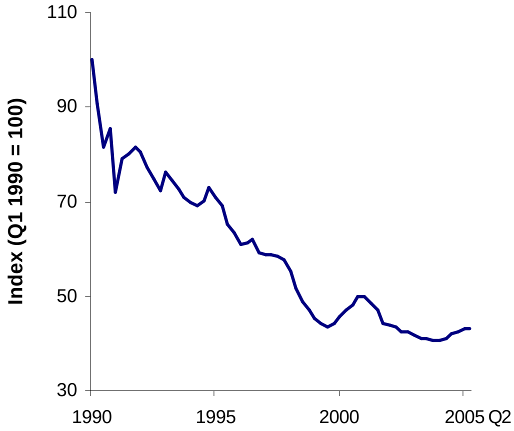


Chart 3e
Retail Rental Price Index



EDUCATION AND FOOD COSTS REMAINED ON ASCENDING TRACK

Education costs continued to rise following the tuition fee hike by both the National University of Singapore (NUS) and the Singapore Management University (SMU), which commenced their new academic year in August.[1] In addition, prices of non-cooked food went up marginally, largely due to more expensive seafood. Similarly, prices of cooked food at restaurants and hawker centres also edged up.

Outlook

Car Prices to Mitigate Inflationary Pressures from Pass-through of Oil Prices

HIGH OIL PRICES ARE LIKELY TO PERSIST

Post-Katrina, the WTI oil prices have receded to a two-month low of around US$61 per barrel, partly on account of relief measures that helped to tame expectations in the oil market. In particular, the International Energy Agency (IEA) directed its member nations to make an extra two million bpd available to the market for 30 days, with a large portion of the oil from outside of the US released in the form of refined products. The OPEC also pledged to produce an additional two million bpd while the US government announced that they were prepared to tap the Strategic Petroleum Reserve to close the supply gap if necessary. At the

[1] For the Nanyang Technological University, the academic year commenced in July.

same time, there were also reports that high prices are beginning to crimp demand, particularly in Asia and the US, as fuel subsidies are reduced and adjustments are made to consumption and production patterns. For instance, the IEA revised downwards its 2005 demand forecast twice after Katrina to 1.26 bpd from 1.6bpd, while the OPEC trimmed its forecast to 1.42 bpd from 1.58 bpd.

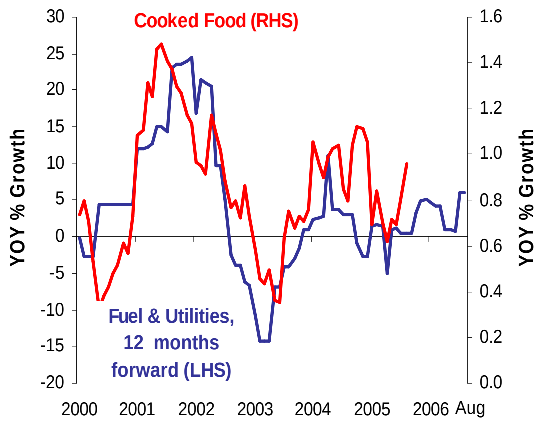
Just as oil producers and refiners in the Gulf of Mexico were scrambling to restore production after the devastation by Katrina, Hurricane Rita's onslaught brought to halt recovery efforts. Although Hurricane Rita inflicted less damage than expected, it has slowed the recovery of oil infrastructure in the region. The US Department of Energy (DOE) reported that seven refineries accounting for 11% of US total capacity remained shut as at October 11, projecting a complete recovery to take many months. With global upstream (crude oil production) and downstream (refinery) spare capacity remaining thin, coupled with the upcoming winter season in the northern hemisphere, prices are likely to stay high going into 2006.

DIRECT AND INDIRECT PASS-THROUGH OF OIL PRICES EXPECTED TO STRENGTHEN

In the present environment of high energy prices, the pass-through into domestic consumer prices is expected to pick up. Although the direct effects have been relatively muted thus far, they are expected to strengthen into 2006. With the recent run-up in wholesale petrol prices, the share of product cost in retail petrol prices is estimated to have risen to around 51%, from 37% at the beginning of the year, implying that the pass-through into retail pump prices could be greater should wholesale prices climb further. In addition, City Gas raised gas tariffs by 2% in September, while SP Services revised electricity tariffs upwards by 7% for Q4, implying a full year increase of 10.2% - the largest y-o-y rise since 2000. Prices of LPG may also go up after having remained unchanged since June 2004.

Higher fuel and utilities charges will in turn raise operating costs in the economy. These cost increases are expected to filter through into consumer prices, especially from the food & beverage, transportation and retail trade segments, where fuel and utilities constitute a high proportion of costs. For example, cooked food prices, which account for 13% of the CPI basket, are likely to rise as they tend to track (with a lag) changes in fuel and utilities costs fairly closely. (Chart 4) Likewise, airlines and courier service providers such as SIA and SingPost, which have imposed fuel surcharges on air tickets and air courier services respectively, may continue to do so should jet fuel prices rise further.

Chart 4
Fuel and Utilities and Cooked Food Prices



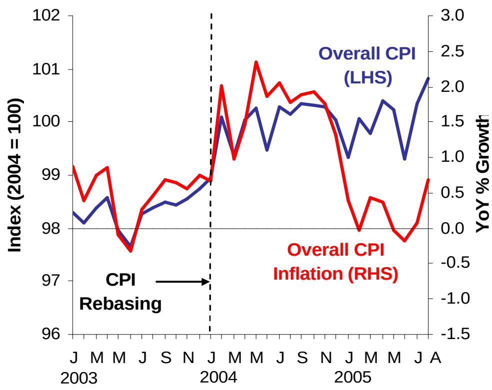
HEADLINE INFLATION TO COME IN AROUND 0-0.5% IN 2005 AND 0.5-1.5% IN 2006

Overall, commodity-related price pressures are likely to be partially offset by falling car prices. Following Land Transport Authority's (LTA) recent quota review exercise, which resulted in an 18% increase in the number of COEs issued monthly, car prices could face further downward pressures. COE premiums for cars in October's first bidding exercise tumbled by more than $3,000, with car dealers responding by slashing prices. However, the plunge in car prices is reported to have induced a surge in orders for new cars recently, which could provide some support for COE premiums.

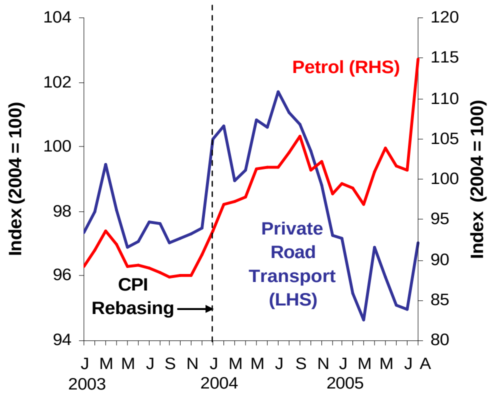
Taking all factors into consideration, headline CPI inflation is forecast to be around 0-0.5% for the year as a whole before rising to 0.5-1.5% next year. Meanwhile, the MAS underlying inflation measure is projected to come in at around 1% this year and 1.5-2.0% in 2006. The downward revision of our forecast for headline inflation and the divergence between headline and underlying inflation mainly reflect lower car prices after LTA's quota review exercise.

Summary of Recent Domestic Price Developments

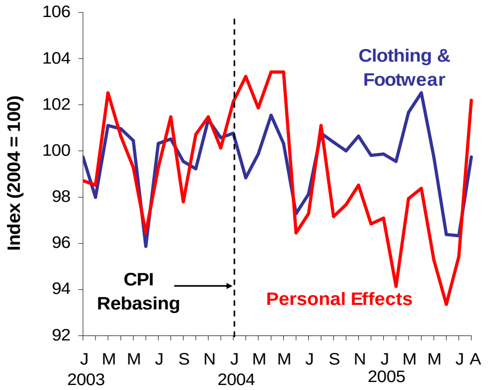
Headline CPI inflation rose to 0.7% y-o-y in August, from 0.1% in July. On a m-o-m basis, the CPI went up 0.5%.



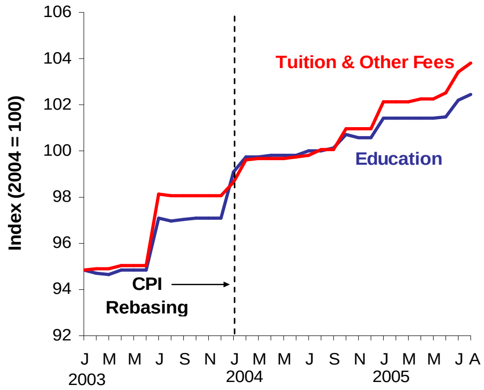
Petrol prices jumped almost 14% on account of hikes in pump quotes and withdrawal of discounts.



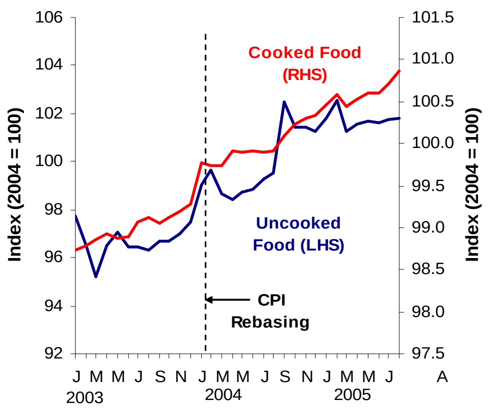
Prices of clothing, footwear and personal effects rebounded as retailers lift prices after the GSS.



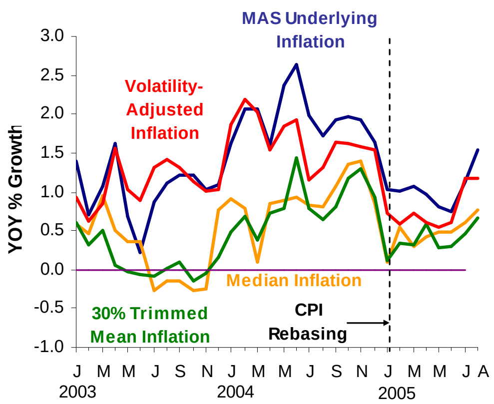
Education costs continued to climb as two more local universities which commenced their academic year in August charged higher fees.



Similarly, prices of both cooked and uncooked food edged higher.



Except for the volatility-adjusted inflation, all other measures of core inflation rose further in August. The MAS underlying inflation measure increased to 1.5% (y-o-y), from 1.1% in the previous month.



Statistical Appendix

Table A.1
Consumer Price Index

	All Items	Food	Clothing & Footwear	Housing	Tpt & Comm	Education & Stationery	Health Care	Recreation & Others
Weights	10000	2338	357	2126	2176	819	525	1659
	INDEX (2004 = 100)							
2004 Sep	100.4	101.1	100.4	100.4	100.4	100.1	100.1	99.4
Oct	100.3	100.8	100.0	100.8	99.9	100.7	100.0	99.6
Nov	100.3	100.8	100.7	100.8	99.3	100.6	100.1	100.0
Dec	100.0	100.7	99.8	100.8	98.4	100.6	100.1	99.9
2005 Jan	99.3	101.0	99.9	96.9	98.4	101.4	100.2	100.0
Feb	100.1	101.5	99.6	100.9	97.4	101.4	100.2	100.0
Mar	99.8	100.8	101.7	99.2	96.9	101.4	100.1	101.6
Apr	100.4	101.0	102.5	100.5	98.0	101.4	100.3	101.6
May	100.2	101.1	99.8	100.5	97.5	101.4	100.2	101.8
Jun	99.3	101.1	96.4	97.4	97.1	101.5	100.3	101.4
Jul	100.4	101.2	96.3	101.9	97.3	102.2	100.5	101.2
Aug	100.8	101.3	99.8	101.9	98.4	102.5	100.5	101.6

Source: Singapore Department of Statistics

Table A.2
Selected Inflation Indicators

	CPI	Import Price Index	Non-fuel Primary Commodities	OPEC Oil Price
	YOY% GROWTH			
2004 Sep	1.9	3.5	16.7	53.5
Oct	1.9	4.3	12.5	59.0
Nov	1.8	2.8	10.6	35.5
Dec	1.3	1.6	8.9	21.2
2005 Jan	0.4	1.4	8.7	33.9
Feb	0.0	2.3	8.0	42.4
Mar	0.4	4.2	9.4	53.6
Apr	0.4	5.6	6.9	53.4
May	0.0	3.2	7.3	28.1
Jun	-0.2	5.1	8.2	49.8
Jul	0.1	5.9	8.1	46.2
Aug	0.7	5.3	10.4	43.1

Source: Singapore Department of Statistics, IMF and Bloomberg