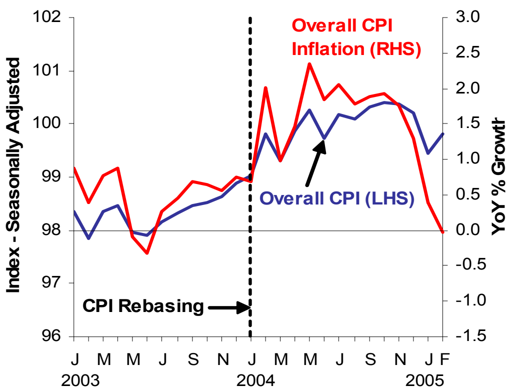
Inflation Monthly
Feb 2005

CPI Rebasing: Impact on Consumer Prices

CPI (2004 = 100)		
% Growth/ SA Level	Jan 05	Feb 05
y-o-y	0.4	**0.0**
m-o-m, SA	-0.8	**0.4**
Index (SA)	99.4	**99.8**



- **Headline CPI inflation fell to 0.0% under the rebased series, due largely to lower car prices**
  Nonetheless, the MAS underlying inflation measure remained unchanged at 1.0%.

- **On a m-o-m SA basis, CPI rose 0.4% due to higher accommodation costs**
  Accommodation costs were higher in February, reflecting the withdrawal of service and conservancy (S&C) rebates after they were given out in January.

- **Drop in car prices was triggered by fall in COE premiums**
  COE premiums continued their trend decline following LTA's decision in September 2004 to increase quotas.

- **Upside risks to external inflation are rising**
  Global oil prices surged to new record highs in early April and are widely expected to remain volatile going forward.

- **CPI inflation is forecast to come in at 0-1% for 2005, before rising to 1-2% in 2006**
  MAS underlying inflation is projected to come in around 1% this year and 1-2% in 2006.

- **Special Item: CPI Rebasing**
  The recent CPI rebasing introduced several key changes, and the report highlights some of them, which have an impact on the headline number.

Recent Developments

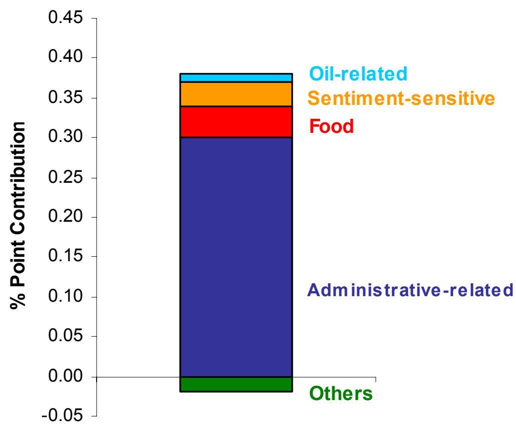
Headline CPI and MAS Underlying Inflation Measures Diverge

The CPI was recently rebased to the year 2004 using the results of the 2002/03 Household Expenditure Survey.[1] This had significant implications on CPI inflation, with the January CPI inflation rate revised from 0.9% to 0.4%. Under the new series, headline CPI inflation fell to 0.0% year-on-year (y-o-y) in February, bringing average inflation in the first two months of the year to 0.2%. Nevertheless, the MAS underlying inflation measure – which excludes private road transport and accommodation costs – was unchanged at 1.0%. The significant divergence between the two inflation measures in recent months largely reflected price developments in the car market, with car prices registering declines compared to the year ago period. A more detailed discussion of the key changes to the CPI due to the rebasing, and the implications for CPI inflation appear in the Box Item below.

Withdrawal of S&C Rebates Boosted Consumer Prices during the month

On a month-on-month, seasonally adjusted (m-o-m, SA) basis, consumer prices rose 0.4% in February. Price movements were mainly confined to a small set of items, with higher accommodation costs partially offset by lower car prices. Most other items in the CPI basket registered mild increases. (Chart 1)

Chart 1
% Point Contribution to CPI Changes (m-o-m, SA), February 2005



Specifically, the increase in accommodation costs reflected service & conservancy (S&C) rebates that were given out in January but not in February. The S&C rebates are part of the Government's GST relief package announced in Budget 2002, aimed at cushioning the impact of the GST hike on Singaporeans. Since 2003, these rebates have been given out in full during selected months of the year, tapering off eventually in 2007. (Table 1) In the past, such rebates did not enter the CPI, but are now incorporated as part of the new methodological changes introduced in the rebased CPI. Rental rebates will also enter the CPI in a similar way, and as such, the withdrawal of these rebates in the month also contributed to the rise in consumer prices. Chart 2 shows the significant impact such rebates can have on the month-to-month movements in the overall CPI series, although such swings would not be observed in comparisons with the year ago period.

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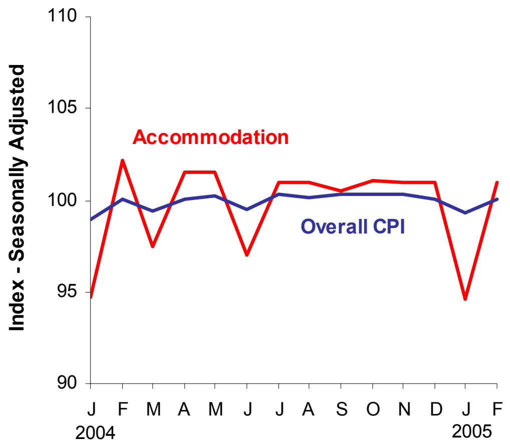
[1] This replaces the old CPI series based on 1997/98 Household Expenditure Survey.

Table 1
Schedule of S&C Rebates, 2005

Month	1-Room	2-Room	3-Room	4-Room	5-Room
January	Full	Full	Full	Full	Half
February	$4	$2	$2	-	-
March	Full	Full	Half	Half	-
April	-	-	-	-	-
May	-	-	-	-	-
June	Full	Full	Full	Half	Half
July	-	-	-	-	-
August	-	-	-	-	-
September	Full	Full	Half	-	-
October	-	-	-	-	-
November	-	-	-	-	-
December	Full	-	-	-	-

Chart 2
Accommodation and Overall CPI



During the month, there were some price pressures from higher non-oil commodity prices. In particular, rice prices strengthened further in February, as the Thai government's rice intervention programme continued to lend support to prices. At the same time, meat & poultry prices, which have adjusted downwards in recent months after the earlier spike due to the poultry ban, climbed up again. Restaurant food prices also saw significant increases during the month.

In addition, prices of mass-market retail items rebounded largely on the back of more expensive ready-made clothing, as the impact of the festive sales wore off. However, prices of personal effects (which comprises largely handbags, wallets etc), which have been largely on a downward path since mid-2004, fell at a sharper pace in February. This could suggest some unevenness in the recovery in the retail sector, even as it continues to pick up gradually from the earlier weakness.

Cheaper Car Prices and Competition Continue to Dampen Prices

With COE premiums plunging below $20,000 recently, many dealers have responded by slashing prices of cars and offering more attractive promotions. Apart from the huge supply of COEs that were released into the market after the mid-year quota review in September 2004, the lower premiums could also have reflected consumers holding back their purchases of cars, partly in anticipation of further cuts to vehicle taxes in the Government's 2005 Budget.

Competition factors held down consumer prices as well. The first petrol price war of this year broke out in February, as competition amongst the four major players here escalated. The price war started out with petrol retailers offering 10% discounts islandwide, before the stakes were upped to 15% a few days later. However, rising wholesale prices of oil products eventually forced some market players to raise retail prices of petrol by six cents towards the end of the month. Meanwhile, another price war brewed in the communications sector, as prices of such items tumbled further on the back of cheaper handphones. For the past several months, local service providers have been offering attractive promotions for handphones and rolling out new mobile phone plans, such as offering free-incoming calls, to attract rivals' customers to switch subscribers.

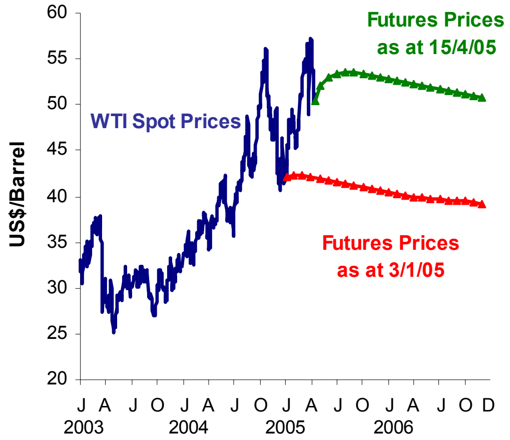
Outlook

External Inflation Risks Remain a Concern

Going forward, there are several inflation risks in the external environment, with CPI inflation in several of our trading partner countries trending up. In particular, commodity price pressures remain from high global oil prices. The West Texas Intermediate (WTI) crude oil prices continued to surge after some respite in late 2004, hitting a high of $58 at one point in April. Although this is only slightly above the previous highs in October 2004, a significant difference this time round is that there appears to be better support at these levels, even as prices recede to around US$50 recently.

Indeed, a tight demand-supply outlook and geopolitical factors are likely to keep global oil prices high and volatile for some time. The International Energy Agency (IEA) projects overall oil demand growth this year to hit around 1.8 million barrels per day (mbpd), compared to an earlier projection of around 1.4 mbpd at end-2004. Nonetheless, demand risks have now edged slightly on the downside, as fears of a surge in Chinese consumption recede. On the supply side, production of oil has been constrained by historically low spare capacity and recent supply difficulties in a number of non-OPEC countries, although the recent pledge by OPEC to raise production by 0.5 mbpd in May could provide some respite. The IMF recently projected that spare capacity would remain thin, at under 2 million barrels per day, right through 2005. This is exacerbated by the limited global oil refining capacity as well, which currently stands at only slightly above levels during the 1980s. These factors have contributed to higher oil price expectations going forward, with the futures markets now suggesting higher prices in the coming months before trending down eventually. (Chart 3)

Chart 3
WTI Spot and Futures



Further Pass-through into Domestic Consumer Prices

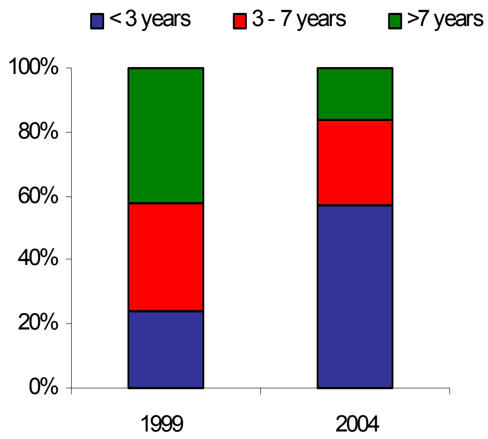
These higher external price pressures are likely to trickle into the domestic economy. Although domestic competition forces have thus far tempered the pass-through of higher import prices, the extent to which local operators/firms could continue absorbing the cost increases may be limited. Apart from the direct impact of oil prices on petrol and electricity, there are indirect effects on other consumer goods and services as well. For example, several consumer products that are made of oil-based materials such as plastics have seen prices rising by 10-20% over the past year. The cost of courier services and air travelling has also risen with fuel surcharges climbing in recent months.[2]

Apart from these external pressures, some increases in domestic cost pressures are also expected, with a rise in several services costs. These include the hike in university tuition fees and a possible increase in public road transport costs. In addition, demand-induced price increases could strengthen as the economy continues to grow, leading to some mild pickup in prices of sentiment-sensitive items. However, keen competition in the domestic economy is expected to hold down price increases, such as in the communications, medical services, and air-travel and related industries.

At the same time, several policy measures would impact consumer prices. There will be a sharp increase in prices of cigarettes, following the tax hike on tobacco products announced in Budget 2005. Parking charges in all government buildings are also expected to see a considerable hike, after a shift in policy to reduce subsidies for civil servants. However, these could be somewhat offset by the reduction in maid levy in April, aimed at helping to relieve the higher costs of maid services that would arise from tightened entry requirements. Car prices, which have been declining, could stabilise as well, and register mild increases after the LTA's announcement of a smaller COE quota available in the coming months. Indeed, with the average age of cars getting "younger", the incentive to replace vehicles may decline, leading to a moderation in the number of deregistrations.[3] (Chart 4)

[2] Source: The Straits Times on 17 April 2005, "These will become more expensive" and "Most firms have yet to pass on increases".
[3] The LTA reviews the COE quota every year, with the number of deregistrations as a major determining factor.

Chart 4
Age Distribution of Cars



Nonetheless, aside from these underlying price pressures, the recent CPI rebasing is expected to impart a downward bias on the headline CPI inflation for the year due to the changes in the weights and composition of the basket. (See box item for more details.) For 2005 as a whole, headline CPI inflation is expected to come in at **0-1%**, before rising to **1-2%** in 2006. The underlying inflation measure is projected to be around 1% this year and 1-2% in 2006. The gradual increase in inflationary pressures in the economy reflects higher commodity prices, rising wages, and increases in services charges over the course of the year.

CPI Rebasing to 2004

The weights and composition of the CPI basket was recently rebased to 2004 to incorporate the latest information from the 2002/03 Household Expenditure Survey (HES). This Box Item will update the CPI basket to reflect the latest household expenditure patterns of Singaporeans. Several key changes to the CPI basket are worth highlighting.

Key changes in the rebased CPI

First, there were **significant shifts in consumption patterns** towards some items that have been experiencing falling prices or lower inflation rates, e.g. communications and motor vehicles (comprising largely cars). Such items would have had a larger (negative) influence on the consumer price outcome as compared to the old basket.

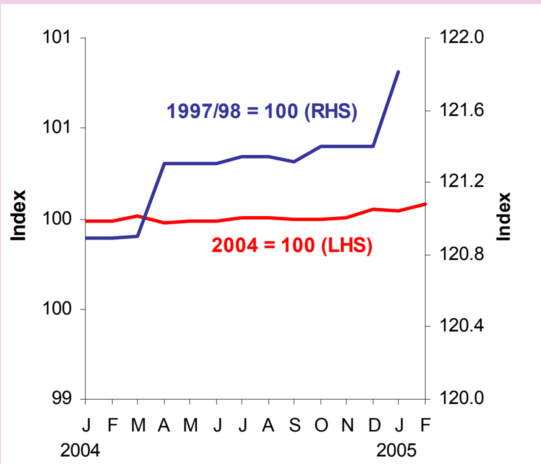
Second, several **new items** that are now included in the rebased series have had a dampening effect on overall prices. For instance, the inclusion of certain categories of medical services had a moderating effect on the movements of overall medical treatment costs. (Chart A)

Third, some items now show more **distinct declining price trends**, such as household durables. Taken together, we estimate that such items comprise about 30% of the new CPI basket. The price developments of some of these items could reflect structural influences that may be persistent, such as liberalisation (e.g. telecommunication services), globalisation (e.g. cheaper import sources), and productivity growth (e.g. technological advances).

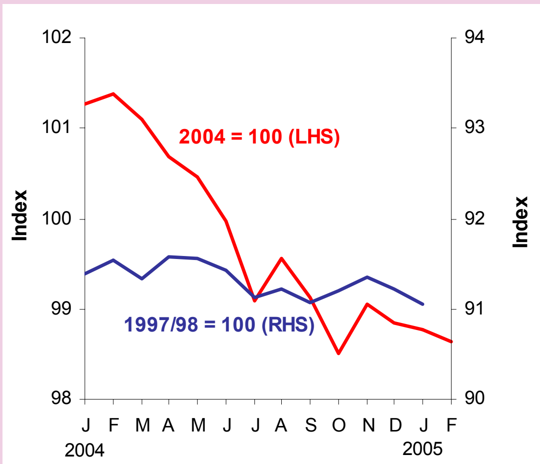
Fourth, several **methodological changes** were also incorporated in the rebased CPI. Notably, rebates for S&C charges and rents, previously excluded from CPI, will henceforth be incorporated in the rebased series. This is likely to introduce considerable volatility to the CPI over the short-term, as government rebates vary from month to month. In addition, the owner-occupied accommodation series will be based on more updated Annual Values for HDB flats, which should provide a more accurate reflection of market price movements.[1]

Chart A
Comparison of 1997/98 and 2004 CPI

(i) Medical Treatment



(ii) Household durables

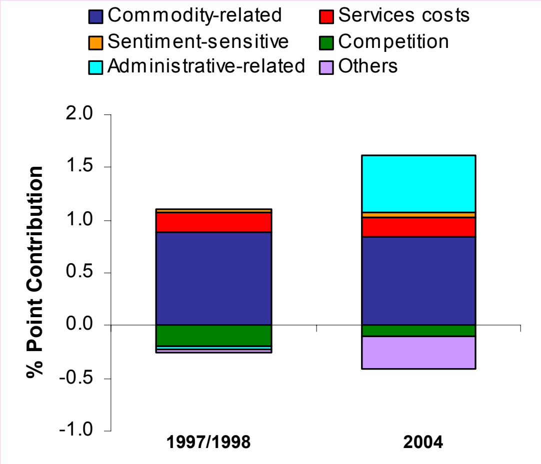


1 Annual Values for HDB flats were kept unchanged during the period 1990-2003.

Comparison of 2004 CPI using old and new base series

To illustrate how the rebasing has influenced the dynamics of the CPI, we compared the movements of the CPI under the old and new series. Given that the new rebased series only begin from January 2004, we analysed the increase in the CPI over 2004, rather than the y-o-y inflation rates.[2] According to this measure, CPI increased by 0.9% over Jan-Dec 2004 under the old series, with the increase showing a larger 1.2% under the new series. Chart B summarises the main factors contributing to the CPI increase in the overlapping period for both the 1997/98 and 2004-based series.

Chart B
Main Factors Contributing to CPI increase (Dec 2004 over Jan 2004)



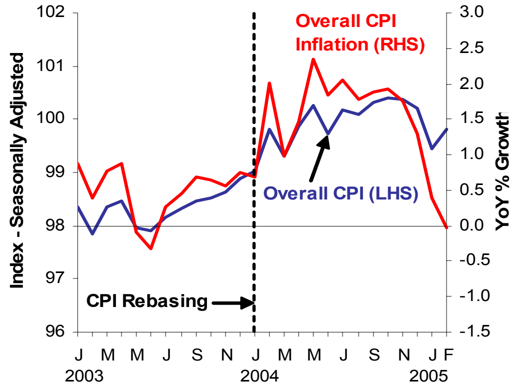
The larger price increase seen under the new series reflects the incorporation of the S&C rebates in the rebased series (reflected in the administrative component in Chart B). This was because rebates were given out in full for all HDB flats in January, lowering the CPI considerably in the beginning of the year, while there were no rebates in December.

At the same time, there were downward pressures as well from other sources. With the weight of vehicles (comprising largely cars) tripling in the new series, from 2% to 7%, the trend decline in car prices over 2004 had a considerably larger impact on consumer prices relative to the old series. In addition, owner-occupied accommodation costs fell more sharply in the new series, due to the incorporation of more regularly updated Annual Values. While this would be a better reflection of market price developments, it has had the effect of lowering housing costs.

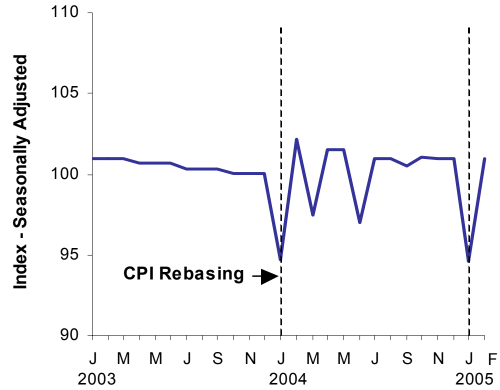
[2] This excludes the increase in January 2004, given that CPI data for December 2003 for the rebased series is not available.

Summary of Recent Domestic Price Developments

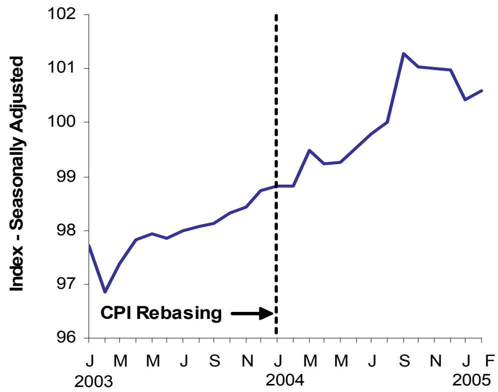
Headline CPI inflation fell to 0.0% y-o-y in February, from 0.4% in January. However, the seasonally adjusted CPI rose 0.4%.



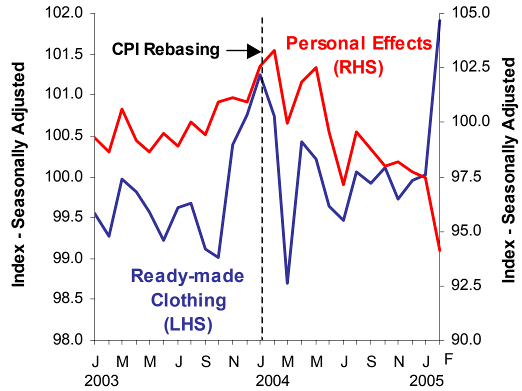
On a sequential basis, the rise in accommodation costs pushed up consumer prices, due to the withdrawal of S&C rebates.



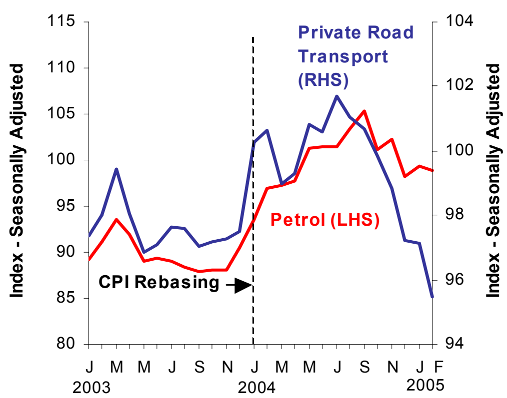
In addition, food prices rose mildly, as rice prices increased further. Restaurant food prices saw a strong pickup as well.



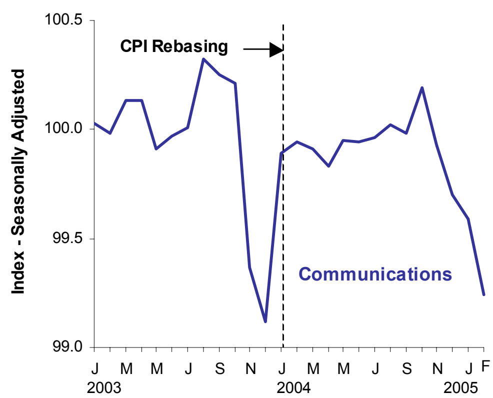
The strength in various mass-market retail items appeared to be mixed. While clothing prices rebounded, prices of personal effects continued to decline.



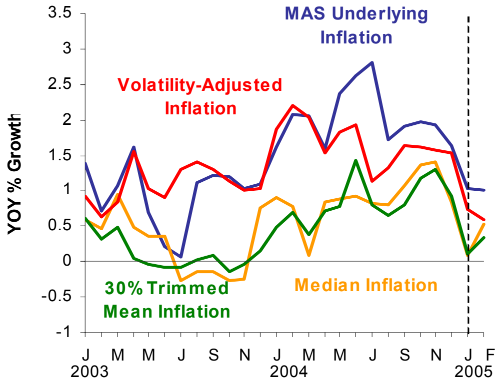
Meanwhile, private road transport costs were dragged down by lower car prices as well as petrol prices.



Communications prices continued to decline further with cheaper handphones.



Except for volatility-adjusted inflation, most core inflation measures have either risen or remained stable. In particular, the MAS Underlying inflation was unchanged at 1%.



Statistical Appendix

Table A.1
Consumer Price Index

	All Items	Food	Clothing	Housing	Tpt & Comm	Educat-ion	Health	Misc
Weights	10000	2338	357	2126	2176	819	525	1659
	INDEX (2004 = 100) – SEASONALLY ADJUSTED							
2003 Jan	98.4	97.7	99.8	100.5	99.4	94.6	93.7	97.7
Feb	97.9	96.9	99.6	100.1	99.5	94.6	93.6	97.6
Mar	98.4	97.4	100.2	100.2	100.0	94.7	93.7	98.5
Apr	98.5	97.8	99.9	101.1	99.0	94.9	93.8	97.3
May	98.0	97.9	99.9	100.3	98.1	95.0	93.9	95.9
Jun	97.9	97.8	99.5	100.5	98.4	95.2	94.1	95.9
Jul	98.2	98.0	100.4	100.2	98.3	96.6	94.5	96.8
Aug	98.3	98.1	99.9	100.1	98.4	96.7	94.7	97.6
Sep	98.5	98.1	99.2	100.1	98.3	97.0	95.0	98.5
Oct	98.5	98.3	99.4	99.5	98.6	97.1	95.2	98.8
Nov	98.6	98.4	100.5	99.3	98.9	97.3	95.4	98.9
Dec	98.9	98.7	100.7	99.3	99.4	97.4	95.2	99.2
2004 Jan	99.0	98.8	100.8	96.9	100.6	98.8	99.6	99.4
Feb	99.8	98.8	100.6	101.3	100.6	99.6	99.6	99.3
Mar	99.3	99.5	99.1	98.4	99.7	99.7	99.6	100.1
Apr	99.9	99.2	100.4	100.6	99.5	99.8	99.6	99.9
May	100.3	99.3	99.9	101.1	100.1	100.0	99.5	100.5
Jun	99.7	99.5	99.5	98.3	100.1	100.1	99.7	100.6
Jul	100.2	99.8	98.2	100.5	100.3	99.5	100.0	100.8
Aug	100.1	100.0	100.1	100.4	100.1	99.7	100.3	99.9
Sep	100.3	101.3	100.1	100.2	100.1	100.1	100.5	99.8
Oct	100.4	101.0	100.2	100.6	99.9	100.8	100.5	99.9
Nov	100.4	101.0	99.7	100.7	99.7	100.9	100.6	100.0
Dec	100.2	101.0	99.9	100.7	99.2	100.9	100.7	99.6
2005 Jan	99.4	100.4	99.9	97.4	98.8	101.1	99.9	100.0
Feb	99.8	100.6	101.4	101.1	97.6	101.3	99.8	100.0

Source: Singapore Department of Statistics

Table A.2
Selected Inflation Indicators

	CPI	Import Price Index	Non-fuel Primary Commodities	OPEC Oil Price
	YOY% GROWTH			
2003 Jan	0.9	1.0	11.9	65.5
Feb	0.4	2.5	11.4	66.7
Mar	0.8	2.1	7.1	30.4
Apr	0.9	0.0	7.2	1.9
May	-0.1	-1.2	7.3	3.6
Jun	-0.3	-0.3	4.2	12.7
Jul	0.3	0.1	1.2	9.3
Aug	0.4	0.6	3.6	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	9.9	17.4
Dec	0.7	0.2	12.1	4.8
2004 Jan	0.7	0.3	16.1	-0.3
Feb	2.0	-2.0	19.6	-6.4
Mar	1.0	-1.9	24.4	9.3
Apr	1.5	-0.3	25.3	27.8
May	2.4	2.6	23.2	41.9
Jun	1.9	2.9	23.8	28.9
Jul	2.0	3.0	24.4	32.0
Aug	1.8	3.6	19.7	40.9
Sep	1.9	3.5	17.0	53.5
Oct	1.9	4.3	12.8	59.0
Nov	1.8	2.8	10.7	35.5
Dec	1.3	1.6	9.1	21.2
2005 Jan	0.4	1.4	9.0	33.9
Feb	0.0	2.3	8.9	42.4

Source: Singapore Department of Statistics, IMF and Bloomberg