

## HIGHLIGHTS & OUTLOOK

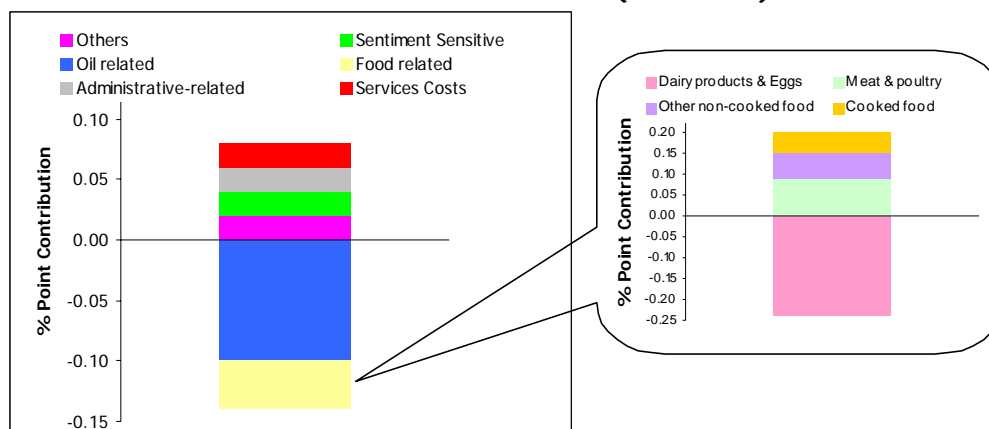
### APPARENT CONTRADICTIONS IN CONSUMER PRICE MOVEMENTS

#### CPI INFLATION DIPPED TO 1.9% IN OCTOBER

**Headline CPI inflation** receded to 1.9% year-on-year (y-o-y) in October, after coming in at 2.0% in the previous month. This brought average inflation for the first ten months of this year to 1.7%. The headline inflation rate was in line with market expectations, with the median forecast at 1.9%. Meanwhile, the MAS underlying inflation – which excludes private road transport and accommodation – edged up to 2.2% in October, from 2.1% in September.

On a month-on-month, seasonally adjusted (m-o-m, SA) basis, consumer prices were unchanged in October, after rising by 0.5% earlier in September. Chart 1 shows the contribution of the various items to the increase in consumer prices for the month. Three apparent contradictions were observed in October's consumer price developments: first, the continued rise in prices of some poultry products despite the partial lifting of the ban on imports from Malaysia; second, the fall in prices of oil-related items, even as global oil prices reached record-highs; and third, the continued strength in prices of tour packages despite the ongoing price war in the airline industry.

**Chart 1**  
**% Point Contribution to CPI Increase (m-o-m SA) in October**



#### CONTRADICTION #1: HIGHER POULTRY PRICES DESPITE PARTIAL LIFTING OF BAN

With the poultry ban on imports from Malaysia being partially lifted on 30 September and supply levels largely restored, we would have expected prices of poultry products to adjust downwards. However, chicken prices in particular continued to rise further in October. According to industry sources, the higher chicken prices could have reflected the pass-through of cost increases through the supply chain. Specifically, Malaysian farms exporting chicken supplies to Singapore had to gain accreditation from the Agri-food Veterinary Authority (AVA), which involved putting in place stringent checks. While these precautionary measures ensured that the imported chicken stayed free of the virus, they also raised costs for the suppliers, who probably passed them on subsequently to wholesales, and then to retailers and final consumers.

In comparison, egg prices saw significant downward adjustments during the month, after tripling in some instances earlier in September. Despite this, prices remained

relatively high, with the dairy products & eggs price index still around 10% higher in October as compared to pre-ban levels.

On balance, the fall in egg prices outweighed the rise in poultry prices, contributing to cheaper overall non-cooked food prices for the month. Nonetheless, with poultry prices remaining high, this filtered through into cooked food prices, with hawker and restaurant food experiencing further price increases.

### **CONTRADICTION #2: CALM IN DOMESTIC OIL-RELATED ITEMS AMIDST RAGING OIL STORM**

Volatility in global oil markets propelled the West Texas Intermediate (WTI) oil prices to new record-highs of above US\$55 per barrel at one point in October. There was considerable upward momentum in oil prices recently, as Hurricane Ivan damaged oil facilities, which delayed shipments out of the Gulf of Mexico. Continued geopolitical uncertainties as well as low inventory levels in the US also exerted upward pressures on prices. However, amidst the raging oil storm on the external front, price developments of domestic oil-related items were unusually calm. Electricity tariffs, for example, were hiked by a mild 1.1% in October – a much smaller quantum as compared to the actual rise in global oil prices.

The divergence between external and domestic oil price dynamics was even more apparent for petrol prices, which fell by 4.2% in October – the steepest sequential decline in almost three years. While the record-high oil prices would inevitably have raised costs, there have been attempts by pump operators to strike a balance between cost recovery and maintain market share, especially in face of rising competition within the industry. As noted in the September 2004 issue of the Inflation Monthly, with Singapore Petroleum Company becoming the third largest fuel retailer here, competition among petrol pump operations would have intensified the ongoing petrol price war. Notably, operators are offering larger and more frequent discounts (of up to 10%), which are introduced island-wide instead of merely being confined to specific locations.

### **CONTRADICTION #3: CHEAP AIRFARES FROM PRICE WAR FAIL TO LOWER OVERALL TOUR PACKAGE PRICES**

Price wars were also evident in the airline industry, with low-cost carriers leading the way in slashing airfares in recent months. Several full-service carriers have also jumped on the bandwagon by offering predatory price cuts. With airfares being one of the largest components of tour package prices, we would have expected these lower airfares to translate into cheaper packaged tours in the CPI basket. Instead, prices of packaged tours have been rising over the past two months. This contradiction could perhaps be explained by a renewed interest in travel, with several tour agencies beefing up their operations and increasing new hires. Another plausible reason is the recent increase in travel bookings for medium- or long-haul destinations, which are generally less price sensitive as compared to short-haul routes.<sup>1</sup>

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### **OIL PRICES RECEDE FROM RECORD HIGHS, BUT STILL POSE UPSIDE RISK**

After breaching past US\$55 per barrel at end-October, the WTI oil prices have receded closer to the US\$40 mark in recent weeks. This is a considerable drop of more than 20% from the recent record highs, as worries about winter heating supplies in the US eased. The US commercial inventories of crude oil have grown rapidly in recent weeks, exceeding levels seen a year ago when prices were around US\$30. At the same time, speculators such as large commodity hedge funds have reversed course to bet on lower oil prices, easing the pressure on oil prices significantly.

Going forward, many analysts believe oil prices could settle at around US\$40 per barrel, although prices are likely to continue to exhibit considerable volatility in the

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<sup>1</sup> As discussed in the September 2004 issue of the Inflation Monthly, short-haul trips are subject to greater competition as most of the discount carriers confined themselves to short-haul routes.

near term. With spare capacity of only about one million barrels a day, almost all of it in Saudi Arabia, there is little cushion for supply disruptions arising from geopolitical strife in oil-producing nations. Moreover, OPEC's recent decision to cut daily oil production by one million barrels from January 2005 could provide some support for prices.

### DOMESTIC COMPETITION PLAYING A BIGGER ROLE IN DAMPENING PRICE PRESSURES

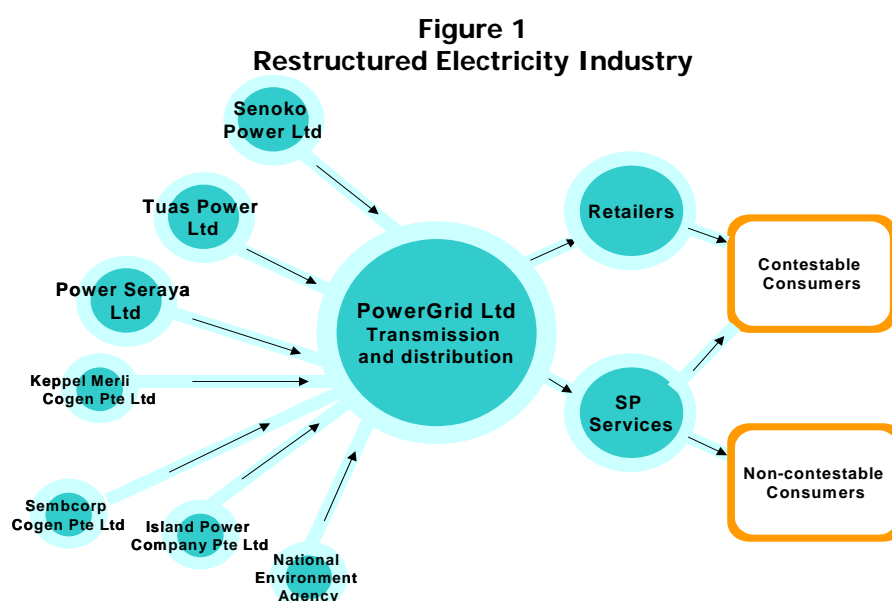
Despite the sharp run-up in global oil prices this year, prices of domestic oil-related items only experienced fairly muted increases thus far, as compared to the oil price increase in 2000. (Table 1) As oil prices subside into next year, the fall in the prices of some domestic oil-related items can also be expected to be correspondingly more muted as compared to 2001. As noted above, consumers have been partly shielded from soaring oil prices over the past year due to the keen competition within the domestic petrol industry.

**Table 1**  
**Inflation Rates of Oil-related Items in the CPI Basket (%)**

	2000	2001	2004F
<b>Petrol</b>	16.8	-2.8	12.9
<b>Electricity Tariffs</b>	23.2	6.0	1.5
<b>WTI Oil</b>	57.5	-14.5	34.0

In addition, electricity tariffs have hardly risen this year. This could in part be attributed to the ongoing liberalisation efforts in the electricity market, a process that started as early as 1995 with the formation of Singapore Power. As noted by Minister Raymond Lim, "Discounting for movements in fuel prices, electricity prices in Singapore have fallen by 9.5% since we started passing on the benefits of liberalisation in January 2002. ... From another perspective, our electricity prices would have been much higher had it not been for liberalisation."<sup>2</sup>

There are now seven players in the power generators competing at the wholesale level, including Senoko Power, Power Seraya and Tuas Power (successor companies of PUB). With these generation companies bidding to sell electricity every half an hour, the wholesale price of electricity fluctuates according to demand and supply on a "real-time" basis. Figure 1 below provides a simple illustration of the structure of the New Electricity Market (NEM), which consists of separate wholesale and retail markets.



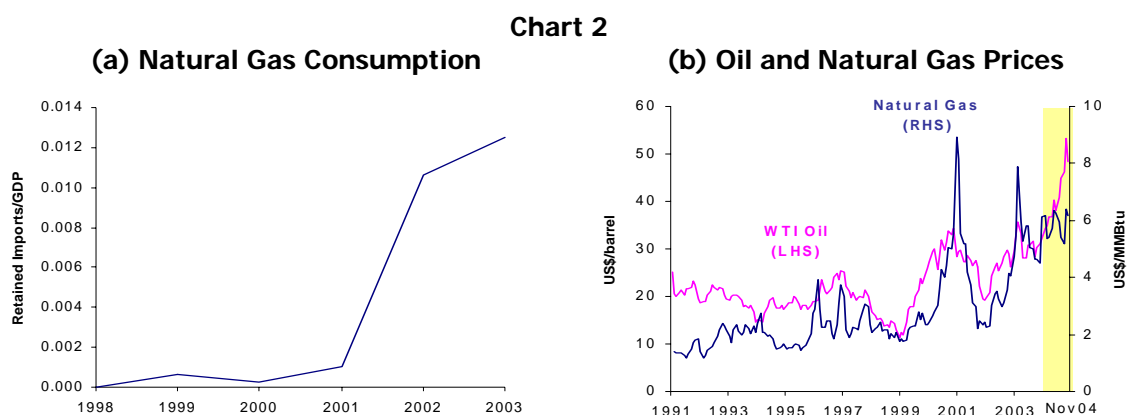
Source: Adapted from Energy Market Authority's website

<sup>2</sup> Speech by Mr Raymond Lim, Minister of State for Trade & Industry and Foreign Affairs, at the PFI 8th Annual Conference on Financing Power & Energy Projects in Asia on 6 October 2003.

While the wholesale market has been fully liberalised, the retail market is being liberalised progressively. Retailers purchase electricity in bulk from the wholesale market and compete to resell it to consumers. Currently, only companies with higher electricity consumption (i.e., contestable consumers) have a choice of purchasing electricity from different retailers. Smaller consumers such as households and small businesses (i.e., non-contestable consumers) can only purchase electricity from SP Services at regulated tariff rates. Over time, the threshold of contestable consumers will be progressively lowered until all consumers become contestable in a few years time. While it may still be early days yet to assess the full impact of the liberalisation efforts on electricity prices, the deregulation has definitely helped to incentivise more competitive pricing behaviour in the industry.

## DIVERSIFICATION IN ENERGY SOURCES ALSO HELPS TO MODERATE PRICE INCREASE

The diversification into natural gas to power the electricity grid also contributed to the more modest increase in electricity tariffs. Indeed, Singapore has been moving towards natural gas to generate electricity supply in recent years. As shown in Chart 2a, there has been an increase in the consumption of natural gas since 1998, mainly coming from Malaysia, West Natuna and South Sumatra in Indonesia. Indeed, around 60% of Singapore's electricity is now fuelled by natural gas, with the remaining 40% powered by oil. Although the price of natural gas is determined by a "cocktail" that includes crude oil prices, the relationship is not one-to-one. As shown in Chart 2b, natural gas prices broadly track global oil prices, although the highlighted yellow portion showed that natural gas prices have remained relatively flat despite the sharp run-up in oil prices. This could also reflect more balanced supply-demand conditions in the natural gas market, as well as less speculation for this commodity compared to oil.



## INFLATION FORECAST AT 1.5-2.0% IN 2004 AND 1-2% IN 2005

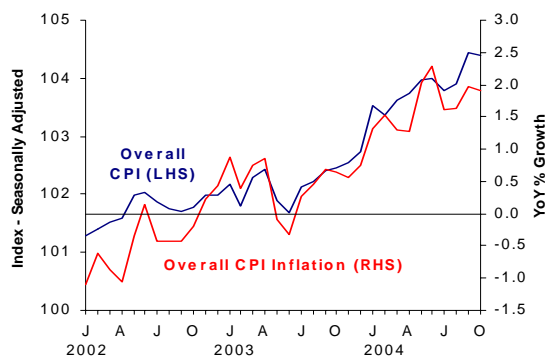
Indeed, competitive pressures have been playing an increasingly important role in domestic consumer price dynamics. Other than electricity, other sectors in the economy that have been subjected to greater competition or liberalisation efforts include communications, retail, airlines as well as medical services – which make up around 30% of the CPI basket. Thus, price developments in these sectors would have a significant influence on overall consumer prices going forward.

Nonetheless, some domestic cost pressures could pose upside risks to overall CPI. In particular, prices of consumer services are expected to go up in the coming year, after remaining unchanged for the past several years. Some of these increases include school miscellaneous fees, tertiary education fees<sup>3</sup> and public road transport costs. Demand-side pressures are also expected to emerge more strongly, with the continued improvement in the labour market conditions.

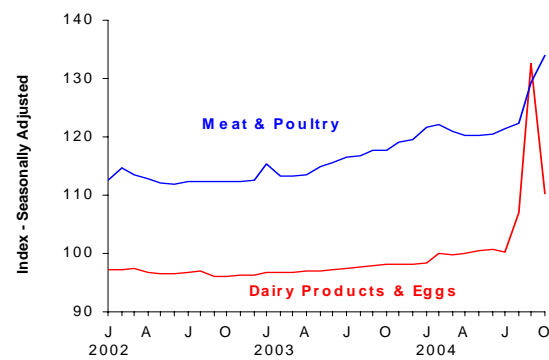
Taking these factors into account, CPI inflation is expected to come in at **1.5-2.0%** for 2004, and at **1-2%** for 2005.

<sup>3</sup> After a three-year freeze, university tuition fees will be revised upwards from August 2005. The undergraduate and postgraduate fees will be hiked by 5% and 6-17% respectively.

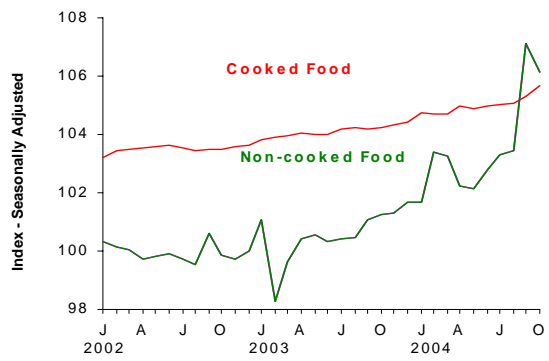
Headline CPI inflation edged down to 1.9% in October, from 2.0% in September. The seasonally adjusted CPI remained stable.



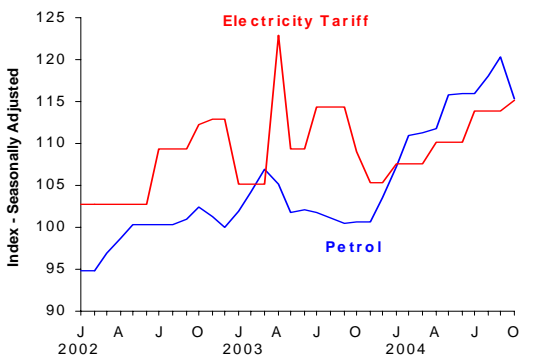
With the resumption of poultry supplies from some parts of Malaysia, egg prices dropped sharply, although meat & poultry prices continued to rise.



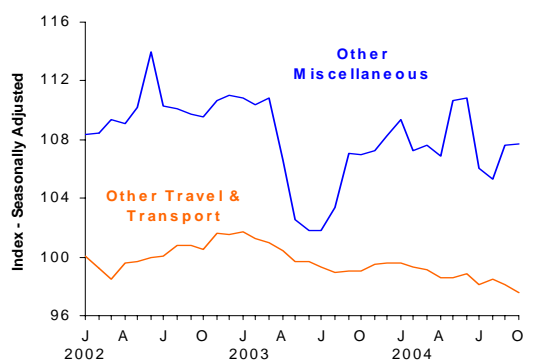
While non-cooked food prices fell, cooked food prices rose, possibly reflecting some second-round effects of the earlier poultry ban.



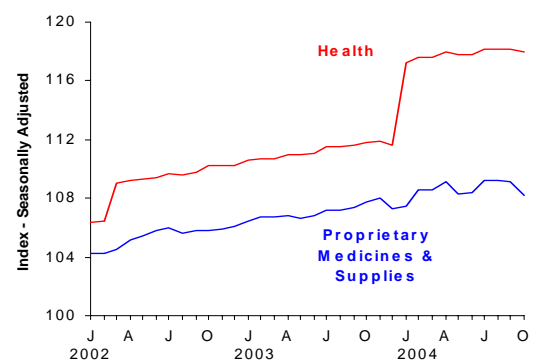
While electricity tariffs were adjusted upwards, petrol prices saw the biggest decline in almost three years due to keen competition within the industry.



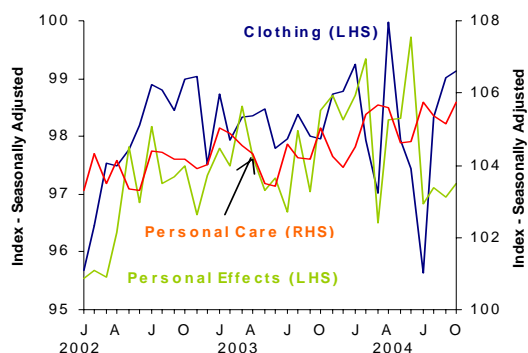
Despite the fall in airfares, prices of tour packages remained firm in the month, as demand for travelling held up.



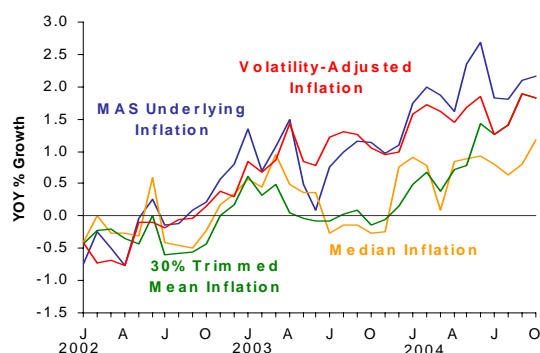
Meanwhile, healthcare costs fell with cheaper vitamins and health-related food products.



Prices of retail items rose, in line with the improving consumer sentiment.



Except for volatility-adjusted inflation, all core inflation measures rose from the previous month. In particular, the MAS underlying inflation increased to 2.2%.



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

**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	103.8	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
Aug	103.9	104.4	98.3	98.9	99.8	113.9	118.2	108.9
Sep	104.4	106.2	99.0	99.0	100.1	114.2	118.2	108.3
Oct	104.4	106.0	99.1	99.3	99.5	114.5	117.9	108.8

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	22.2	28.9
Jul	1.6	3.0	22.9	32.0
Aug	1.6	3.6	19.7	40.9
Sep	2.0	3.5	17.7	53.5
Oct	1.9	4.3	12.3	59.0

Source: Department of Statistics, IMF and Bloomberg