HIGHLIGHTS & OUTLOOK

WEAK DEMAND OUTWEIGHS SUPPLY-SIDE FACTORS ON CPI

Headline CPI inflation came in weaker-than-expected at 0.4% y-o-y

Headline CPI inflation came in at 0.4% year-on-year (y-o-y) in Feb 2003, down from 0.9% in the previous month. This was much weaker than market expectations, with many analysts forecasting overall CPI inflation to come in unchanged at around 0.9%.

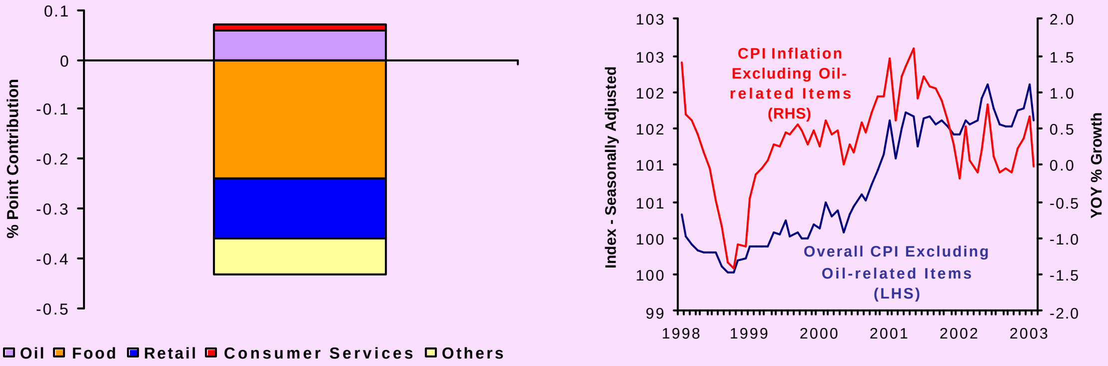
On a seasonally adjusted, month-on-month (m-o-m, SA) basis, the index declined by 0.4% in February, the first contraction in six months. The extent of the fall was the sharpest since May and June 2001 in the thick of the economic recession, when CPI fell by 0.4% on a sequential basis in both months. The MAS underlying inflation – which excludes accommodation and private road transport – also came in weaker at 0.7% in February, compared to 1.4% in January.

Recent movements in CPI reflect one-off influences and weak underlying demand

We can categorise the factors influencing recent CPI developments into two broad groups: (i) one-off supply-side factors and (ii) cyclical demand factors. The one-off influences on CPI – namely the GST hike from 3% to 4% implemented in January and oil price developments tied to concerns of a global oil supply disruption – have worked in the direction of supporting CPI inflation, while cyclical factors arising from generally weak demand conditions have largely had a dampening effect on consumer price movements. (Chart 1a.)

Chart 1

a) Contributions to m-o-m, SA Change in CPI b) CPI Inflation & CPI Excluding Oil-related Items



Global oil prices rose from US$25-28 per barrel in Q4 2002 to around US$30 in January, increasing further to US$32 in February, as fears of an outbreak of war in the Middle East disrupting oil supplies mounted in the first two months of the year. The rise in global oil prices has translated into a significant increase in domestic pump prices in February, following a round of price hikes in January. Petrol retailers raised prices by around 2-4 cents in January, and by another 5-9 cents subsequently in February.[1/] The price of cooking gas (Liquefied Petroleum Gas) also rose by almost 3% in February. Excluding the effects of the oil price hike, seasonally adjusted CPI would have fallen by 0.5%, while the headline CPI inflation would have come in at 0.3% y-o-y in February instead. (Chart 1b.)

While the GST was identified as another factor supporting CPI inflation, we noted that its pass-through effects appear to have been countered somewhat by weak underlying demand pressures in February. In particular, the prices of certain **retail items** such as ready-made clothing, personal care and recreation items, which increased strongly in January, subsequently fell in February. One possible explanation for this is that retailers could have raised prices in January in response to the GST hike, but then decided to cut the ex-GST prices in February when demand and sales weakened. An indication of the weakness in consumer demand is retail sales volume, which fell by 6.2% (m-o-m, SA) in Jan 2003 after registering positive growth for three consecutive months.[2/] With retailers unable to pass on the price increase to consumers, we can expect the lower retail prices to translate into a margin squeeze for retailers.

[1/] Nonetheless, petrol pump operators have been offering discounts at selected petrol kiosks along Bukit Timah Road, which has been extended to the Northern parts of Singapore as well.

[2/] Retail sales volume (on a m-o-m, SA basis) grew by 6.1%, 0.4% and 6.2% in the final three months of 2002.

Indeed, the decline in February's CPI was largely concentrated in retail prices, reflecting the weakness in consumer sentiments amidst growing uncertainties in the economic environment, both domestic and external, and continued high unemployment rates. Although prices of non-cooked food were expected to come in lower in February after the seasonal boost in January associated with the Chinese New Year celebrations, the decline was larger than expected. Some upward price pressure was initially expected, with several supermarket chains (e.g. NTUC FairPrice) phasing in the GST increase for non-essential items after January. However, the lower prices of these items need to be viewed in the context of the difficulty in adjusting for the shift in the timing of festive occasions (Chinese New Year was two weeks earlier compared to last year) and other seasonal factors. As a result, there may be some overstatement in January's seasonally adjusted CPI number and understatement in February's number.

However, prices of consumer services held steady

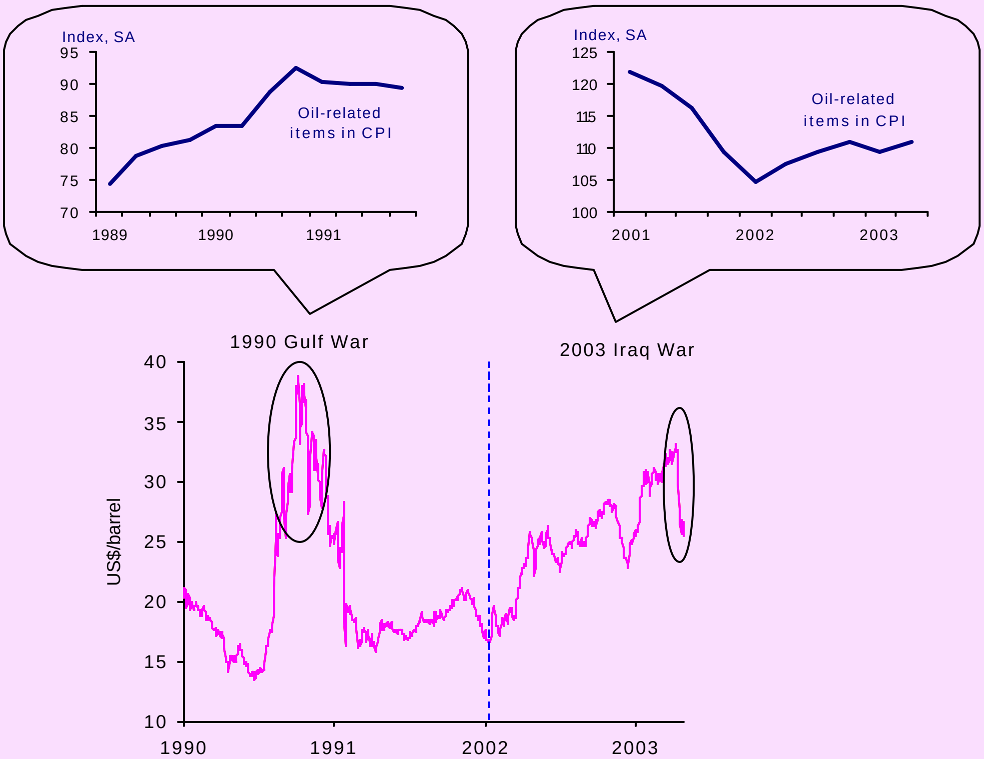
In comparison, prices of consumer services have continued to hold up. Healthcare costs rose slightly on account of higher prices of proprietary medicines and supplies, while medical and dental fees remained stable after significant increases last month. Education costs remained fairly steady as well. Although prices of school textbooks & stationery came in lower, tuition fees edged up slightly.

TAKING A LOOK INTO THE FUTURE…

In the near term, oil prices are likely to add volatility to consumer prices…

In the coming months, CPI inflation will continue to be influenced by the effects of some of the one-off factors mentioned earlier. In particular, volatility in the headline number will continue to stem from oil-related consumer items (which are estimated to comprise 5% of the CPI basket). With the start of US offensive on Baghdad in late March, global oil price fell initially to around US$24 per barrel, on expectations of a quick US victory. However, oil prices have started creeping up again, to about US$26 currently, as the prospect of a quick US victory faded. In addition, the recent civil unrest in Nigeria, which is one of the top ten producers of oil in the world, is likely to put further upward pressure on oil prices. This unrest has slashed oil output in the country by 880,000 barrels per day, a decline of 40% of their daily production. (Nigeria's supply represents around 8% of total OPEC output.)

Chart 2
OPEC Oil Prices and CPI of Oil-related Items



The developments in the global oil prices are quite different this time round as compared to that during the 1990 Gulf War. (Chart 2) In particular, the run-up in oil prices was much sharper then, rising from less than US$14 per barrel before the invasion in Jul 1990 to reach a peak of around US$32 per barrel within a period of three to four months. In comparison, world oil prices have increased more gradually since the last few months of 2002 – oil prices rose by just US$4 over a period of four months (from Sep 2002 to Feb 2003). The more gradual increase could partly reflect a war premium that had already been built into oil price over time, given the longer lead-up to the war this time round, as well as earlier concerns over the disruption to oil supply from Venezuela during end-2002.

The higher world oil prices in both periods were also filtered into domestic consumer prices, especially that of oil-related items. During the 1990 Gulf War, the surge in oil prices resulted in domestic prices of oil-related items (specifically that of petrol and electricity tariffs) rising by double-digit rates. Higher oil prices from the Gulf crisis were also partly responsible for the upward revision in public transport fares during that time. In comparison, the pass-through effects of oil prices have been more muted thus far in 2003, with prices of petrol and electricity tariffs recording a peak-to-trough increase of less than 10% each. We should, however, note that the full effect of world oil price increases has not fully come through, given that domestic prices usually respond with some lag to the overall movements in oil prices.

We can therefore expect greater volatility in oil prices in the near term, at least until the hostilities in the Middle East abate. The developments in world oil prices will have adverse repercussions on domestic prices of consumer items with significant oil content. Specifically, electricity tariffs will be increased by around 17% in April, while petrol prices may also see some increases in the coming months.

...while prices of retail items are generally expected to stabilise in the coming months

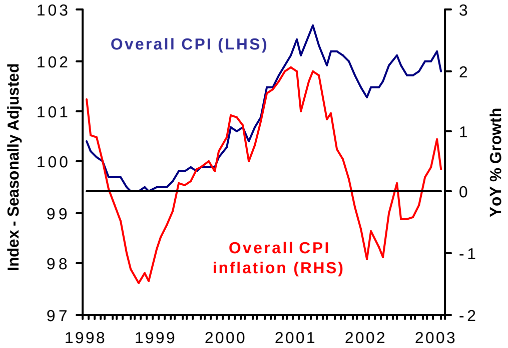
While prices of retail items have fallen considerably in February, we could see greater stability in prices in the coming months, as the sale season at many department stores ends. However, there could be some downside risks in the near term, as retail sales are likely to remain sluggish in light of the outbreak of the SARS. Tourist arrivals to Singapore are likely to be affected negatively, while domestic consumers avoid crowded places for fear of contracting the disease. The preliminary data from the Singapore Tourism Board showed that visitor arrivals fell by 8.8% in March following an increase of 2.3% in January and 7.5% in February. Already, there have been an increasing number of booking cancellations for hotels in Singapore, while business volumes for restaurants and retail outlets have also been hit. Several international cruise liners have also given Singapore a miss, the most recent being the decision by the Japanese liner Pacifica Venus to bypass a scheduled call at Singapore on 30 March. Before that, ResidenSea's The World ship decided to extend its stay in Australia for an extra month rather than call on Singapore as planned. Going forward, there are likely to be a few more cancellations.

Meanwhile, the recent Budget measures will also impact CPI inflation

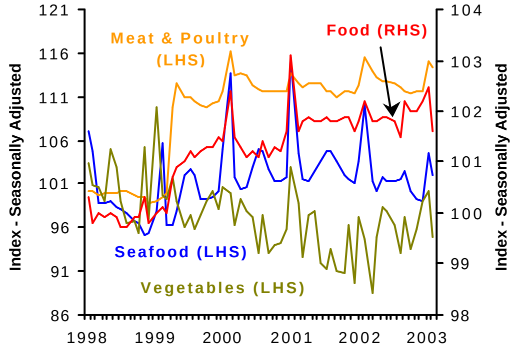
In addition, the announcement of the FY2003 Budget on 28 Feb 2003 highlighted several tax and fee changes that will impact overall CPI in the near term. Liquor and tobacco duties, which were increased with effect from 1 Mar 2003, is likely to have the largest impact on consumer prices. However, the impact of these increases will be partly offset by the lowering of the additional registration fee (ARF) and excise duty on cars, which will help keep a lid on private road transport costs. Maid levies will also remain frozen for the year.

Taking all these factors into account, our forecast for CPI inflation this year as a whole **remains unchanged at between 0.5% and 1.5%.**

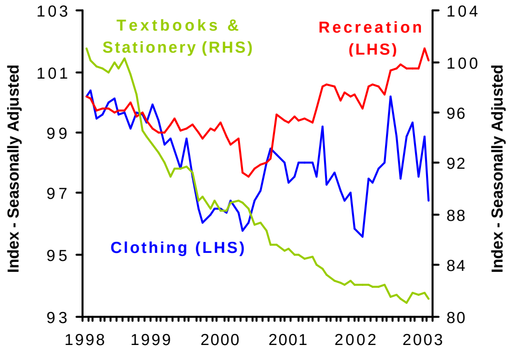
Headline CPI inflation came in at 0.4% y-o-y in February, a decline from 0.9% in the previous month. The seasonally adjusted index fell by 0.4% m-o-m in January.



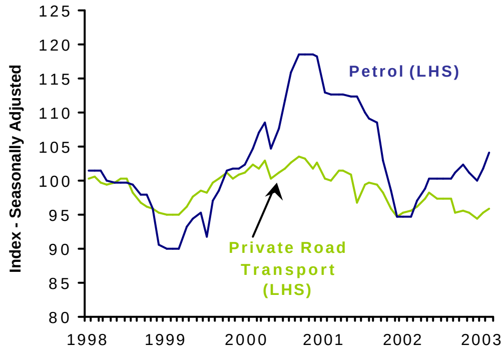
Prices of several food items fell in February, such as meat & poultry, seafood and vegetables, after the festive boost in January.



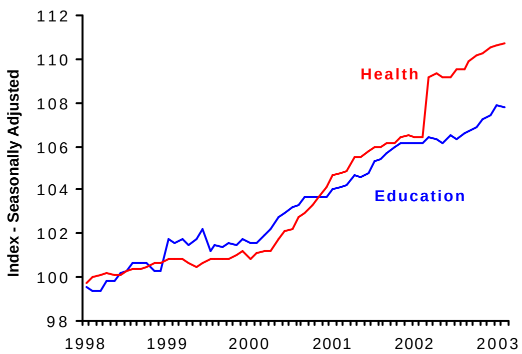
Prices of retail items such as clothing, recreation and books & stationery fell markedly in February, after increasing in January due to the GST hike.



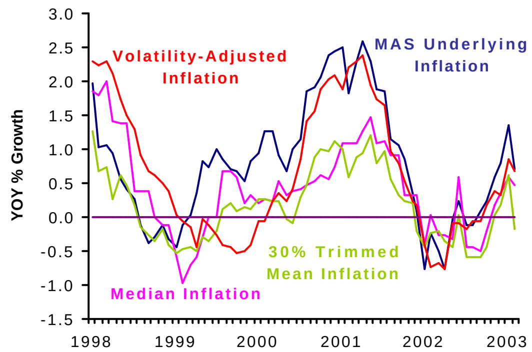
Private road transport costs, however, continued to rise in February, reflecting higher petrol prices due to the rise in global oil prices.



Meanwhile, prices of consumer services like education continued to hold up, while healthcare costs registered slight increases on account of more expensive medicines.



All the MAS core inflation measures except the volatility-adjusted measure came in lower in February, as compared to the previous month. While the median and volatility-adjusted inflation edged down slightly to 0.5% and 0.7 respectively, the MAS underlying inflation came considerably lower at 0.7%, while the trimmed mean inflation was at -0.2%.



MONETARY POLICY DIVISION
ECONOMIC POLICY DEPARTMENT

ANNEX 1

Consumer Price Index

Period	All Items	Food	Clothing	Housing	Tpt & Comm	Education	Heatlh	Misc
Weights	10000	2752	443	2292	1803	729	305	1676
	Index – Seasonally Adjusted							
2000 Jan	100.3	101.4	96.5	99.3	100.7	101.6	100.9	100.8
Feb	100.7	102.4	96.4	98.9	101.4	101.6	101.1	100.7
Mar	100.6	101.5	96.8	99.0	101.1	101.9	101.2	101.4
Apr	100.7	101.3	96.4	99.3	101.3	102.2	101.2	101.3
May	100.4	101.1	95.8	99.8	99.0	102.7	101.8	101.0
Jun	100.7	101.2	96.1	100.0	99.9	102.9	102.1	101.5
Jul	100.9	101.1	96.8	100.4	100.4	103.2	102.2	101.9
Aug	101.5	101.4	97.1	101.8	100.7	103.3	102.8	102.1
Sep	101.5	101.1	98.0	101.7	101.0	103.6	102.9	102.0
Oct	101.7	101.3	98.5	101.9	101.1	103.7	103.3	102.5
Nov	101.9	101.2	98.3	102.1	100.9	103.7	103.7	103.5
Dec	102.1	101.6	98.0	102.2	101.3	103.7	104.1	103.7
2001 Jan	102.4	103.1	97.4	102.7	100.8	104.0	104.7	103.8
Feb	102.1	101.6	97.6	103.1	100.5	104.1	104.8	103.4
Mar	102.5	101.8	98.0	103.0	100.9	104.2	104.9	104.6
Apr	102.7	101.9	98.0	103.3	100.7	104.7	105.5	105.1
May	102.3	101.8	98.0	101.8	100.1	104.6	105.5	105.2
Jun	101.9	101.8	97.6	102.1	98.3	104.8	105.8	105.6
Jul	102.2	101.9	99.2	101.6	99.3	105.3	106.0	106.0
Aug	102.2	101.8	97.3	101.4	99.2	105.4	106.0	106.1
Sep	102.1	101.8	97.7	101.1	98.9	105.7	106.1	106.1
Oct	102.0	101.9	97.1	100.9	98.5	105.9	106.2	105.9
Nov	101.7	101.9	96.8	100.6	98.0	106.1	106.4	105.3
Dec	101.5	101.6	97.0	100.7	97.4	106.2	106.5	105.1
2002 Jan	101.3	101.8	95.9	99.8	98.1	106.2	106.4	105.2
Feb	101.5	102.2	95.6	99.4	98.4	106.2	106.4	105.3
Mar	101.5	101.8	97.5	99.4	98.4	106.4	109.1	105.1
Apr	101.6	101.8	97.4	99.5	98.7	106.3	109.3	104.7
May	101.9	101.9	97.8	99.6	99.0	106.2	109.1	106.0
Jun	102.1	101.9	98.0	99.7	98.9	106.5	109.2	107.3
Jul	101.9	101.8	100.2	99.9	98.9	106.3	109.5	104.9
Aug	101.7	101.5	98.9	99.7	98.7	106.6	109.5	105.2
Sep	101.7	102.2	97.5	99.5	97.6	106.7	109.9	105.4
Oct	101.8	102.0	98.9	99.6	98.0	106.9	110.2	105.6
Nov	102.0	102.0	99.3	99.8	98.4	107.2	110.3	105.6
Dec	102.0	102.2	97.6	99.9	98.0	107.4	110.5	106.0
2003 Jan	102.2	102.5	98.9	99.3	99.3	107.9	110.6	106.7
Feb	101.8	101.6	96.8	98.9	99.5	107.8	110.7	106.4

ANNEX 2

Period	CPI	Import Price Index	Non-fuel Primary Commodities	Opec Oil Price
	YOY% Growth			
2000 Jan	0.9	7.5	6.2	133.1
Feb	1.3	8.5	9.6	168.4
Mar	1.2	10.2	9.0	122.7
Apr	1.1	8.2	7.8	53.5
May	0.5	9.2	7.6	77.0
Jun	0.8	11.1	7.3	86.2
Jul	1.2	11.0	6.5	51.3
Aug	1.6	9.6	2.3	46.0
Sep	1.7	9.7	1.7	42.4
Oct	1.8	9.9	-0.5	41.2
Nov	2.0	8.2	-1.2	30.8
Dec	2.1	4.6	-1.5	-2.6
2001 Jan	2.0	4.5	-2.1	-2.4
Feb	1.3	3.8	-2.9	-5.2
Mar	1.8	1.6	-3.0	-12.3
Apr	2.0	3.4	-2.3	7.7
May	1.9	2.6	-1.7	-2.9
Jun	1.2	1.3	-1.3	-10.5
Jul	1.3	0.3	-1.6	-14.1
Aug	0.7	-0.6	-2.1	-14.5
Sep	0.5	-2.7	-7.0	-22.7
Oct	0.2	-4.2	-9.3	-36.0
Nov	-0.2	-3.9	-7.2	-43.2
Dec	-0.6	-2.1	-8.4	-26.5
2002 Jan	-1.1	-1.8	-8.6	-24.4
Feb	-0.6	-2.1	-7.5	-25.6
Mar	-0.9	-0.8	-4.6	-4.4
Apr	-1.1	-1.0	-5.2	0.5
May	-0.3	-1.7	-6.3	-5.8
Jun	0.1	-2.9	-2.8	-8.9
Jul	-0.4	-2.0	0.1	6.0
Aug	-0.4	-0.6	1.3	5.7
Sep	-0.4	0.7	7.9	13.8
Oct	-0.2	1.6	13.4	40.2
Nov	0.2	0.8	11.3	37.2
Dec	0.4	2.1	11.5	59.6
2003 Jan	0.9	3.1	12.1	65.5
Feb	0.4	5.3	12.5	66.7