

HIGHLIGHTS & OUTLOOK

COUNTERBALANCING INFLUENCES ON CONSUMER PRICES

Headline CPI inflation came at **1.5%** year-on-year (y-o-y) in February, slightly higher than the 1.3% recorded in January. This was largely in line with market expectations of 1.4% (median forecast).¹ The MAS underlying inflation – which excludes accommodation and private road transport – also came in higher at 2.0% y-o-y, as compared to 1.7% a month ago. This was the first time since May 2001 that the underlying inflation rate reached the 2% mark.

However, on a seasonally adjusted, month-on-month (m-o-m, SA) basis, the overall price index receded slightly by 0.2% in February, after the sharp jump of 0.8% in January. This was the first sequential decline for consumer prices since June 2003. The February's consumer price developments reflected the *counterbalancing influences of external price increases and the offsetting effect accorded by domestic competitive pressures*. Thus, there was a significant fall in prices of travel services reflecting competitive airfares, even as higher commodity-related price pressures continued to underpin consumer price developments in February. Meanwhile, apart from some increases in services cost, several retail items also recorded relatively strong price increases in the month, in part reflecting the pass-through of the GST increase.

COMPETITION FROM LOW-COST CARRIERS KEEP PRICES OF TRAVEL-RELATED ITEMS IN CHECK

Prices of "other miscellaneous" items (comprising largely holiday & tour packages) fell by almost 2% in February, after rising briskly for the past six months following the recovery from SARS. The decline in prices reflected the moderation in travel demand with the end of holiday season. While the emergence of budget airlines may not have directly led to the price declines (as many tour agents do not have tie-ups with these budget carriers as yet), competition from these low-cost carriers could have led some incumbent players such as Singapore Airlines and its subsidiary SilkAir to offer more attractive prices in a bid to retain some of their more price-conscious passengers.² Given that airfares account for almost 70% of the total cost of tour packages, the cheaper airfares offered by the existing airlines would have lowered overall costs of tour packages.

GST EFFECT WAS MORE APPARENT WITH END OF SALES SEASON

Notwithstanding the decline in overall prices, several items in the CPI basket saw price increases. In particular, several retail items recorded relatively strong price increases in February, with the GST effect becoming more apparent with the end of the sales season.³ Except for ready-made clothing, prices of most retail-related items including footwear, personal effects, personal care, household durables and non-durables rose in February. The improvement in the economic climate may also have allowed more retailers to pass on the GST increase to consumers.

¹ Source: Reuters News on 19 March 2004, "Poll: Singapore inflation seen easing in Feb".

² Following the introduction of Malaysia's Air Asia flights to some of the regional countries, SIA also offered discount fares on several regional short-hauls including Bangkok, Bali, Jakarta, Manila and Hanoi. Source: The Business Times on 18 January 2004, "Start of price war between airlines?"

³ As discussed in the in the January 2004 issue of the Inflation Monthly, the relatively muted pass-through of the GST hike on consumer goods as compared to the first phase in January 2003 could be due to the proximity between Christmas and Chinese New Year, which did not allow retailers to unwind the earlier Christmas discount sales immediately.

PRICES OF CONSUMER-RELATED SERVICES CONTINUED TO RISE, ALBEIT MORE MILDLY...

Meanwhile, prices of consumer-related services, particularly that of healthcare and education, saw a modest boost in February, after experiencing significant increases in the preceding month. The rise in healthcare costs was mainly on account of more expensive vitamins & health food, while the increase in education costs largely reflected higher tuition fees. Fees at some childcare centres were revised upwards by as much as several hundred dollars, reflecting cost increases due to higher rentals.⁴

...WHILE PRICES OF COMMODITY-RELATED ITEMS TRENDED UP

As in previous months, commodity-related prices exerted upward pressure on overall CPI. In particular, petrol prices saw another hike of five cents a litre in early February, after an earlier upward adjustment in mid-December.⁵ Rising prices of energy commodities also led to higher liquefied petroleum gas (LPG) prices.

Likewise, prices of non-cooked food rose by 1.7% in February, partly reflecting the pass-through effects of higher prices of food-related commodities, as well as the impact of the recent preventive measures against the bird flu outbreak. As part of its initiatives to diversify its import markets to avert future food supply disruptions, NTUC FairPrice began the import of fresh eggs from Australia.⁶ However, this inadvertently pushed up prices of eggs, as these Australian produce cost more than double those of Malaysia's or local ones. Other non-cooked food items such as rice, vegetables and seafood also rose in February.

UPWARD REVISION IN CPI INFLATION FORECAST TO 1.5-2.0% FOR 2004

With the anticipated rise in external inflationary environment and a modest pickup in domestic cost pressures, headline CPI inflation forecast for 2004 has been revised upwards, and is now expected to come in at 1.5-2.0%. (Our earlier forecast range was between 0.5-1.5%.) The revision has also been predicated on a more optimistic economic outlook going forward, with the anticipated pickup in demand-side price pressures. There were also larger-than-expected price increases arising from several supply-side factors including the commodity-related price hikes in early 2004. In addition, our forecast has taken into account some changes in indirect taxes as announced in the FY2004 Budget.

A COMBINATION OF DEMAND- AND SUPPLY-SIDE FACTORS TO SUPPORT PRICES OF OIL...

Going forward, commodity price developments could pose some upside risks to domestic consumer prices. The recent rise in global oil prices to above US\$30 per barrel reflected a combination of supply- and demand-side factors. The growth in world oil consumption has been faster than anticipated, led in part by China's economic boom.⁷ There were also supply constraints such as OPEC's production cuts as well as the heightened global uncertainty and ongoing geopolitical tensions. Nonetheless, oil futures indicated that current high prices are unsustainable. (Chart 1) There was indeed some moderation in prices more recently, due to an unexpectedly large increase in US crude inventories. There are also doubts over OPEC's ability to adhere to the production cuts. In addition, the eventual return of Iraqi oil production expected in the later part of the year could keep a lid on price increases.

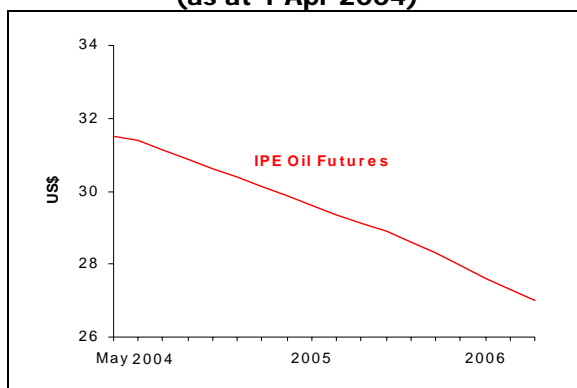
⁴ Source: Today on 19 March 2004, "Childcare conundrum".

⁵ Source: The Business Times on 6 February 2004, "Shell, BP follow Caltex to raise petrol prices".

⁶ Source: The Straits Times on 20 February 2004, "No scramble for eggs from Down Under".

⁷ This has led the International Energy Agency (IEA) to revise its global oil demand forecast recently for 2004 to rise by 1.65 million bpd, around 1 million bpd more than forecast in early 2003.

Chart 1
International Petroleum Exchange (IPE) Brent Oil Price Futures⁸
(as at 1 Apr 2004)



Source: Bloomberg

...AS WELL AS NON-OIL COMMODITIES

Likewise, prices of a wide range of commodities have been on an uptrend, supported by fears of shortages and a general pickup in demand as the global economy strengthens. Rapid industrialisation in China was also identified as one of the key forces driving the sharp rise in demand for various industrial-related commodities, in particular metals. Going forward, the price gains in soft commodities could see some moderation in the months ahead, while prices of hard commodities are expected to peak in 2004 as supply responds to higher prices. Rising freight charges will further add to the costs of these commodities.⁹ These higher costs will eventually trickle in as higher import prices and subsequently into consumer prices, especially that of food items.

DOMESTIC COMPETITIVE PRESSURES TO RESTRAIN SOME PRICE INCREASES

Despite rising external price pressures, the generally competitive domestic environment could restrain some of these price increases. For example, the increase in domestic food prices is likely to be somewhat dampened by the already-competitive supermarket segment, as well as cheaper sourcing from low-cost countries such as Latin America and Africa. The keen competition within the petrol industry forced pump operators to offer price discounts, for fear of losing market share. Going forward, while pump operators could remain fairly cautious in introducing price hikes, some pass-through of higher global oil prices can be expected, as it is unlikely for them to absorb the cost increases indefinitely. In addition, it is unclear at this stage how the recent consolidation in the local petrol industry (via the sale of BP's Singapore petrol kiosk stations to one of the remaining four operators¹⁰) could affect the pricing behaviour at petrol kiosk stations.

Meanwhile, although the recent FY2004 Budget measures may lead to price increases in selected consumer items, these could again be dampened by some domestic competitive pressures. In particular, immediately after the increase in excise duties of cigarettes at end-February, there was a price war in some housing estates, where shopkeepers offered price discounts of up to 80 cents per pack.¹¹ Price increases could also be capped by the entrance of more low-priced brands in the market.¹²

⁸ Since there is no futures market for OPEC oil prices (the price indicator that MAS usually monitors), the IPE Brent oil price futures are used instead to provide a general trend of price expectations going forward. The historical average price differences between Brent and OPEC oil prices are about a dollar per barrel.

⁹ Source: Straits on 19 March 2004, "Freight rates soar on China demand".

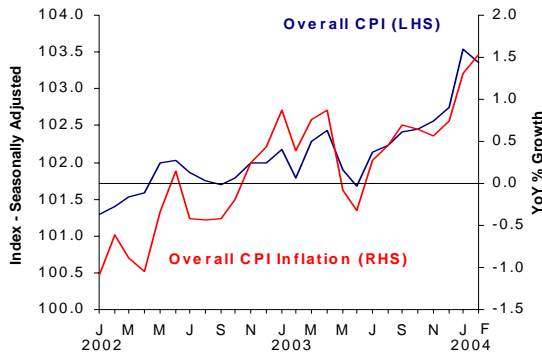
¹⁰ Source: The Business Times on 7 January 2004, "BP to exit petrol retail business in Singapore, Malaysia".

¹¹ Source: Channel NewsAsia on 2 March 2004 "Cigarettes price war erupts in some Singapore housing estate".

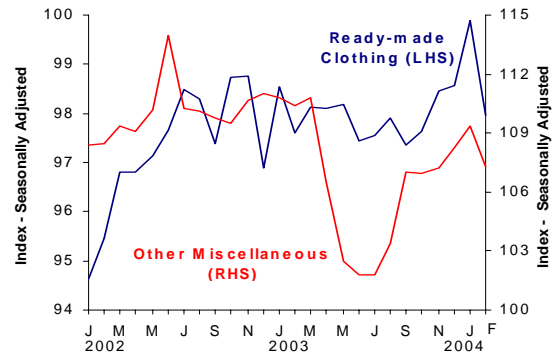
¹² At least 18 new low-priced brands have entered the market since November 2000. Source: The Straits Times on 3 March 2004, "Cheaper brands of cigarettes make inroads".

In addition, the recent hike in excise duty for taxis by 10% points may suggest that taxi companies could fork out an additional \$2,000 more for every new taxi, given that the open market value for a big cab is around \$20,000.¹³ Although these higher costs could eventually be passed on to consumers, increased competition arising from the recent entry of three more new taxi companies may help to moderate the upward adjustment in fares.

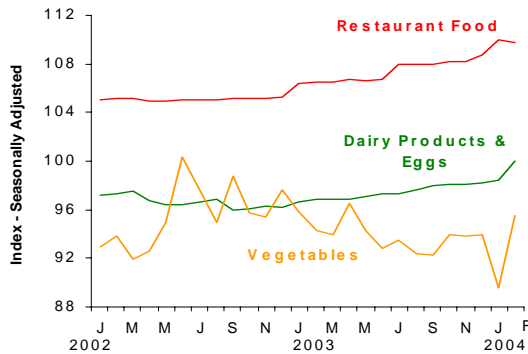
Headline CPI inflation rose further to 1.5% y-o-y in February, from 1.3% in January. However, the seasonally adjusted index declined by 0.2%, after a 0.8% hike a month ago.



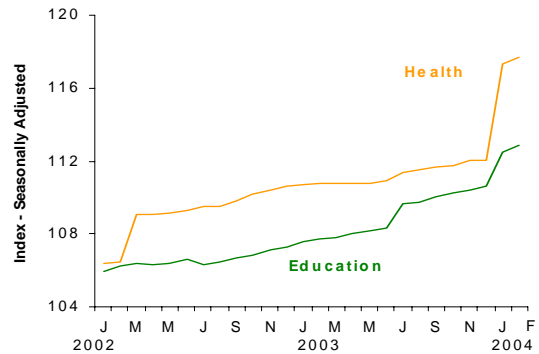
Prices of “other miscellaneous” items (comprising mainly packaged tours) declined markedly for the first time in six months. Ready-made clothing prices fell in February as well.



Restaurant meals were cheaper, although this was offset by higher prices of non-cooked food items such as dairy products & eggs, and vegetables.

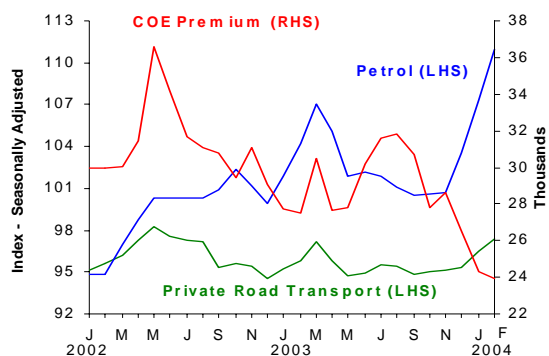


More expensive vitamin & health products led to higher healthcare costs, while higher tuition fees and dearer school textbooks & stationary pushed up education costs.

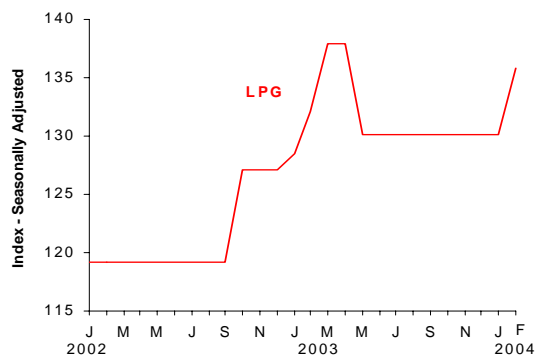


¹³ Source: The Straits Times on 28 February 2004, “Cheaper cars”.

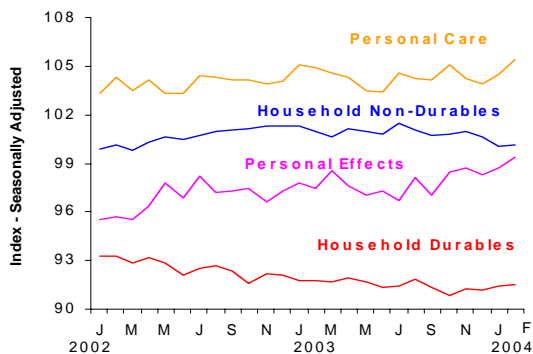
Private road transport costs rose - despite falling car prices and COE premiums - largely due to higher petrol prices in February.



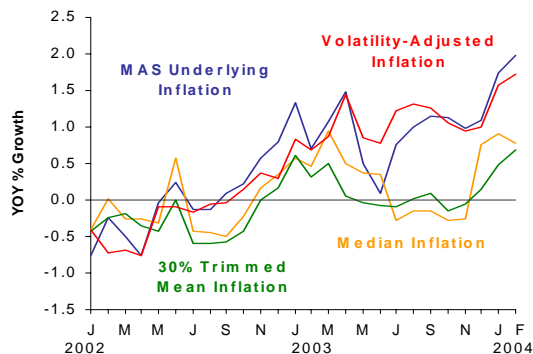
The high global oil prices in recent months led to an increase in LPG prices.



Meanwhile, prices of several retail items including personal effects, personal care, household durables and non-durables picked up with the end to the sales season.



Except for the median inflation, all measures of core inflation came in higher for February, as compared to the previous month.



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	100.6	103.9	104.7	103.6
Feb	102.0	101.4	98.3	103.1	100.3	104.0	104.8	103.3
Mar	102.5	101.9	98.1	103.1	100.8	104.2	104.8	104.4
Apr	102.7	101.9	98.1	103.2	100.6	104.7	105.3	105.0
May	102.3	101.9	98.1	101.8	100.1	104.8	105.5	105.3
Jun	101.9	101.8	98.0	102.0	98.1	104.9	105.8	105.6
Jul	102.3	101.9	98.0	101.5	99.2	105.3	106.0	106.2
Aug	102.2	102.0	97.2	101.3	99.2	105.4	106.0	106.1
Sep	102.1	101.8	98.5	101.0	99.2	105.6	106.1	106.1
Oct	102.0	101.9	97.3	101.0	98.7	105.9	106.2	105.9
Nov	101.7	102.0	96.6	100.6	98.1	106.1	106.4	105.4
Dec	101.6	101.6	97.1	100.6	97.7	106.3	106.6	105.2
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

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	-2.9	-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	-2.8	-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	11.1	37.2
Dec	0.4	0.0	11.3	59.6
2003 Jan	0.9	1.0	11.8	65.5
Feb	0.4	2.5	11.4	66.7
Mar	0.8	2.1	7.2	30.4
Apr	0.9	0.0	7.1	1.9
May	-0.1	-1.2	6.8	3.6
Jun	-0.3	-0.3	3.9	12.7
Jul	0.3	0.1	1.3	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	6.7	3.8
Nov	0.6	0.4	9.7	17.4
Dec	0.7	0.2	12.2	4.8
2004 Jan	1.3	0.3	16.5	-0.3
Feb	1.5	-2.0	19.9	-6.4