

Highlights

The Singapore economy grew by an impressive 7.7% in 2007, marking the fourth consecutive year of strong growth. At the same time, job creation surpassed the previous high of 2006, bringing down the unemployment rate to a decade low of 1.6% in December last year. At the turn of 2008, domestic GDP growth continued to be firm, despite the headwinds from the slowing US economy and continuing turmoil in the global financial markets.

Looking ahead, Singapore's economic growth is likely to ease in the next few quarters in view of the deterioration in the external outlook. That said, full-year GDP growth of 4-6% is still achievable, barring a deep recession in the US economy. Regional demand is expected to hold up in the near term, while sources of support driven by sector-specific trends will also prevent the Singapore economy from sliding into a sharp downturn in 2008.

Chapter 1 of the *Review* traces the recent performance of the domestic economy. We identify the factors which impacted growth in the last two quarters, and consider how cooling investor sentiment could play out in the asset markets, particularly in the value chain of property-related activities. We also evaluate the macroeconomic policy setting and examine the relative importance of income and price (or cost of funds) effects in underpinning domestic asset prices.

Chapter 2 analyses the wage-price dynamics in the Singapore economy. CPI inflation has risen since the second half of 2007, reflecting a confluence of external and domestic cost pressures. In particular, global oil and food prices have soared, while on the domestic front, wages and rental costs have risen alongside tight labour and commercial property markets.

Chapter 3 presents our outlook for GDP growth, the labour market and inflation in Singapore, taking into account developments in the global economy and IT industry. In contrast to last year's broad-based growth story, the prospects for 2008 will vary across industries depending on their sensitivity to the US economic slump. We offer a tentative assessment

of those activities that are most insulated from a US slowdown and those most vulnerable to the risk of further US weakness. We expect CPI inflation in Singapore to stay elevated in the first half of 2008, as external and domestic cost pressures continue to pass through, before moderating in the second half of the year. This Chapter also includes an analysis of those factors that have contributed to the recent rise in global food price inflation and interpret these developments in the context of longer-term trends in real commodity prices. Separately, we offer a stylised description of the price transmission mechanism in Singapore, highlighting the importance of the import price channel and derived demand channel as underlying sources of CPI inflation.

Finally, the *Review* incorporates two Special Features, which draw on the ongoing research work of the Department and its engagement with economists in academia. The first revisits the ongoing debate on the fall of the US\$ and the implications for its role as the world's reserve currency. The general consensus is that the dollar is likely to further share its reserve currency status with other currencies over the longer term, reflecting the emergence of a more broad-based global economy and the move towards flexible exchange rate regimes. Nevertheless, given the entrenched position of the US as the default banker to the world and the strong incumbency of the US dollar, the replacement of the dollar as the world's leading currency is unlikely to occur anytime soon. The second Feature on "Rivalry and Prosperity" is contributed by Professor Paul Romer, who visited EPD in January this year under the MAS' Eminent Visitor Programme. He vividly illustrates how non-rival goods, particularly ideas, can be combined in infinite ways to give rise to an unlimited stream of innovations, which is the basis of improvements in our standard of living.

The next issue of the *Review* will be released in October 2008.

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