Price Stability and Monetary Policy in Singapore
Outline of Presentation

Price Stability
  Definition, Rationale and Measure

The Exchange Rate as the Instrument for Monetary Policy
  Rationale

The “BBC” System
  Features of the Band, Basket and Crawl

Monetary Policy in Singapore
  Processes and Recent Decisions
Medium-Term Price Stability

“The principle object of the Authority shall be... to maintain price stability conducive to sustainable growth of the economy.” – MAS Act

- Low and Stable Inflation
  - Less uncertainty over returns on long-term investment
  - Firms are able to commit to longer planning horizons
  - Ensures a competitive export industry

Sustainable Growth

Small and Open Economy
What is the MAS Core Inflation measure?

- Excludes the cost of private road transport and accommodation
- These components are volatile and are driven by administrative measures e.g. COE
- Not appropriate to exclude food and energy given high share (27%) in a household’s typical consumption basket
...although it also looks at a range of other price and cost measures that underpin inflationary pressures in the economy.

Global Prices of Primary Commodities and Electronics Goods

Output Gap and Unit Labour Cost

- Index (Q1 1980=100)
- Per Cent

- Energy
- Industrial Inputs
- Food & Beverage
- Electronics

- Unit Labour Cost (YOT Growth)
- Output Gap (% of Potential GDP)
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The exchange rate-centred monetary policy framework as the means to price stability

Ultimate Objective:
Price Stability as the Basis for Sustained Economic Growth

Intermediate Target:
S$ nominal effective exchange rate

“...Underlying this shift in emphasis away from targets for interest rates and money supply growth in the conduct for monetary policy is the view that the exchange rate is a relatively more important anti-inflation instrument in the context of the small and open Singapore economy...”

Why is the exchange rate the ideal monetary policy instrument?

- It is relatively controllable by the MAS.
- It has a strong and stable relationship with domestic inflation.
- It is suited to Singapore’s economic circumstances.
Singapore is a highly trade-dependent economy with free capital mobility.

- Small Economy with No Natural Resources
- High Degree of Openness to Trade
- High Degree of Openness to Capital Flows
- Exchange Rate

Trade to GDP Ratio

- Imports
- Exports

% of GDP
Singapore is a highly trade-dependent economy with free capital mobility.

- Small Economy with No Natural Resources
- Exchange Rate
- High Degree of Openness to Trade
- High Degree of Openness to Capital Flows

Assets in Banking Sector

- Asian Dollar Market
- Domestic

Exchange Rate

Singapore is a highly trade-dependent economy with free capital mobility.
The S$ Nominal Effective Exchange Rate is the ideal monetary policy instrument. Given a 1% ↑ pt (one-off) in:

- S$NEER
- Interest Rate

**Impact of Policy Instruments**

- Exports
- GDP
- CPI
Exchange rate policy affects inflation through two channels.

- **Direct channel**
  - **S$NEER translates foreign price of imports into S$**.
  - A stronger S$NEER lowers import prices.
  - **Imported foreign inflation channel**

- **Indirect channel**
  - **S$NEER affects export demand, thereby influencing demand for factor inputs**.
  - **Derived demand channel**

- **CPI Inflation**
Singapore’s inflation performance has improved and is comparable to the OECD.
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### Characteristics of Singapore’s Exchange Rate System

<table>
<thead>
<tr>
<th>BASKET</th>
<th>The exchange rate is managed against a trade-weighted basket of currencies of our major trading partners and competitors</th>
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<tbody>
<tr>
<td></td>
<td><em>Mitigates volatility of international foreign exchange markets</em></td>
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<tr>
<td>BAND</td>
<td>The trade-weighted S$ is allowed to float within an undisclosed policy band</td>
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<tr>
<td></td>
<td><em>Absorbs short-term market volatility, provides flexibility in managing the exchange rate</em></td>
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<tr>
<td>CRAWL</td>
<td>The policy band itself is adjustable and allowed to “crawl”, reflecting underlying fundamentals</td>
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<td><em>Prevents misalignment in the currency</em></td>
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Policy Lever (1): Slope of policy band

Example 1:
Apr 2010: Increase the pace of appreciation

Normally undertaken when MAS assesses that the trajectory for economic activity in the medium term is changing gradually.
Policy Lever (2): Width of policy band


Normally undertaken when developments cause a short-term increase in S$NEER volatility.
Policy Lever (3): Level of policy band

Example 3: Apr 2010: Re-centre policy band at current level of S$NEER

Normally undertaken when developments cause an abrupt shift in the path of economic activity
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3-Stage Monetary Policy Process

1. Policy Formulation
2. Policy Decision
3. Policy Implementation
The policy decision involves an assessment of the balance of risks to growth and inflation.

The change in the Monetary Policy stance is a function of the deviation of output and inflation from trend.
Recent Monetary Policy Decisions

- **Boom: Modest & Gradual Appreciation**
  - Flatten policy band

- **Great Recession: Neutral Policy Stance**
  - Re-centre downwards

- **Recovery: Modest & Gradual Appreciation**
  - Re-centre, shift to appreciation path
  - Increase Slope & Widen Band
  - Re-centre upwards

- **Subdued Growth**
  - Reduce slope

Index Q1 2008 = 100

- **S$NEER**
  - Maintain

- **CPI Inflation**
  - Subdued Growth
  - Boom: Modest & Gradual Appreciation

- **GDP Growth**
  - Great Recession: Neutral Policy Stance
  - Recovery: Modest & Gradual Appreciation
  - Subdued Growth

Graphs show the evolution of inflation, GDP growth, and exchange rate (S$NEER) over time from 2008 to 2011.
Summary

Price Stability

Low and stable inflation ensures that resources are efficiently allocated and households and firms can make optimal savings and investment decisions. The primary indicator of price stability is the MAS Core Inflation measure.

The Exchange Rate as the Instrument for Monetary Policy

The exchange rate has a strong and stable relationship with domestic inflation. It is very well-suited to a small, open economy.

The “BBC” System

The S$NEER is managed against a Basket of currencies from Singapore’s major trading partners. The width and level of the Policy Band, as well as its Crawl (slope) can be adjusted at each monetary policy review.

Monetary Policy in Singapore

In view of the expected moderation in core inflation as economic activity slows, MAS reduced the slope of the policy band in October 2011. Monetary policy has become increasingly challenging given numerous external shocks to the economy, permanent relative price changes, and rising asset prices. MAS has enhanced its monetary policy toolkit to deal with these new challenges.
Thank You