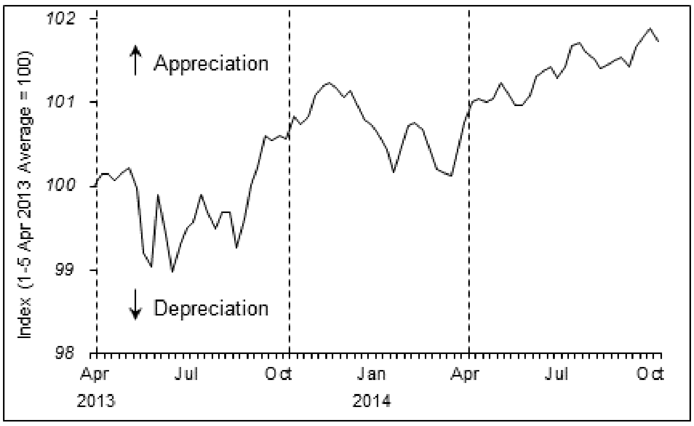
14 October 2014

Monetary Policy Statement

INTRODUCTION

1. In April 2014, MAS maintained a modest and gradual appreciation path of the S$NEER policy band, with no change to its slope, width, and the level at which it was centred. This policy stance, which has been in place since April 2012, was assessed to be appropriate for containing domestic and imported sources of inflation amid the ongoing economic restructuring.

Chart 1
S$ Nominal Effective Exchange Rate (S$NEER)



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2. Over the last six months, the S$NEER fluctuated within the upper half of the policy band. It trended upwards from April until July, strengthening alongside the generally positive investor sentiment in Asia. The S$NEER then experienced some downward pressures from August to mid-September, largely reflecting a rise in geopolitical risks and market reactions to the possibility of an earlier-than-expected rate hike by the US Federal Reserve. However, it subsequently resumed a mild appreciation trajectory. Given the accommodative global interest rate environment, the three-month S$ SIBOR remained low and steady, averaging 0.41% from April to September 2014.

OUTLOOK FOR 2014 AND 2015

3. The Singapore economy is projected to grow at a moderate pace for the rest of 2014 and in 2015, as the expected cyclical uplift from external demand will be tempered by domestic supply-side constraints. CPI-All Items inflation has eased and should stay subdued during this period. However, MAS Core Inflation is likely to remain firm, given cost pressures from the tight labour market and higher prices of food imports from the region.

Growth

4. According to the *Advance Estimates* released by the Ministry of Trade and Industry today, Singapore's GDP expanded by 1.2% in Q3 2014 on a quarter-on-quarter seasonally adjusted annualised basis, following the 0.1% contraction in Q2. The manufacturing sector turned around, reflecting a pickup in the electronics and precision engineering industries. Overall services growth was muted, as the weakness in global commodity demand weighed on re-export and trade financing activities. Sentiment-sensitive segments within the finance & insurance sector also saw some sequential pullback due to the escalation of geopolitical tensions in Ukraine.

5. The global economy should continue to expand, but at an uneven pace across countries. The US economy will lead the recovery, with private consumption supported by sustained improvement in the labour market and corporate investment gaining traction amid rising capacity utilisation rates. However, growth in the core Eurozone economies and Japan is likely to remain weak, hampered by structural headwinds. In Asia, the ASEAN economies and NIEs should benefit from the US recovery and the mild upturn in the global IT industry, while China is expected to stay on its moderating growth path.

6. The continued improvement in global demand should provide some support to the external-oriented sectors of the Singapore economy, such as manufacturing and trade-related services. However, the growth performance will vary across industries. Some manufacturing firms are facing supply-side constraints and falling product prices. As they reconfigure their operations in Singapore, output could be negatively impacted in the short term. The domestic-oriented healthcare and education sectors will stay resilient on the back of strong underlying demand, though other services industries that are reliant on labour and face greater competition could experience profit margin pressures. On balance, real GDP is projected to grow by 2.5–3.5% in 2014 and should maintain a broadly similar pace of expansion next year.

Inflation

7. MAS Core Inflation, which excludes private road transport and accommodation costs, averaged 2.2% y-o-y in July–August, similar to Q2 and up from 2.0% in Q1 2014. This relatively firm outcome was largely due to continued pass-through of higher wages and other business costs to the prices of consumer services. Imported food inflation was also elevated because of the higher cost of food from the region, which in turn partly reflected the effects of supply disruptions. Meanwhile, CPI-All Items inflation declined to an average of 1.0% y-o-y in July–August 2014 from 2.4% in Q2, on account of weaker car prices and imputed rentals on owner-occupied accommodation.

8. Going forward, external price developments are expected to stay generally benign, given ample supply buffers in the major commodity markets. However, domestic food inflation could be impacted by higher prices of regional food supplies. At the same time, with the economy at full employment, wages should continue to increase and filter through to prices, in particular, of services items for which demand remains firm, such as healthcare and education. On a year-ago basis, MAS Core Inflation is projected to pick up gradually into early next year, before easing in the second half of 2015. MAS Core Inflation is forecast to average 2–2.5% in 2014 and 2–3% in 2015.

9. CPI-All Items inflation should stay subdued for the rest of this year and throughout 2015. Car prices and imputed rentals on owner-occupied accommodation will continue to dampen inflationary pressures, amid the expected increase in the supply of COEs and newly-completed housing units. CPI-All Items inflation is now forecast to be 1–1.5% in 2014, given the recent weakness in car prices. For 2015, it is projected at 0.5–1.5%, reflecting also the impact of muted housing rentals.

MONETARY POLICY

10. The Singapore economy should expand at a moderate pace in the quarters ahead. Wage inflation is likely to remain relatively firm, and businesses in food-related and some services sectors could further pass on cost increases. Consequently, MAS Core Inflation is projected to stay above its historical average over the next few quarters even as CPI-All Items inflation remains subdued.

11. MAS will therefore maintain its policy of a modest and gradual appreciation of the S$NEER policy band. There will be no change to the slope and width of the policy band, and the level at which it is centred. This policy stance is assessed to be appropriate for containing domestic and imported sources of inflationary pressures, and ensuring that inflation expectations remain well anchored. MAS will continue to closely monitor the impact of external developments and domestic restructuring on the growth and inflation prospects for Singapore.