

Highlights

The Singapore economy is in its fourth year of robust growth and has performed better than expected thus far in 2007. Concomitantly, a record number of jobs was created, which reduced the unemployment rate to a six-year low of 2.3% in June. Notwithstanding the moderation in growth momentum in Q3, underlying economic conditions remain supportive amidst a generally favourable external environment. Against this backdrop, and with GDP growth averaging around 8% in the first three quarters, the economy is on track to achieve a full-year growth rate at the upper end of the 7-8% forecast range.

Looking ahead, the global economy should continue to expand in 2008, albeit at a more moderate pace. Strong domestic demand and trade in the Asian region will continue to provide support, even though there may be some weakening in the industrialised economies. Singapore's GDP is therefore expected to grow at its medium-term potential rate of 4-6% in 2008. Nevertheless, two key concerns continue to cloud the economic horizon and bear close monitoring. First, there is the possibility of a sharp downturn in US consumer spending arising from the ongoing correction in the housing market; and second, global oil prices could remain at an elevated level.

Chapter 1 of the *Review* describes in detail the recent performance of the domestic economy. We highlight how non-IT activities, particularly those associated with the financial and property markets, have propelled growth in the first half of this year. In this chapter, we also assess the macroeconomic policy setting and, in particular, document MAS' monetary policy stance since 2001, which has been focused on the preservation of price stability over the course of the business cycle.

Chapter 2 examines the wage-price dynamics in the Singapore economy. CPI inflation picked up in the third quarter as a result of both external and domestic sources of cost pressures. The increase in global food prices was a key external influence on inflation, although its impact was dampened by Singapore's diversified food import sources. Domestic factors also contributed to higher consumer prices. Apart from the one-off impact of the GST hike, which was introduced in July, there was some pass-through of business costs, such as wages and rentals. Underlying cost

pressures are expected to stay firm alongside the strong and sustained expansion in the global and domestic economies.

Chapter 3 contains our assessment of the growth, labour market and inflation outlook for Singapore. We provide the background for our baseline forecast of domestic growth next year, highlighting the strong momentum in non-IT manufacturing, construction and business services. We also point to early indications of some strengthening in the IT sector. Amidst lingering uncertainty, however, financial markets are likely to be particularly sensitive to information from incoming data. This chapter includes an assessment of the extent to which domestic macroeconomic data releases have impacted on the short-term level and volatility of the S\$/US\$ exchange rate.

Finally, the *Review* incorporates two Special Features which highlight some of the Department's research work. The first takes a look at two major macro-econometric models of the Singapore economy – the MAS Monetary Model of Singapore (MMS) and the NUS Econometric Studies Unit Model (ESU01). In collaboration with the ESU01 architects, we compare the key characteristics of the two models and highlight some interesting differences in their modelling approach, for example, in the specification of the trade block of equations. The simulation of a negative demand shock sheds further light on the peculiarities of the transmission mechanisms built into the two models. Such comparative exercises are invaluable in allowing modellers to explore the different interpretations of macroeconomic developments in the Singapore economy and to gain deeper insights for forecasting and policy analysis. The second Feature revisits the US-Asia decoupling hypothesis. Distinguishing between long-run and short-run influences, we find little evidence of structural decoupling so far, but there could be weaker synchronisation in the short term as the impact of a temporary US slowdown on Asia is mitigated by growth in other parts of the world, as well as domestic demand in the region.

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

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