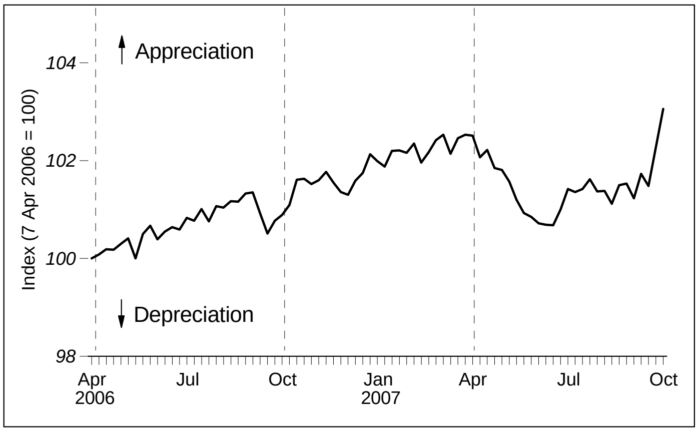
10 October 2007

Monetary Policy Statement

INTRODUCTION

1. In April this year, MAS reaffirmed the policy of a modest and gradual appreciation of the S$NEER policy band which has been in place since April 2004. This policy stance has contributed to low and stable inflation amidst the robust economic growth over the past few years.

Chart 1
Nominal Effective Exchange Rate (S$NEER)



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2. Since the last policy review, the S$NEER has eased from the upper end of the policy band, although in recent weeks it has edged up following the renewed weakness of the US$. (Chart 1) Despite the turbulence in global financial markets arising from the US subprime mortgage problems, financial markets in Singapore, in particular the money markets, have continued to function in an orderly manner.

3. The three-month domestic interbank interest rate fell from 3.5% at end-February to 2.5% in June. While the disruption of US and European money markets in early August had led to a temporary spike in the domestic three-month rate to about 3%, it has since eased to around 2.5%.

OUTLOOK FOR 2007 AND 2008

4. The Singapore economy has performed better than expected thus far in 2007, with robust growth recorded across most industries. Notably, the non-IT industries and asset market-related activities – that is, those associated with the property market as well as the financial advisory and capital markets – contributed significantly to overall GDP growth in the first half of the year. In Q3, Advance Estimates

released by the Ministry of Trade and Industry pointed to a moderation in economic momentum, largely on account of a pullback in some asset market-related activities. Nonetheless, financial markets have rebounded recently and underlying economic conditions remain supportive. GDP growth is therefore on track to come in at the upper end of the 7-8% forecast range this year, up from the 4.5-6.5% forecast during the April review.

5. Looking ahead, growth prospects of the US economy have weakened in line with the ongoing correction in the housing market and tighter credit conditions. Other economies are also likely to see some softening in the near term. However, the global economy is expected to remain resilient, particularly in Asia, where domestic demand and regional trade should continue to be firm. In the Singapore economy, growth will be led by non-IT manufacturing, construction and business services, which have built up a strong momentum and are more dependent on regional and domestic sources of demand as well as developments in specific product markets.

6. At this stage, our assessment is that the Singapore economy is likely to expand at a slower rate in 2008 than in the recent past, reflecting weaker global economic growth. Singapore's GDP growth rate is expected to come in within its potential of 4-6% next year.

7. CPI inflation in Singapore came in within expectations at 0.8% in the first half of this year, compared with 1% in 2006. Inflationary pressures have since picked up amidst the buoyant domestic economic conditions and the recent rise in global oil and food prices. Wage and rental increases have strengthened, and the unemployment rate has fallen to a six-year low of 2.3% in June. Inflation rose to an average of 2.8% in July-August, with about half the increase attributed to the one-off impact of the GST hike. The higher inflation also reflected stronger economic conditions and the pass-through of rising business costs to retail prices. As a result, CPI inflation is now projected to come in at 1.5-2% for 2007, from the 0.5-1.5% range expected at the time of the last policy review.

8. Domestic price pressures are expected to persist due to heightened supply constraints, while externally, oil, food, and other commodity prices will remain firm into next year. Further, rising residential property prices and rentals will lead to a more significant increase in CPI accommodation costs. For the first half of 2008, headline CPI inflation is projected to rise to about 3.5% on a year-on-year basis on account of the GST hike, as well as the base effects of lower energy and car prices in H1 2007. In the second half of the year, inflation should ease, and come in at 2-3% for 2008 as a whole.[1] The MAS underlying inflation measure, which excludes accommodation and private road transport costs, is projected at 1.5-2.5% in 2008.

MONETARY POLICY

9. The Singapore economy has expanded at a rapid pace in 2007, underpinned by robust growth in non-IT manufacturing and asset market-related activities in the first half of the year. Going forward, while the economy is expected to moderate to a more sustainable pace, inflationary pressures stemming from external sources, as well as domestic conditions including a tight labour market and rising rental costs, will persist.

10. Against this backdrop, MAS will continue with the policy of a modest and gradual appreciation of the S$NEER policy band in the period ahead. However, we will increase slightly the slope of the S$NEER policy band. There will be no re-centring of the policy band, or any change in its width. In our assessment, this policy stance will remain supportive of economic growth while capping inflationary pressures and ensuring price stability over the medium term.

[1] The GST increase is expected to have a one-off impact of around 0.7% point on the annual inflation rate in 2007 and 2008.