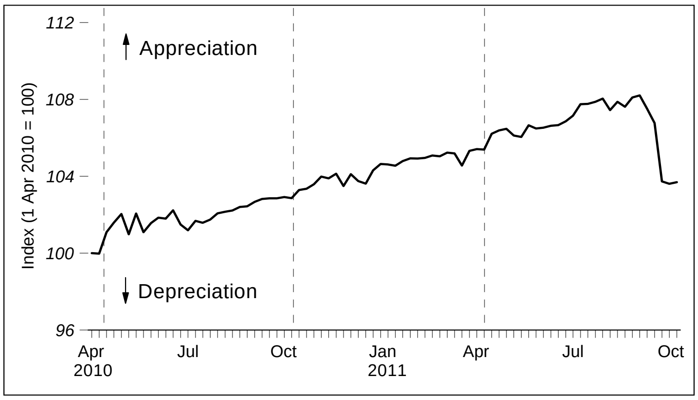
14 October 2011

Monetary Policy Statement

INTRODUCTION

1. MAS re-centred the S$NEER policy band upwards in April this year, with no change to the slope and width of the band, amidst tight factor markets and strong pressures on domestic costs and prices. This was the third consecutive tightening move since April 2010, aimed at ensuring price stability in the medium term, while keeping growth on a sustainable path.

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



- - - - - indicates release of Monetary Policy Statement

2. From April to early September 2011, the S$NEER (Chart 1) had generally appreciated and remained within the upper half of the policy band. This reflected the broad-based weakness in the US$ and investor interest in higher-growth economies. However, the S$NEER has since fallen to the lower half of the band, reflecting a pullback in investor risk appetite on concerns over the deepening debt crisis in the Eurozone and softer growth prospects for Asia. The domestic three-month interbank rate eased further after April, but has increased to 0.44% as of early October.

OUTLOOK FOR 2011 AND 2012

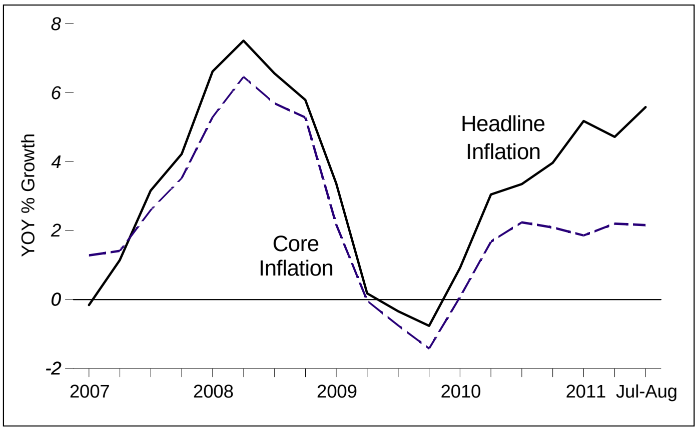
3. The Singapore economy has weakened over the last six months, weighed down by supply-side disruptions arising from the earthquake in Japan and, more recently, by faltering global demand. According to the Advance Estimates released by the Ministry of Trade and Industry today, Singapore's GDP expanded marginally by 1.3% on a quarter-on-quarter seasonally adjusted annualised basis in Q3 2011, following the 6.3% contraction in the preceding quarter. The continued weakness in activity was most evident in electronics-related manufacturing, while sentiment-driven segments of the financial sector were also hit. The biomedical sector however provided support to GDP growth during the quarter.

4. The outlook for the global economy has deteriorated sharply against the backdrop of increased uncertainty in financial markets. The Eurozone economy, faced with an ongoing sovereign debt crisis, will be constrained by fiscal austerity and tightening credit conditions. Private consumption in the US continues to be hampered by the sluggish labour market and anaemic housing prices, while firms remain cautious in their investment spending. With final demand in the advanced economies softening, growth in Asia will slow, notwithstanding some support from domestic demand. At the same time, the global IT industry continues to experience excess supply and could see further correction in output in the coming quarters. Against this backdrop, Singapore's GDP growth in 2011 is expected to be around 5%. With the weak external environment likely to persist, the Singapore economy will expand more slowly in 2012 and growth could be below its potential rate of 3–5%.

5. The MAS measure of core inflation, which excludes private road transport and accommodation costs, stood at 2.2% in Q2 and the first two months of Q3, compared to 1.9% in Q1 2011. Core inflation better reflects underlying price pressures in the economy and is the most relevant among the range of indicators that MAS monitors for monetary policy. The core inflation over the last two quarters reflected higher global commodity prices compared to a year ago, as well as some pass-through of wage increases arising from the tight labour market.

6. Headline CPI inflation rose from 4.7% in Q2 2011 to 5.6% in July–August. This mainly reflected higher COE premiums and the imputed rental cost of owner-occupied housing, which is the largest component of accommodation costs in the CPI.[1/] The core inflation has been significantly lower than headline inflation since the middle of 2010. (Chart 2)

Chart 2
Headline and Core CPI Inflation



7. The ongoing slowdown in domestic economic activity will reduce tightness in the labour market and alleviate price pressures. Inflationary pressures emanating from abroad should also subside. As a result, core inflation should gradually ease from an estimated 2.3% in Q4 this year to 1.5% at the end of 2012. It is forecast to be around 1.5–2% in 2012, compared to about 2.1% in 2011.

8. The strength in rentals due to a temporary shortage of completed dwellings will, however, cause the imputed rental cost of owner-occupied housing to rise further at a fairly strong pace. Private road transport costs may also remain firm in response to the tight COE supply. As a result, headline inflation will be elevated for the rest of this year before easing, especially in the second half of 2012. For the full year, it is expected to come in at around 5% in 2011 and 2.5–3.5% in 2012.

1/ The CPI accommodation series also includes the costs of actual rented accommodation and minor repairs.

MONETARY POLICY

9. Given the stresses and fragility in the advanced economies, the prospects for growth in Singapore's major trading partners have deteriorated. With the slowdown in demand, growth in the Singapore economy could fall below its potential rate of 3–5%. Thus, core inflation should ease next year, although headline inflation could stay elevated in the near term reflecting the higher imputed rental cost of owner-occupied housing.

10. MAS will continue with the policy of a modest and gradual appreciation of the S$NEER policy band in the period ahead. However, given the expected moderation in core inflation, the slope of the policy band will be reduced, with no change to the width of the band and the level at which it is centred.