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## LIST OF ABBREVIATIONS

ACU	Asian Currency Unit
ASEAN	Association of Southeast Asian Nations
BCA	Building and Construction Authority
BEA	US Bureau of Economic Analysis
COE	Certificate of Entitlement
CPF	Central Provident Fund
CPI	consumer price index
CSP	community, social & personal
DBU	Domestic Banking Unit
DLI	Domestic Liquidity Indicator
ECB	European Central Bank
EIA	Energy Information Administration
EPG	Economic Policy Group
EU	European Union
FAO	Food and Agriculture Organisation of the United Nations
FDI	Foreign Direct Investment
FI	Fiscal Impulse
GFCF	Gross fixed capital formation
GST	goods and services tax
HDB	Housing Development Board
IEA	International Energy Agency
IMF	International Monetary Fund
IPI	import price index
IPO	Initial Public Offering
ISM	Institute of Supply Management
IT	information technology
m-o-m	month-on-month
NIEs	newly-industrialised economies
NEER	nominal effective exchange rate
NODX	non-oil domestic exports
OECD	Organisation of Economic Cooperation and Development
OPEC	Organisation of the Petroleum Exporting Countries
PMI	Purchasing Managers' Index
q-o-q	quarter-on-quarter
REER	real effective exchange rate
SAAR	seasonally-adjusted annualised rate
SIBOR	Singapore interbank offered rate
SOR	swap offered rate
WTO	World Trade Organisation
WTI	West Texas Intermediate
y-o-y	year-on-year

# Preface

The *Macroeconomic Review* is published twice a year in conjunction with the release of the MAS Monetary Policy Statement. The *Review* documents the **Economic Policy Group's (EPG)** analysis and assessment of macroeconomic developments in the Singapore economy, and shares with market participants, analysts and the wider public, the basis for the policy decisions conveyed in the Monetary Policy Statement. It also features in-depth studies undertaken by EPG on important economic issues facing Singapore.

The *Review* was edited by Associate Professor Peter Wilson, and continues to feature our collaborations with academics. We are pleased to have Professor Jeffrey Frankel of Harvard Kennedy School write about product price targeting in Special Feature B of this issue.

The data used in the *Review* were drawn from the following government agencies, unless otherwise stated: BCA, CPF Board, DOS, EDB, HDB, IE Singapore, LTA, MOF, MOM, MTI, STB and URA.

The *Review* may be accessed in PDF format on the MAS website: [http://www.mas.gov.sg/publications/macro\\_review/index.html](http://www.mas.gov.sg/publications/macro_review/index.html).

The *Review* may also be purchased at major bookstores, online (<http://asp.marketasia.com.sg/Spore/sporeindex.asp>), or on an annual subscription basis (details can be found on the last page).

# Highlights

Since the last *Review*, global economic growth has slowed further—the soft patch witnessed in the early part of 2011 persisted into the second half of the year, although growth patterns were divergent across regions. In the Eurozone, sovereign debt worries precipitated a region-wide economic contraction, while growth in Asia-ex Japan slipped on faltering external demand and disruptions to supply chain networks. Resilient domestic demand, however, buffered the impact on most ASEAN economies. The US economy also continued to recover, with sustained consumer spending providing a lift to growth. In line with the general pullback in external demand, the Singapore economy experienced a further consolidation in trade-related activities in the second half of 2011, with the manufacturing sector bearing the brunt of the slowdown. However, underlying support from domestic and regional-oriented services partly offset the contraction, resulting in a relatively mild decline in overall GDP growth compared to previous downturns.

Chapter 1 begins with an overview of recent developments in both the external environment and domestic economy. It also contains a section that traces the evolution of Singapore’s trade balance over the last decade from an expenditure perspective, examining the consumption, production and capital goods components in greater detail. Notably, Singapore’s trade balance has been fairly robust over the last decade. In particular, the surplus in the production balance has increased, underpinned by a shift towards higher value added production in the pharmaceutical and petrochemical industries. Moreover, exports of capital goods have surged over the past two years, underlining Singapore’s rising prominence as a global and regional manufacturing hub in areas such as precision engineering and aircraft components.

Chapter 2 looks at recent trends in the labour market and prices. In 2011, overall job creation remained strong but was unevenly distributed between the domestic and export-oriented sectors. While the construction and services sectors both enjoyed robust employment gains, the manufacturing sector saw retrenchments towards the turn of the year. The confluence of a mild economic downturn amid a still-tight labour market caused both wage growth and productivity to moderate, with the former exerting some restraint on the increase in unit labour costs. Nevertheless, consumer price inflation remained persistent as the pass-through of earlier cost increases picked up, even as domestic demand conditions held firm. Meanwhile, imported inflation came in slightly stronger than anticipated, stemming from some temporary weakness in the exchange rate towards end-2011, as well as increasing oil prices arising from ongoing geopolitical events.

Chapter 3 focuses on the outlook for the external and domestic economies, against the backdrop of receding tail risks and a tentative improvement in the near-term prospects for the US. The global economy is expected to resume a steady, though sub-par growth path in 2012, as a result of continuing headwinds arising from public and private sector deleveraging in the advanced countries. As such, Singapore is likely to experience a modest expansion of 1–3% this year, with significant upsides capped by lingering uncertainties in the global economy. In particular, trade-related activities could see a slower upturn, compared with the more sanguine prospects for the domestic-oriented sectors. At the same time, domestic supply constraints are likely to remain tight and geopolitical tensions will keep global oil prices elevated. Together, these factors will support further increases in domestic costs and prices, though the pace will ease from the high seen earlier this year as the output gap narrows and stabilises.

Looking further into the medium-term, the resource constraints faced by Singapore will become increasingly binding, and the economy would need to rely less on labour force expansion and more on productivity improvements for growth. In Chapter 3, the different phases of these supply-side induced adjustments are discussed. Taking into account this ongoing medium-term restructuring as well as cyclical developments in the economy, the macroeconomic policy stance was kept on a broadly tightening bias. The tighter monetary policy stance is expected to temper, but not fully offset, the pass-through of

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supply-side cost increases, while the FY2012 Budget focused on medium-term initiatives aimed at building the long-term capacity of the economy, strengthening the structure of social support, and alleviating frictional costs during the economy's transition.

Heightened activity in the local stock and property markets in recent years has raised questions about the wealth effects of these assets on consumer expenditure, as seen in other countries such as the US, UK and Australia. In Box A, we take a new approach to this issue in Singapore using a robust time-series econometric approach that captures both the short-run and long-run effects of asset price changes, as well as asymmetries in the behaviour of these asset prices. We find that neither stock nor property prices have a significant impact on consumer expenditure in Singapore in the short term, and these results are consistent across both quarterly and monthly frequencies.

To complete this *Review*, we highlight two special features centred on global economic issues, which are particularly relevant for open economies. Special Feature A considers how the evolution of China's wage and productivity dynamics has affected global inflation outcomes over the last decade, by analysing the pass-through of its labour costs to import prices in Hong Kong and Singapore. The results suggest that strong wage growth in China has indeed had a significant impact on the import prices of the two major trading centres, after controlling for the robust productivity gains in the manufacturing sector. The implication is that if China's labour costs continue to rise and the Lewisian turning point is reached, whereby the supply of rural labour declines significantly, then importing countries could face higher costs than in the past, in the absence of appropriate monetary policy responses.

Finally, this *Review* ends with a Special Feature by Professor Jeffrey Frankel of the Harvard Kennedy School entitled, "Product Price Targeting—A New Improved Way of Inflation Targeting". In this timely conceptual piece, Professor Frankel proposes Product Price Targeting (PPT) as an alternative approach to conventional inflation targeting which uses a broad output-based price index as the anchor for monetary policy. PPT has the advantage of being robust with respect to terms-of-trade shocks and is, therefore, appropriately designed for countries where these shocks are a source of macroeconomic instability, particularly those that specialise in the export of oil and gas, copper, and coffee.

The next issue of the *Review* will be released in October 2012.

Economic Policy Group  
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