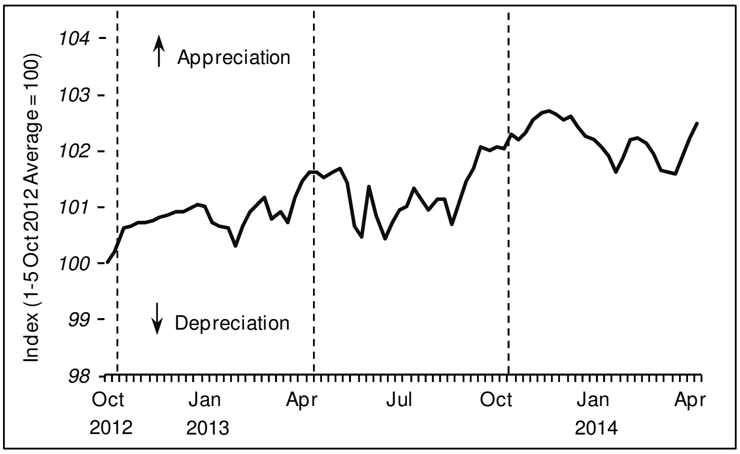
14 April 2014

Monetary Policy Statement

INTRODUCTION

1. In October 2013, MAS maintained the 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, taking into account the balance of risks between external demand uncertainties and rising domestic inflationary pressures.

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



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2. Over the last six months, the S$NEER generally eased towards the mid-point of the policy band. The S$NEER initially appreciated over October and November on account of the decline in major currencies, which in turn reflected the fiscal impasse in the US and expectations of further quantitative easing in Japan. However, it weakened following the announcement that the US Federal Reserve would begin to taper its asset purchase program. Geo-political events and the slowdown in China's growth also added to the downward pressure on the S$NEER. More recently, the exchange rate has strengthened slightly. Throughout the period, global liquidity conditions remained highly accommodative. The three-month S$ SIBOR was stable at around 0.40%, while the three-month US$ LIBOR averaged 0.24%.

OUTLOOK FOR 2014

3. The Singapore economy is expected to grow at a moderate pace in 2014, supported by the cyclical uplift in the industrialised economies. Notwithstanding the weak growth outturn in Q1, the level of economic activity should stay on a broad upward trajectory for the rest of the year. At the same time, CPI-All Items inflation and MAS Core Inflation are expected to pick up in the coming months

after easing recently. The latter will be elevated as firms continue to pass on accumulated cost increases to consumer prices. The labour market is projected to remain tight.

Growth

4. According to the *Advance Estimates* released by the Ministry of Trade and Industry today, Singapore's GDP rose by a modest 0.1% in Q1 2014 on a quarter-on-quarter seasonally-adjusted annualised basis, following the 6.1% expansion in Q4. Growth in manufacturing and trade-related activities eased, as inclement weather in the US dampened demand for Singapore's exports. The financial services industry expanded at a slower pace, in part due to negative global market sentiments as the US Federal Reserve commenced the tapering of its asset purchase program. In comparison, growth in the domestic-oriented sectors, including construction, remained firm.

5. The outlook for the global economy has brightened, anchored by improving prospects in the G3 as a whole. In the US, the recovery in the labour market will continue to support consumer spending, which should bring about some pickup in corporate capital expenditure, including in business IT upgrading. The Eurozone is forecast to emerge from two consecutive years of economic contraction, as fiscal drags and financial conditions ease. Together with a mild turnaround in the global IT industry, these developments will buttress growth in Asia ex-Japan, even as domestic demand in the ASEAN economies softens and China's GDP growth slows amid its ongoing structural reforms.

6. Against this backdrop, Singapore's trade-related sectors should grow at a moderate pace. Domestic-oriented activities are expected to stay resilient, supported by construction of transportation, housing and social infrastructure. Nevertheless, overall growth will be capped by supply-side constraints, particularly in the labour market. The Singapore economy is projected to expand by 2–4% in 2014, although the growth profile could be uneven. The unemployment rate is likely to remain low.

Inflation

7. MAS Core Inflation, which excludes private road transport and accommodation costs, picked up to average 2.0% y-o-y between October 2013 and February 2014 from 1.6% in the first nine months of 2013. This was predominantly due to a more significant pass-through of wages and other business costs. Import prices in domestic currency terms also increased slightly in recent months, notwithstanding subdued external price pressures. Meanwhile, CPI-All Items inflation moderated, averaging 1.6% since October 2013 compared to 2.5% in January–September 2013, as car prices declined and imputed rentals on owner-occupied accommodation rose at a slower pace.

8. For the rest of the year, external price developments should be benign, given the ample supply buffers in major commodity markets and modest inflation in most of Singapore's key import source countries. Domestic cost pressures, particularly stemming from a tight labour market, are likely to remain the primary source of inflation. Firms are expected to continue to pass on accumulated costs, which could lead to broad-based price increases across the economy. Accordingly, sequential core price increases this year should be slightly higher than the historical average. On a year-ago basis, MAS Core Inflation is expected to average 2–3% in 2014, up from 1.7% in 2013.

9. CPI-All Items inflation will rise in the coming months due to the low base a year ago when COE premiums fell, but it should ease in the second half of 2014. For the whole year, car prices should add negligibly to inflation. Amid the large supply of newly-completed housing units, imputed rentals on owner-occupied accommodation are now expected to stabilise in 2014. MAS is revising the forecast for CPI-All Items inflation in 2014 from 2–3% to 1.5–2.5%, mainly reflecting this weaker outlook for imputed rentals over the rest of the year.

MONETARY POLICY

10. Barring a significant shock in the external environment, the Singapore economy should expand at a moderate pace over the course of the year. Wage pressures will persist and firms are likely to pass on business costs to consumer prices. Consequently, MAS Core Inflation is expected to stay elevated.

11. MAS will therefore maintain its policy of a modest and gradual appreciation of the S$NEER policy band. There will be no change to the slope of the policy band, and the level at which it is centred. The width of the band will be kept unchanged. The policy stance is assessed to be appropriate for containing domestic and imported sources of inflation, and ensuring medium-term price stability as a basis for sustainable growth. MAS will continue to be vigilant over developments in the external environment, including in financial markets, and stands ready to curb excessive volatility in the S$NEER.