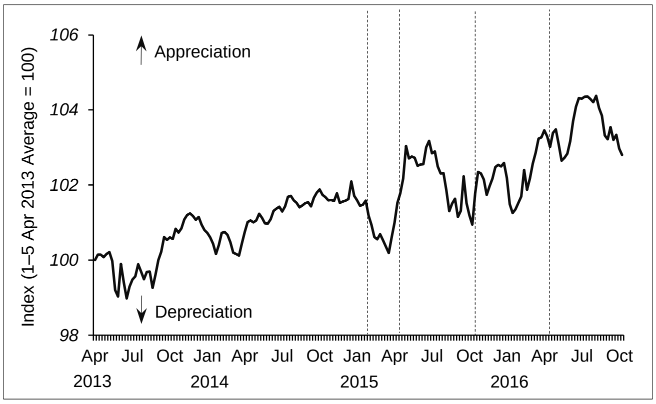
14 October 2016

Monetary Policy Statement

INTRODUCTION

1. In April 2016, MAS reduced the slope of the Singapore dollar nominal effective exchange rate (S$NEER) policy band to zero percent. There was no change to the width of the policy band or the level at which it was centred. This policy stance was assessed to be appropriate given the more modest outlook for economic growth in 2016 as well as the expectation that MAS Core Inflation would average slightly below 2% in the medium term.

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



indicates release of Monetary Policy Statement

2. Since April 2016, the S$NEER has fluctuated mainly in the upper half of the policy band, reflecting weakness in some regional currencies, as well as the Pound Sterling. The S$NEER peaked in early August, and has more recently depreciated towards the mid-point of the policy band. The average level of the S$NEER over the last six months has been higher than that in the six months prior to April, notwithstanding the 0% slope in the S$NEER policy band.

3. The three-month S$ SIBOR declined from 1.01% as at end-April 2016 to 0.87% as at end-September 2016.

OUTLOOK

4. The Singapore economy is projected to grow at a slower pace in 2016 than envisaged in the April policy review. GDP growth is on current indications not expected to pick up significantly in 2017, reflecting weak global demand and the cyclical as well as structural factors weighing on Singapore's exports. MAS Core Inflation will rise modestly from around 1% this year to average 1–2% in 2017, amid

emerging slack in the labour market and generally subdued consumer sentiment. Over the medium term, core inflation is expected to trend slightly below 2% on average.

Growth

5. According to the *Advance Estimates* released by the Ministry of Trade and Industry today, the Singapore economy contracted by 4.1% on a quarter-on-quarter seasonally adjusted annualised basis in Q3 2016, following the marginal 0.2% expansion in Q2. The decline was concentrated in the manufacturing sector, reflecting sluggish external conditions. In line with the slump in trade flows, performance in the transport & storage sector was also lacklustre, with a contraction in the average volume of sea cargo handled in Jul–Aug, compared with Q2. However, there were partial offsets from other growing areas in the economy, including tourism-related activities and public infrastructure construction.

6. The outlook for the global economy has not changed materially since the April review, with only modest growth expected on the back of resilient domestic demand in the G3 and the region. However, there is a continuing shift in the composition of demand towards less import-intensive consumption spending, and as a consequence, global trade in 2016 and 2017 is projected to grow more slowly than previously expected. The global investment cycle has yet to show signs of an upswing, and this will continue to weigh on the region's exports into 2017.

7. Against this external backdrop, Singapore's trade-related sectors will continue to pose a drag on GDP growth in the quarters ahead. At the same time, the transport engineering and selected precision engineering clusters within manufacturing will be hampered further by weak demand for oil exploration and production equipment. Sea transport services will remain affected by the slowdown in trade within Asia. In the domestic economy, softening economic sentiment and emerging slack in the labour market will weigh on the retail trade and real estate segments. In comparison, modern services, such as information & communications, and selected domestic-oriented sectors should continue to provide support to the economy, underpinned by government spending and robust demand for healthcare and education services.

8. Overall, growth in the Singapore economy is projected to take a step-down in H2 2016 from the 2.0% recorded in H1, and full-year GDP growth is likely to come in at the lower end of the 1–2% forecast range. Growth is expected to be only slightly higher in 2017.

Inflation

9. MAS Core Inflation, which excludes the costs of private road transport and accommodation, rose to 1.0% y-o-y in July–August 2016 from 0.7% in H1, as the temporary disinflationary effects from lower oil prices and Budgetary and other one-off measures dissipated. Meanwhile, CPI-All Items inflation picked up to −0.5% y-o-y in July–August compared to −0.9% in H1, largely due to the smaller contraction in private road transport cost.

10. On the external front, imported inflation is likely to rise mildly given ample supply buffers in the commodity markets and soft global demand conditions. Notwithstanding continued short-term volatility, global oil prices are expected to increase next year from its trough in 2016. Domestically, overall cost pressures should be muted, in line with emerging slack in the economy. Amid a pullback in hiring, conditions in the labour market have slackened. This will cap underlying wage growth, even as

non-labour business costs have eased. Moderate price increases for some consumer services including healthcare and education are expected, but the subdued growth environment will constrain the extent of cost pass-through. Although MAS Core Inflation is projected to rise from around 1% in 2016 to 1–2% in 2017, the ascent will be gradual.

11. The cost of private road transport is projected to rise in 2017, reflecting the combined impact of administrative price increases[1], higher petrol prices, and an expected tapering of supply of COEs. In comparison, amid subdued demand conditions and the elevated residential property vacancy rate, housing rentals could decline further, albeit at a slower pace than this year. All in, CPI-All Items inflation has troughed and is expected to come in at 0.5–1.5% in 2017, from around −0.5% this year.

MONETARY POLICY

12. Growth in the Singapore economy has weakened and is not expected to pick up significantly in 2017. MAS Core Inflation will rise only gradually next year. Over the medium term, core inflation is still expected to trend towards but average slightly below 2%.

13. MAS will therefore maintain the rate of appreciation of the S$NEER policy band at zero percent. The width of the policy band and the level at which it is centred will be unchanged.

14. MAS assesses that a neutral policy stance will be needed for an extended period to ensure medium-term price stability. The current policy band provides some flexibility for the S$NEER to accommodate the near-term weakness in inflation and growth. MAS will continue to closely monitor economic developments as they evolve over the coming months.

1 These include the expiry of the one-year road tax rebate for petrol vehicles, as well as the upward revision of car park charges by HDB and URA with effect from 1 December 2016.