Regional Macro

# Singapore: Inflationary pressures persist

Phillip Research Team

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Phillip Securities Research Pte Ltd

2011 Real GDP / Inflation: 4.9% / 5.2%

2012(f) Real GDP / Inflation: 2.5% / 3.5%

**Odds of a technical recession have receded on firmer exports and manufacturing data. Specifically, non-oil domestic exports have showed signs of a broad-based recovery in both electronic and non-electronic shipments. Manufacturing output has picked up and electronics production is on track for a tepid recovery.**

**While risks to growth remain, domestic inflationary pressures persist. Thus, we expect MAS to maintain its current policy of a modest and gradual appreciation of the S$ nominal effective exchange rate (NEER) at the upcoming MAS Monetary Policy Statement in April.**

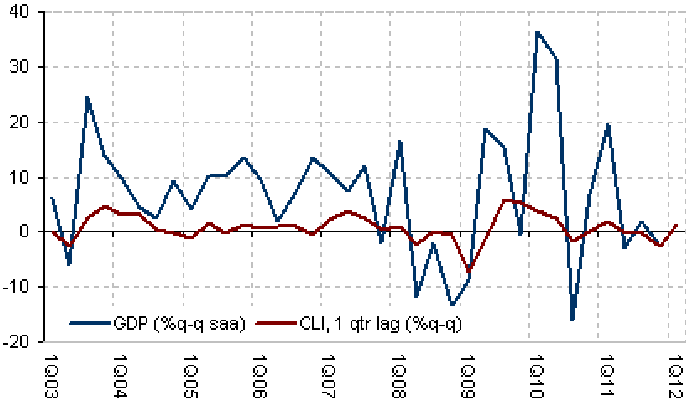
**A tight monetary policy stance, against the backdrop of sluggish global macroeconomic environment, is unlikely to be conducive for growth as well as equity markets.**

## Economic Growth

Despite contracting by 2.5% on a quarter-on-quarter seasonally-adjusted annualised basis (q-q saa) in 4Q11, the odds of a technical recession in 1Q12 have reduced on account of the following factors.

- First, forward-looking indicators suggest that economic growth is likely to pick up on a sequential basis. In 4Q11, the composite leading index (CLI) rose slightly by 1.2% on a q-q basis, suggesting that GDP ex-biomedical manufacturing sector (ex-BMS) is likely to rise in 1Q12 (Fig 1). Singapore manufacturing PMI also rose for the second consecutive month as new export orders continued to improve. This bodes well for manufacturing (ex-BMS) production in the near term. Biomedicals manufacturing output is expected to remain healthy due to increased production of active pharmaceutical ingredients in 1Q12, according to EDB's January Survey of Business Expectations of the Manufacturing Sector.

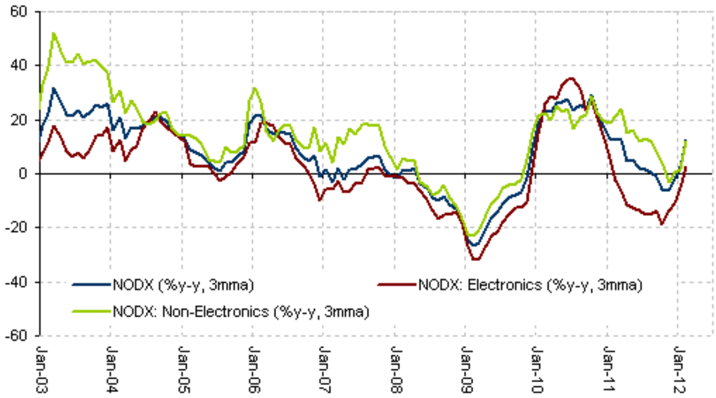
**Fig 1. CLI points to a sequential rebound.**




Source: CEIC, PSR est.

- Second, non-oil domestic exports have showed signs of a strong and broad-based recovery (Fig 2). In February, non-oil domestic exports (NODX) rebounded by 30% year-on-year (y-y), reversing from the mild decline of 2.4% in the preceding month on the back of broad-based recovery in electronic and non-electronic shipments. Though the strength in February's exports could be partly attributed to the Lunar New Year effect, non-oil domestic exports (for January and February combined) still expanded by 13% y-y.

**Fig 2. Recovery in exports was broad-based.**

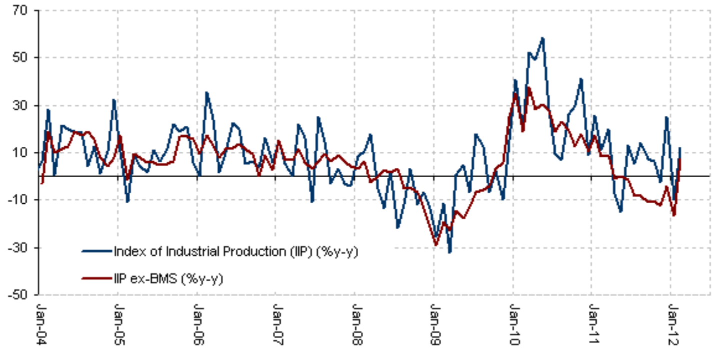



Source: CEIC, PSR est.

- Third, industrial production (particularly electronics) is on track for a tepid recovery. Singapore's manufacturing output expanded by 12% y-y in February 2012, reversing from the contraction of 9.6% in the preceding month. Excluding the biomedical manufacturing, overall manufacturing output increased 7.1% in February (Fig 3).

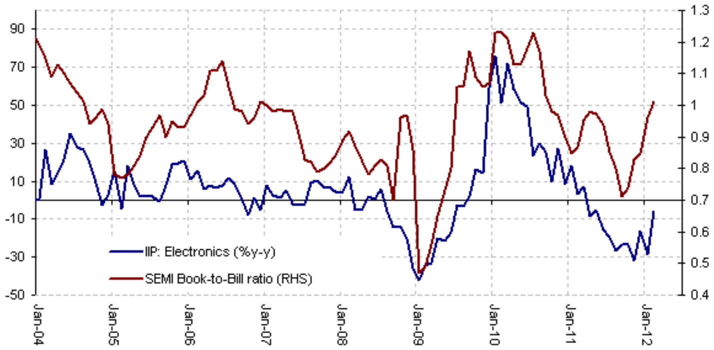
  Electronics output -which accounts for around a third of total manufacturing output- posted a milder decline (6.0%) relative to the preceding month (29%). This was due to a surge in the data storage segment's output (79%) on the back of strong demand in the wake of last year's Thailand floods which disrupted hard disk drive production. Looking ahead, production in the electronics cluster should pick up on account of the following: (i) While weakness in the semiconductors segment persist, memory and contract chipmakers globally have increased spending on advanced process technologies, resulting in the SEMI book-to-bill ratio to rise above parity for the first time in 17 months in February. This bodes well for the semiconductor segment, with positive spillovers to the precision engineering cluster. (ii) Singapore electronics PMI continued to improve and remain in expansionary territory for the third consecutive month in March on the back of increased domestic and external orders. (iii) Firmer global demand, along with the decline in electronics inventories in Singapore, should continue to boost output (Fig 4).

**Fig 3. Manufacturing on track for a tepid recovery.**




Source: CEIC, PSR est.

**Fig 4. Electronics production in Singapore might be bottoming.**




Source: CEIC, PSR est.

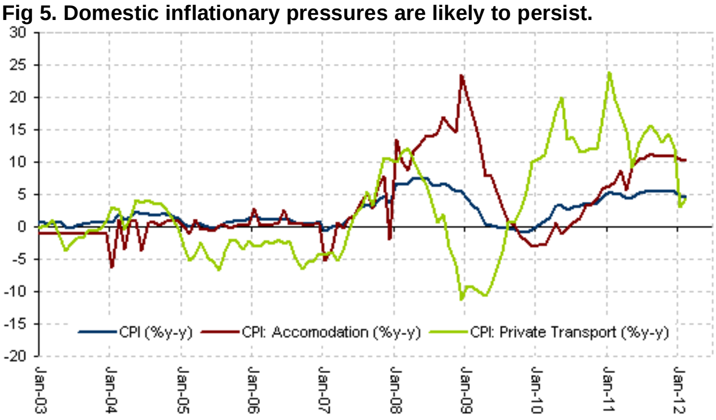
**For the whole of 2012, we expect real GDP to moderate to around 2.5%, down from 4.9% in the preceding year.** Trade-related sectors are likely to face headwinds from weaker external demand in a muted global macroeconomic environment, despite tentative signs of a pick-up in the US economy as well as (brief) stabilisation of the EU sovereign debt crisis. Furthermore, supply constraints could weigh on growth. Specifically, small medium enterprises and construction firms are likely to be adversely affected by the tightening of foreign worker policies as the Singapore economy restructures in a bid to achieve productivity-led growth. Downside risks to growth -emanating from (i) the prospect of a sharp spike in oil prices from geopolitical tensions in the Middle East as well as (ii) an escalation of the eurozone sovereign debt crisis- persist.

## Inflation

Headline inflation for the whole of 2012 is likely to come in at 3.5% (the upper end of the government's inflation forecast range) after having risen by 4.7% y-y for the first 2 months of this year (Fig 5). Looking ahead, inflation is expected to remain elevated in 1H12, before moderating gradually in 2H12, partly on high base effects. Our inflation outlook takes into account the following factors.

- First, wage pressures -arising from higher foreign worker levies as well as a reduction in the Dependency Ratio Ceilings- could pass through to consumer prices.
- Second, accommodation cost will remain elevated (at least in the near term) in view of the tight housing market. In Jan-Feb, accommodation cost -which accounted for around 20% weight in the CPI basket- grew by 10% y-y, almost similar to growth of 11% in 4Q11.
- Third, private road transport cost pressures will persist on the back of tight COE supply. In Jan-Feb, private road transport cost -which accounted for 12% weight in the CPI basket- eased from 13% in 4Q11 to 3.7%. However, this moderation should been viewed in the light of a correction in COE premiums as well as car prices alongside weaker demand during the December school holidays.

**Fig 5. Domestic inflationary pressures are likely to persist.**




Source: CEIC, PSR est.

An appreciation of the Singapore dollar might be effective in (i) moderating imported costs of food and energy and (ii) dampening external demand. **However, a stronger Singapore dollar still might not be able to fully mitigate domestic drivers of inflation.**

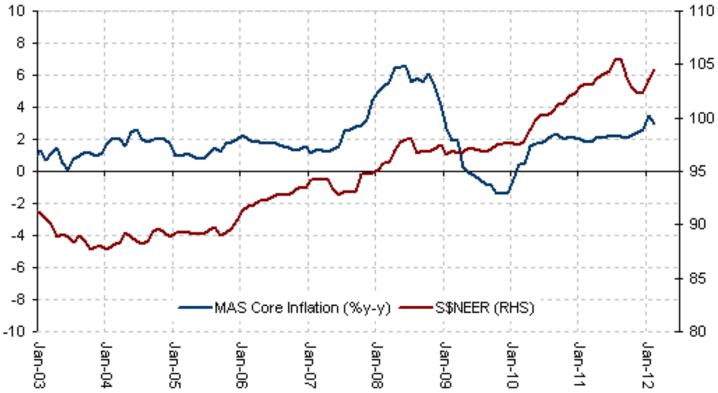
In view of rising wage pressures, we expect MAS core inflation -which excludes private road transport and accommodation costs- to register 2.0%, also at the upper end of the government's forecast range after registering 3.2% for Jan-Feb. Nonetheless, should domestic and external cost pressures continue to rise, inflation data could still surprise on the upside.

## Exchange Rate

At the upcoming MAS Monetary Policy Statement (MPS) in April 2012, we expect MAS to **maintain its current policy of a modest and gradual appreciation of the S$ nominal effective exchange rate (NEER)**. Since Oct 2011 (the previous MPS), global economic prospects have brightened -marginally- on the back of an incipient economic recovery in the US and tentative stabilisation of the sovereign debt crisis in the EU. However, the economic outlook is fraught with uncertainties arising from (i) sovereign debt crisis in the EU, (ii) geopolitical tensions in the Middle East and (iii) fiscal issues in the US. On the inflation front, headline and core inflation is likely to come in around the upper end of the official inflation forecast. Furthermore, there are upside risks to inflation from rising oil prices if the situation in the Middle East continues to deteriorate. On balance, the government might accept slower growth in 2012 (as medium-term growth is still consistent with potential) but will maintain **a modest and gradual appreciation of the S$ NEER** to ensure price stability in the medium term (Fig 6).

Still, we caution that there is a small likelihood -though not our baseline scenario- that MAS might tighten pre-emptively in April MPS to anchor inflation expectations against the backdrop of a tight labour market as well as elevated energy prices.

**Fig 6. Inflationary risks -especially core inflation- warrant a stronger Singapore dollar.**




Source: CEIC, BIS, PSR est.

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