ECONOMIC SURVEY OF SINGAPORE (2010)

Key Messages

1 Good morning, welcome back to MTI. Today, we will discuss the growth and inflation outlook for 2011 and we will announce the results for 2010 as a whole.

2 Let us begin with **recent economic developments**. Latest data now show that the recession in 2009 was shallower than earlier estimated. Real GDP contracted by **0.8 per cent** in 2009, compared to the earlier estimate of a 1.3 per cent decline.

3 This makes the strong rebound in 2010, at **14.5 per cent**, even more remarkable.

GDP Outlook for 2011

4 For 2011, we expect GDP growth to moderate to around **4 to 6 per cent**. This is obviously slower than the record pace in 2010 but still above our medium-term potential. It is unchanged from our forecast three months ago, as the key considerations we had then remain relevant.

5 First, the **global economy** remains on a path of recovery, powered by Asia but with the G-3 also contributing to growth.

6 The **US** economy will continue to grow. Three sources of support for the US economy:

a. <u>One</u>, fiscal policy. The extension of the Bush tax cuts has removed a key source of uncertainty, and led to increased fiscal support going into 2011. In fact, the US will be the only major advanced economy with a positive fiscal impulse this year.

b. <u>Second</u>, monetary policy. The Federal Reserve has signalled continued commitment to reducing unemployment, even beyond the scheduled expiry of the quantitative easing measures in the middle of the year.

c. <u>Third</u>, private final demand has finally shown signs of improvement in recent months. Consumers will spend more, reflecting both pent-up demand and the wealth effects from increases in equity prices. Business spending will continue to increase, as firms broaden their investments beyond information technology to industrial equipment and commercial real estate.

d. But while US growth will be positive, its pace will be modest.

- The labour market is still weak: unemployment remains high at **9 per cent**. Nearly 14 million Americans are out of work.
- The housing market remains sluggish in the US: Home prices are still around **30 per cent** below pre-crisis peaks.

7 In the **European Union**, we also expect cyclical recovery to continue. But the pace will be even slower than in the US.

a. Buoyant export demand, from the US and emerging Asia, has benefitted the EU, especially the larger European economies, especially Germany.

b. But the recovery in domestic demand remains modest. Fiscal policy is likely to be tighter in Europe and structural weaknesses in labour markets will constrain employment growth.

8 In **Asia**, however, growth is expected to remain robust.

a. The manufacturing Purchasing Managers' Index (PMI) for regional economies continues to be in expansionary mode. This points to continued growth in manufacturing output in the near-term.

b. Domestic consumption in Asia will be buoyant, especially in China where employment is healthy and incomes are rising rapidly.

c. Business investment in China will continue to grow, underpinned by rising corporate profitability and improving balance sheets. China's import demand will be strong in 2011, benefitting regional manufacturers.

d. Buoyant demand conditions in the region will in turn underpin strong intra-regional trade flows. This will benefit our wholesale trade sector.

e. Rising affluence in the region bodes well for our financial services sector.

9 Reflecting favourable external demand environment, we expect the Singapore economy to grow at **4 to 6** per cent, in 2011. This is above our medium-term trend rate of growth of 3 to 5 per cent.

10 In fact, there is some upside potential to this 4 to 6 per cent range:

a. New plant facilities are expected to commence operations in the electronics and BMS clusters. , the scale of which is uncertain at this point, We have therefore put in a conservative growth estimate for these sectors.

b. Second, the sentiment-sensitive segments within financial services, such as trading activities, could do better than currently envisaged.

11 The positive economic outlook is not without **downside risks** to growth.

12 First, sovereign debt concerns in the peripheral EU economies persist, even though market volatility appears to have stabilised compared to three months ago.

a. Given the sluggishness in the real economy, any fresh financial sector vulnerabilities could dampen growth significantly.

13 Second, inflationary pressures have emerged in Asia, due to rising global commodity prices and growing demand induced by income and credit expansion.

a. The regional economies have stepped up tightening measures to keep inflation in check. More tightening could follow if cost pressures continue to build up.

b. If the tightening measures are not well calibrated, there could be sharper reduction in regional growth than we expect.

Emerging Cost Pressures

14 The key macroeconomic challenge this year will not be growth but dealing with emerging cost pressures. External demand is strong and the economy is growing faster than its underlying potential. Cost pressures will increase as supply-side constraints become binding.

15 The main constraint is labour.

a. The overall unemployment rate, at **2.2 per cent**, is low, compared to historical average of **2.9 per cent**.

b. The share of vacancies unfilled after six months is high, especially for sectors such as hotels and restaurants, and financial services.

c. At the same time, foreign employment cannot increase as much as it did pre-crisis.

d. We can expect, therefore, some upward pressure on wages in the near-term. Nominal wages, which rose by **5 per cent** in 2010, are likely to continue increasing in 2011.

16 But 2011 is unlikely to be a repeat of 2007/2008, when the economy faced the risk of more generalised overheating. While cost pressures are building up, we are not looking at an over-heating economy.

a. One, the labour market is not as tight as it was in 2007/2008, when unemployment hit a 10-year low of **1.7 per cent**.

b. Two, the gap between aggregate demand and supply capacity of economy is not as large as it was in 2007/2008. The resources available to support economic activities are not as stretched as it was in 2007/2008.

c. Three, monetary policy has been pre-emptive, with the exchange rate on an appreciating trend which will help to cool down the economy.

d. Four, rental costs are not expected to rise significantly this time around. There is a healthy supply of commercial and industrial space coming onto the market this year and next year. In fact, we are already beginning to see an increase in office rentals beginning to moderate.

e. Five, unlike 2007 when there was a construction boom, this time, growth in construction demand is moderate. Furthermore, despite increases in global commodity prices, prices of key construction materials such as steel bars are still less than half the peak levels seen in 2007/2008.

17 In short, while we expect some build-up of cost pressures this year, the situation will not be as acute as in 2007/2008.

18 I will now hand over to the Deputy MD of MAS, Mr Ong, who will present the outlook for consumer price inflation in 2011.

Inflation Outlook for 2011 (MAS)

19 Let me follow on from the Permanent Secretary's remarks to talk about the inflation outlook for 2011. Headline CPI inflation, when we looked at it a year ago, rose from 3.4 per cent in the third quarter of 2010 to 4.0 per cent in Q4 last year. Some of you may recall, even in past media briefings like this, we had mentioned about year-end CPI edging up close to 4 per cent. It averaged 2.8 per cent for the whole of 2010, in line with MAS' projection. Inflation in Q4 of 2010 was driven by higher costs of private road transport and accommodation. Into this year, 2011, these two factors, along with higher food prices around the festive Chinese New Year period, will push up headline inflation to 5 to 6 per cent in the first few months of this year. Thereafter, we expect headline inflation to moderate, especially in the second half of the year, as the base effects dissipate.

20 For the full year of 2011, CPI inflation is projected to average between 3 to 4 per cent, up from an earlier forecast of 2 to 3 per cent. This will be driven by four factors, each accounting for roughly about a quarter of the headline number.

a. <u>Firstly</u>, the surge in COE premiums in recent months will result in private road transport contributing significantly to headline inflation in the early part of this year. However, a lower demand for cars will cap further sharp rises in car prices.

b. <u>Second</u>, residential property rentals have risen sharply since the Q3 of 2010 and will continue to have an impact on headline inflation in the first half of 2011. As alluded to by PS, the tighter housing market situation, however, should ease in the second half of 2011 as more supply comes onstream.

c. <u>Thirdly</u>, the recent spike in prices of some food commodities is likely to feed into domestic food prices in the short term. Barring further supply shocks, global oil prices are also likely to rise moderately in line with the gradual global economic recovery, from about US$90 per barrel now to around US$100 or so towards the end of the year.

d. Finally, services inflation will have a larger impact on CPI inflation compared to last year. This largely reflects the strong wage pressures amidst the tight labour market.

21 Nonetheless, MAS' assessment of underlying price and cost pressures is largely the same as that in the previous policy review which took into account price increases alongside the strong rebound and continued growth of the economy. The one percentage-point rise in the headline inflation forecast is mainly due to the higher cost of cars and accommodation. Reflecting this, the forecast of MAS core inflation rate[1], which some of you may recall, exclude the cost of private road transport and accommodation, which have a more administrative policy dimension. So the MAS core inflation rate, which is designed to capture the persistent trend rate of inflation in the economy, remains at 2 to 3 per cent.

22 As monetary policy works with some lag, the previous pre-emptive policy moves in April and October last year will continue to have a restraining effect on growth and inflation over the course of this year. At this stage, there is no need to revise the monetary policy stance that was announced last October. The MAS will continue to monitor price and cost developments in the economy closely, and remains focused on supporting non-inflationary economic growth over the medium-term. The next scheduled monetary policy announcement will be in April this year.

Conclusion

23 To sum up, the pace of economic growth will moderate in 2011, but is expected to remain healthy at **4.0 to 6.0** per cent. 2011 will be different from previous years. Growth will be healthy but will be nowhere near as spectacular as it was in 2010 when the economy was rebounding from a recession. There are risks on the horizon, especially in Europe, but we are not facing the prospect of a global economic crisis as in 2009. We are growing above the economy's underlying potential. This means there will be a build-up in cost pressures, especially in the labour market, but we expect them to be more contained than in 2007/2008. On the whole, a good year for growth but we need to be vigilant of cost pressures.

[1] The MAS core inflation measure excludes the cost of private road transport and accommodation.