

## **(2) DEALING WITH INFLATION**

### ***Global Outlook***

2.1 Inflation is the other major uncertainty in the global economy, and a concern for us. After a period of very low inflation over the last 10 years, it has re-emerged and is now an economic problem everywhere in the world.<sup>1</sup>

2.2 Oil prices have risen by 50% over the last year. Raw food prices at the end of January 2008 had risen by 55% globally, compared to a year ago. Commodity prices in general have risen by 31%.<sup>2</sup> All these increases in raw material prices have cascaded down into higher transport costs, more expensive manufactured goods, and costlier consumer foods.

2.3 The basic factors which have led to these price increases are not expected to go away soon. The demand for food especially has continued to rise globally, especially with the rapid growth of the middle classes in China and India. This is part and parcel of expanding global prosperity, but it is happening at a time when food supply is constrained because of bad weather, and more agricultural land is converted from producing food crops to producing bio-fuels.

2.4 We therefore have to brace ourselves for a period of relatively higher inflation globally, which will affect the prices of the goods we import. We cannot say how long it will last, but we have to expect that it will remain high, in the first half of this year especially. For example, China's worst winter in 50 years will likely add pressure to prices of certain foods in the next six months.

## ***Inflation in Singapore***

2.5 Singapore has already been affected by this recent rise in global inflation. Inflation was about 2% for 2007 as a whole, but it was much higher towards the end of the year than it was at the start. Consumer price inflation reached 4.4% for December 2007. Overall, we currently expect inflation at 4.5% to 5.5% in 2008, but with inflation being higher in the first half of the year than the second.

2.6 The relatively high 'headline' Consumer Price Index (CPI) numbers that we are now seeing, like in December, are partly due to the GST increase in July last year. The CPI inflation figure continues to show the impact of the GST change, because it is comparing prices this month with prices twelve months ago, i.e. before the GST increase in July 2007. But if we compare prices today with prices say in September last year, there has been little further increase due to the GST change. The GST change has caused only a one-off increase in prices, and not continuing price increases.

2.7 Singaporeans have also not been materially affected by the GST increase, because the Government has provided the majority of citizens with substantial offsets, which more than make up for the increased spending on GST by most families. Lower-income families are in fact receiving offsets which are several times larger than their higher GST payments. (Excluding the impact of the GST increase, which has been fully compensated for, December 2007 CPI inflation is estimated at slightly less than 3.0%.)

2.8 There is also a technical reason, due to the rising values of homes, that is leading to high headline CPI numbers. The increase in the assessed Annual Values of homes will contribute significantly to inflation this year [*more than 1.0% of the expected 4.5% to 5.5% inflation*]. However, here too, most Singaporeans are not materially affected, as 95% of citizens own their own homes and do not pay rentals.

2.9 Nevertheless, even if we exclude this technical factor due to home values, and the one-off effect of the GST increase, inflation today is higher than what we have been used to in Singapore for many years.

## ***Our Strategies***

2.10 The rising cost of living that Singaporeans face is a major concern for the Government. Prices of certain essential items like cooking oil, bread, milk and other dairy products have gone up significantly over the past year.

2.11 We must start by recognising that the key problem we face going forward is that of imported inflation caused by high global prices, especially of food and oil. Some of our inflation does reflect domestic factors. I have just mentioned the GST increase, which has been compensated for, and the Annual Values of homes, which have no material impact on Singaporeans. The rapid growth of our economy has also pushed up wages and rental costs. However, our CPI inflation is not due to domestic inflationary expectations, causing wages to go up to compensate not only for inflation experienced, but even for future inflation expected, resulting in higher costs for businesses, higher prices for consumers, and an upward spiral of wages and prices. We must not let domestic inflationary expectations set in, because it will entrench inflation in Singapore even after external inflationary pressures have subsided.

2.12 Our strategies will ensure that Singapore continues to have lower inflation than the rest of the world over the medium term. We have achieved that for many years now, and will keep it that way in future. The Government is also helping lower-income Singaporeans and those in need directly with the immediate problems they face.

2.13 Our strategies to help Singaporeans cope with inflation essentially comprise five planks.

2.14 *First*, we seek to moderate imported inflation through our Singapore dollar exchange rate policy. This has been MAS's consistent policy objective. For several years, MAS's policy has been a modest and gradual appreciation of the Singapore dollar. In October last year, MAS increased slightly the slope of the currency band, meaning that it allowed a slightly faster appreciation of the currency. Our exchange rate policy has helped to keep inflation down. Had the MAS not allowed the Singapore dollar to appreciate over the last two years, our CPI inflation in the last quarter would have averaged 6.5%, instead of the 4.1% that was actually recorded (MAS estimates).

2.15 However, there is a limit to how fast the Singapore dollar can appreciate without hurting our economic performance and growth, and eventually causing wages to fall. An overly strong Singapore dollar can bring inflation down, but at the cost of lower growth and higher unemployment. This is why, while we can

mitigate imported inflation through MAS's exchange rate policy, we cannot insulate ourselves completely from the effects of global inflation passing through to the Singapore economy.

2.16 *Second*, we are stepping up diversification of food sources so as to minimise spikes in the prices of foods we import which would otherwise happen when there is a disruption in supply from any one country. The Agri-Food and Veterinary Authority of Singapore (AVA) is facilitating private importers buying from new sources overseas, where the foodstuffs meet our standards. For food products that are already imported from well-diversified sources, the Government will continue to work with retailers to increase public awareness of cheaper food choices and substitutes.

2.17 These policies of mitigating imported inflation, through exchange rate policy and source diversification, have helped to lower food inflation in Singapore.

2.18 The *third* way in which Government policies help Singaporeans cope with inflation has been our support of home ownership as a key pillar of society, and especially the heavy subsidies that we provide for lower-income Singaporeans to own a home. Even lower-income Singaporeans therefore have substantial equity in their homes which rises over time and is generally protected against inflation. We have become used to this in Singapore. But it in fact insulates Singaporeans, especially our retirees, from increases in rental costs which are a significant long-term concern in other countries. In the US for example, about a fifth of older Americans rent their homes. The rental costs make up close to one-third of their expenditures each month.

2.19 *Fourth*, the Government provides assistance directly to Singaporeans who face problems coping with the cost of living. This approach of helping those in need directly is better, and more sustainable than taking reflex actions such as imposing price controls on essential goods. Everything we see in the countries that have tried price controls, even today, tells us that these are not real solutions, and will only lead to hoarding, black markets, and even more problems for ordinary people over time.

2.20 Our fundamental approach to helping Singaporeans in need is to help them to get a good income for themselves. The best way to do so has been and remains to help needy Singaporeans get a job, and to encourage them to stay at it, upgrade themselves, and support their family members.

2.21 Last year we introduced the Workfare Income Supplement (WIS) scheme, to add to the income and savings of Singaporeans at the lower end of the wage

ladder. It is a significant incentive to work. For a worker above 45 and earning a wage of \$1,000 or below, the scheme will supplement his wages by 10% to 20% each year. 287,000 workers have received their first payouts in January this year, receiving a total of \$150 million from the Government. For those who are truly unable to work, for example because of disability, we have the Public Assistance (PA) Scheme.

2.22 We will continue to complement these institutionalised schemes, by providing discretionary assistance to those in need. This is why we have boosted the ComCare Fund, which now stands at \$600 million, and Medifund which has reached \$1.4 billion.

2.23 Further, where we make good surpluses on the budget, we have redistributed benefits back to Singaporeans, with more going towards the elderly and the needy. For example, the GST Offset Package last year provides benefits spread out over four years. For a lower-income household, what they will receive *this year* alone from the GST Offset Package, together with the WIS, will be substantial.

2.24 HDB two-room households will this year receive, on average, continuing benefits from the GST Offset Package and the WIS that will in fact be equal to 12% of their annual incomes. Even if we exclude the benefits that they cannot use to meet their immediate expenses – in other words exclude the Post-Secondary Education Account top-ups for their children who are still in school, and the CPF component of WIS - the benefits add up to an average of 8% of their incomes. 8% exceeds any increase in their overall cost of living that might be expected this year<sup>3</sup>, and this is *before* counting any additional benefits that this year's Budget will provide them, and any growth in wages that they may get in 2008.

2.25 Even four-room and five-room households will receive significant benefits this year as a result of what was announced *last year*, which will offset at least a good part of the increase in costs of living they experience this year.

2.26 Later in the speech, I will lay out additional benefits to Singaporeans that this year's Budget will provide as part of our sharing of last year's Budget.

2.27 The *fifth* plank of the Government's strategy is the most fundamental to how we cope with rising global inflation. Our strategy is to keep our economy competitive and build up our capabilities so that we can enjoy good economic growth. This is the best offset to global inflation, which will be with us not just for a few months but possibly a few years – to educate and train up our people,

attract new investments, create jobs, and sustain good growth of incomes for our whole population.

2.28 This is indeed why most Singaporeans experienced good growth in real incomes last year, even as inflation went up. Even lower-income (non-retiree) households, those in the bottom 20%, saw significant real growth of 5% in their total incomes (7.1% in nominal terms), as more members of their households obtained jobs.

2.29 If global inflation stays high, all countries will be affected by it and we will not be able to totally insulate ourselves. But there is no reason why we cannot keep growing, and keep outperforming. And because our economy has done well and we have healthy surpluses, we now stand from a position of strength. We have the resources and the capacity not just to deal with our immediate problems, but to look ahead and position ourselves to deliver more years of good growth and quality jobs for our people.

<sup>1</sup> Average inflation in industrial countries was about 9% in the early 1980s, but dropped to between 2% to 3% in the early 1990s and to a low of 1.8% in the early 2000s.

<sup>2</sup> *The Economist* commodity-price index, February 5, 2008.

<sup>3</sup> No significant difference is expected in the rate of increase of the cost of living for lower-income households compared to middle- and higher-income households in 2008. Although the lower-income group will be more affected by rising food prices, they will be less affected by the higher cost of fuel.