



Media Release

Specter of global protectionism spooks Singaporeans' inflation expectations to rise to 3.43%

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Singapore, 16 April 2018 (Monday) – Singaporeans' One-year-Ahead median inflation expectations elevated to 3.43% in March 2018, in response to a faster rate of normalisation of US monetary policy and a heightened threat of a trade war among US and major economies, according to the research findings of the latest quarterly survey for the Singapore Index of Inflation Expectations (SInDEx) by the Sim Kee Boon Institute for Financial Economics (SKBI) at Singapore Management University (SMU).

The cyclical global growth that we had envisioned last quarter of 2017 seems to have continued, particularly in the G3 economies with continued stability in job growth with the lowest unemployment in the US since the turn of the century holding steady at 4.1% underpinned by a steady recovery in oil and commodity prices. Despite the positive outlook on global growth there are several factors that drives this divergence both internationally and domestically.

First, this stable growth prospect and in particular, a 2.9% increase in hourly wages in January to its highest level since 2009, has also brought about faster anticipated pace of normalisation of the US monetary policy under the leadership of the newly minted Federal Reserve Board chair Jerome Powell. The US stock market priced in the prospect of more rate hikes, and the ensuing much higher volatility in the financial market. It was indeed inflation expectations driving the financial market through anticipated policy action. While the risk of more increases in the benchmark rate has subsided somewhat, the volatility hasn't after a long period of phenomenal stable growth in the market since the global financial crisis capped off by the reduction in corporate tax rate and regulations by the current US Administration.

Second, while the global economy seems to have taken a turn for the better, multilateral global trade is facing headwinds. The risk to free trade coming on the back of US administration's announcements of tariffs on steel and aluminum, and other items, and consequent reciprocal action by its major trading partners, in particular China, have opened up the risk of a full-fledged trade war. This has also increased the uncertainty of the markets and the prospect of a higher unanticipated inflation expectations in the medium to long term.

Finally on the domestic front, several factors affecting prices were at play. First, the factors that had an uplifting effect of prices. Singapore's economy has maintained a positive growth momentum and the job market has improved with slightly lower unemployment rate in the fourth quarter of 2017, with slightly higher wage growth compared to the previous quarter. Wage increase is a pass through cost and could have increased inflation expectations. The strength of the Singapore dollar against the greenback also meant that imported inflation is more benign despite increasing global demand. Despite a reduction in the Certificate of Entitlement quota, private road transportation prices have declined but was offset by a slight increase in the cost of food and services. In summary, given the global uncertainty, local costs and potential of a trade war amid the normalisation of monetary policy globally, Singaporeans who responded to the SInDEx survey felt that there is an uptick in inflation expectations both in the medium term and long term. It is hardly surprising that in its April policy announcement, the Monetary Authority of Singapore have tightened the monetary policy for the first time in several years.

SInDEx was developed under the supervision of Assistant Professor of Finance Aurobindo Ghosh of the SMU Lee Kong Chian School of Business and partially funded by SMU Sim Kee Boon Institute for Financial Economics. The SInDEx survey, supported and implemented by Agility Research & Strategy, a leading Asian consumer insights and strategy firm with a large client base of government and private sector clients, is derived from an online survey of around 500 randomly selected individuals representing a cross section of Singaporean households. The online survey helps researchers understand the behaviour and sentiments of decision makers in Singaporean households. The quarterly SInDEx survey has yielded two composite indices, median SInDEx1 and median SInDEx5. Medians are less affected by outliers in survey-based methods, hence median SInDEx is used for the current release.

In the latest and the twenty-seventh wave of the SInDEx survey conducted in March 2018, consumers shared their views on expectations of inflation-related and asset management related variables over the medium term (One-year-Ahead) to long term (Five-year-Ahead).

The results of the March 2018 survey showed that the median One-year-Ahead headline inflation (or CPI-All Item inflation) jumped nearly 50 basis points up to 3.43% from 2.97% recorded in December 2017. As a comparison benchmark, the *mean* One-year-Ahead headline inflation rate, also edged up to 3.90% in the March 2018 survey compared to 3.22% recorded in the December 2017 survey. Additionally, new for the March 2018 SInDEx survey, the median one-year-ahead inflation expectations of some of the components of CPI-All Item inflation like Food, Transport, Housing & Utilities and Healthcare are polled at 3%.

Compared to the historical median headline inflation expectations (since September 2011) average of 3.44%, current One-year-Ahead median headline inflation is still marginally lower, but it is marginally higher than the recent first quarter average of 3.41% for the one year ahead headline inflation expectations..

Excluding accommodation and private road transportation related costs, the One-year-Ahead median Singapore core inflation expectations was recorded at 3.30% in March 2018, significantly higher than the December 2017 surveyed value of 2.91%. For a subgroup of the population who own their accommodation and use public transport, the

One-year-Ahead median Singapore core inflation rate for the subgroup also rose to 3.27% in March 2018 from 2.92% polled in December 2017. This subgroup's expectations of core inflation closely resembles the Singapore Core Inflation Expectations, as unlike the general population they are not exposed to private transport or private accommodation expenses. These results indicate that there seems to be a fairly stable but elevated perception of future overall price changes representing the Singapore core inflation rate that excludes housing and private road transportation.

In summary, the One-year-Ahead median Singapore Index of Inflation Expectations (Median SInDEx1), a composite weighted index of One-year-Ahead median inflation expectations, increased to 3.37% in March 2018 from 2.90% in the December 2017 survey. The median SInDEx1, however, remained lower than its historical average value of 3.44% since its inception in September 2011. SInDEx1 is constructed as a plausible alternative and more stable measure of inflation expectations by putting lower weightage on the more volatile and policy-sensitive components such as accommodation, private transportation, food and energy. Median SInDEx1 is also less adversely affected by extreme values, unlike the original mean SInDEx1.

SMU Assistant Professor of Finance Aurobindo Ghosh, who is the Principal Investigator of the SInDEx Project highlighted, "Global financial markets are run by expectations, which means that the market participants price in what is expected. These prices of financial assets will only move significantly when there are unexpected changes in economic variables or economic climate. The financial market volatility in the last month or two was a reaction to the prospect of faster rise in the global interest rates triggered by sustained and synchronous growth in major economies. However, we observe that a rise in protectionism borne out by trade tariffs imposed unilaterally, even as a negotiation tactic, might precipitate a global trade war. With a multinational and intricately connected global supply chain, any increase in prices of intermediate goods can trigger higher prices across the board. It's hardly surprising that an increased risk of trade war and faster pace of normalisation of monetary policy can increase inflation expectations globally, not just in Singapore."

For the longer horizon, the Five-year-Ahead median headline (CPI-All Items) inflation expectations in March 2018 survey rose up to 4.15% from 3.72% in December 2017. The current polled number is still slightly less than its historical average of 4.27% since the survey started in September 2011. For the purpose of comparison, survey finding shows that the *mean* Five-year-Ahead headline inflation recorded 4.65% in the March 2018 survey, slightly higher than the 4.07% recorded in December 2017 survey.

The Five-year-Ahead median Singapore core inflation rate (excluding accommodation and private road transportation related costs) inched up to 3.87% in March 2018 from 3.41% in December 2017. Overall, the composite Five-year-Ahead median Singapore Index of Inflation Expectations (median SInDEx5) increased in March 2018 to 3.94% from 3.56% in December 2017, still substantially lower than its historical average of 4.09%.

"One challenging aspect of quantifying expectations of inflation among economic participants is that almost everyone makes their decisions based on separate sets of information, i.e. news awareness, personal knowledge and experience. Hence, it is imperative to ascertain the level of signal and noise in their responses on inflation expectations. At times of economic uncertainty these levels of noise seem to be

heightened. Surveys, while being the best non-market based measure to look into future expectations, suffer from various biases inherent in such measurements. An ongoing research at SMU, in collaboration with partners, have identified some factors that can potentially reduce this so called ‘anchoring bias’ that appears when respondents latch onto visible pieces of information rather than revealing their true opinion about economic variables. We are addressing some of these issues in the current and future surveys through changes in the questionnaire design using behavioral economics besides asking about both components and aggregate inflation expectations.” Prof Ghosh added.

Methodology

Two indices were created, median SInDEx1 and median SInDEx5, to measure the 1-year inflation expectations and the 5-year inflation expectations. The data for the SInDEx survey was collected online from about 500 consumers. The sampling was done using a quota sample over gender, age and residency status to ensure representativeness of the sample. Employees in some sectors like journalism and marketing were excluded as that might have an effect on their responses to questions on consumption behavior and expectations.

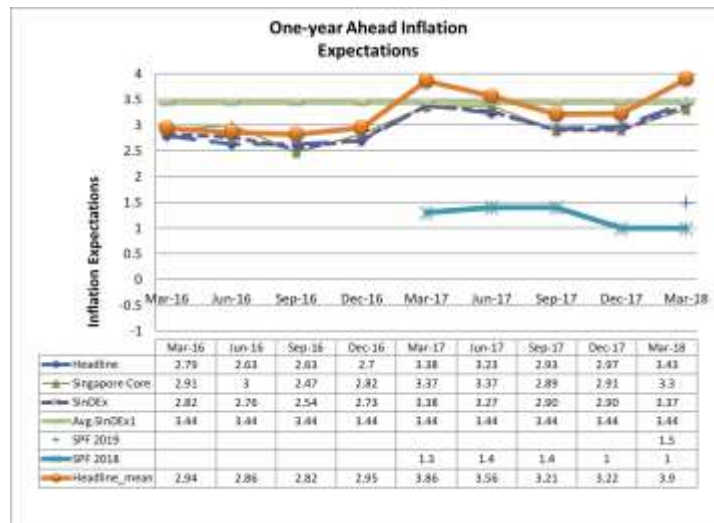


Figure 1: One-year-Ahead-inflation expectations in Singapore



Figure 2: Five-year-Ahead-Inflation Expectations in Singapore



Figure 3: One-Year and Five-Year Ahead Inflation Expectations

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The Sim Kee Boon Institute for Financial Economics (SKBI) is the premier Asian institute for applied financial research and training in financial economics. It is the think-tank within SMU that spearheads cutting-edge research in financial markets that is driven by industry and societal needs in Singapore and the region. SKBI focuses on five fundamental pillars of research, namely Financial Innovation, Financial Inclusion, Capital Markets, Asset Management and Corporate Finance.

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