



Media Release

Singaporeans' inflation expectations slide to 3.11% with policy tightening despite headwinds from possible global trade wars

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Singapore, 16 July 2018 (Monday) – Singaporeans' One-year-Ahead median inflation expectations dropped to 3.11% in June 2018 in response to slight tightening of the monetary policy in Singapore, despite the potential of a trade war between US and other major economies, particularly China. This is 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 World Bank, in their Global Economic Prospects report released in June 2018, has underscored that global growth seem to have plateaued a shade over three percent and will potentially see some softening over the next two years. The headwinds to global growth are mainly emanating from the risks to global trade as a result of protectionist policies, financial market stress from investors' concern of the creditworthiness of certain emerging market economies, escalating pace of normalisation of monetary policy in major economies, and lingering geopolitical risks. Cyclical recovery in the commodity markets is continuing, particularly in large emerging economies like China and India, despite a moderation in first quarter growth in the G3 economies (US, Eurozone and Japan). The main global growth engine, the US economy, despite significant risk from an escalating trade war with China, is still on a steady growth path of above 2%, with unemployment rates hovering around two decade lows of about 4%.

While the positive broad-based economic outlook on global growth is reassuring, there are certain factors that can dampen growth and drive up global prices both internationally and domestically in Singapore.

First, with the June 2018 interest rate hike, the prospect of faster than anticipated pace of normalisation of the US monetary policy under the leadership of the new Federal Reserve Board chair Jerome Powell might increase the volatility of global financial markets. A strengthening US dollar may also increase the burden of economies which are import-orientated, particularly given the price increase for various commodities accentuated by a steady recovery in global oil prices.

Second, the specter of trade wars and potential of protectionist policies have not subsided, in fact a trade war is flaring up between the world's two largest economies, US

and China. This has also increased the risk in the financial markets and the prospect of higher unanticipated inflation expectations in the medium to long term.

Finally, on the domestic front, we highlight some factors that may have had an impact on inflation expectations. First, after a prolonged period of neutral stance and strong evidence of sustained growth of the Singapore economy, the Monetary Authority of Singapore (MAS) increased slightly the slope of the S\$NEER policy band in its April 2018 Monetary Policy Statement. This might help counter the expected rise in the cost of US dollar-denominated imports such as oil and other commodities. Second, there has been a significant decline in Certificate of Entitlement (COE) premiums to a multi-year low that might have had a downward impact on CPI-All Items Inflation without affecting MAS Core Inflation, which excludes accommodation and private road transportation costs. Finally, improving labour market conditions might have some uplifting effects on inflation as higher wages pass through to domestic prices.

In summary, given the combined and often counterbalancing impacts of a tightening of monetary policy in advanced economies, and the impact on domestic prices despite the potential of a Sino-US trade war, Singaporeans who responded to the SInDEx survey felt that there is a decline in inflation expectations both in the medium term and the long term.

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-eighth wave of the SInDEx survey conducted in June 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 quarterly SInDEx survey conducted in June 2018 revealed that the median One-year-Ahead headline inflation (or CPI-All Item inflation) dropped significantly to 3.11% from 3.43% recorded in March 2018. As a comparison benchmark, the *mean* One-year-Ahead headline inflation rate also pared to 3.45% in the June 2018 survey compared to 3.90% recorded in the March 2018 survey.

Compared to the historical median headline inflation expectations (since September 2011) average of 3.43%, current One-year-Ahead median headline inflation is still much lower, and is marginally lower than the recent second quarter average of 3.17% for the one year ahead headline inflation expectations.

In the June 2018 SInDEx survey, the team at SMU together with the Behavioural Insights Team (BIT, originally part of the United Kingdom Cabinet Office) and the

Monetary Authority of Singapore also polled individuals about constituents of CPI-All item inflation expectations while providing the respondents with more relevant information to facilitate an informed response. This research was conducted to sharpen the SInDEx survey questions and adjust them for potential behavioural bias in responses. In the June 2018 expanded SinDEx survey, the median one-year-ahead inflation expectations of some of the components of CPI-All Item inflation such as Transport, Housing & Utilities and Healthcare were recorded at 3%, while Food inflation was polled at 2%.

The overall median Headline Inflation Expectations, after adjusting for potential behavioural biases, was recorded at 2% in June 2018. This remained unchanged from a similar survey conducted in March 2018. This also suggests that the median inflation expectations seem to be anchored fairly well despite various short-term uncertainties of the global economy.

Excluding accommodation and private road transportation related costs, the One-year-Ahead median Singapore core inflation expectations was recorded at 3.29% in June 2018, marginally lower from the March 2018 surveyed value of 3.30%. 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 dropped to 3.19% in June 2018 from 3.27% polled in March 2018. 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 road transportation or accommodation expenses. These results indicate that there seems to be a fairly stable but slightly subdued perception of future overall price changes representing the Singapore core inflation rate that excludes housing and private road transportation.

As before, the research team also polled the respondents for their one-year-ahead expectations of inflation after excluding accommodation and public road transportation expectations, the respondents were provided with further information of current and past inflation rates. The one-year-ahead inflation expectations excluding accommodation and private road transportation was polled at 2%, this was also unchanged from a similar survey done in March 2018.

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, declined to 3.20% in June 2018 from 3.37% in the March 2018 survey. The median SInDEx1, however, remained lower than its historical average value of 3.43% 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, "The risk to global free trade with unilateral or retaliatory tariffs imposed pose a clear and present danger to price stability in the globalised economy. In academic literature, evidence shows unanticipated changes in inflation can adversely impact global financial markets and consequently the prospects of growth. Hence, deliberate normalisation of monetary policy might not be effective in case where there are factors such as protectionist policies that can adversely affect

prices and prospects of jobs and economies. So far, inflation expectations of Singaporeans have been quite grounded after adjusting for behavioural bias; however, we cannot preclude the possibility of a surge in inflation if a full-fledged trade war among the major economies of the world is not averted through negotiations. In particular, the adverse impact of unhinged inflation expectations could be detrimental to global growth.”

For the longer horizon, the Five-year-Ahead median headline (CPI-All Items) inflation expectations in the June 2018 survey dropped to 3.77% from 4.15% in March 2018. The current polled number is still slightly less than its historical average of 4.25% since the survey started in September 2011. For the purpose of comparison, survey finding shows that the *mean* Five-year-Ahead headline inflation recorded 4.26% in the June 2018 survey, a downward correction from the 4.65% recorded in March 2018 survey. The 5-year ahead median inflation expectations, after adjusting for behavioural biases, was recorded at 3%, once again unchanged from the survey polled in March 2018.

The Five-year-Ahead median Singapore core inflation rate (excluding accommodation and private road transportation related costs) pared to 3.69 % in June 2018 from 3.87% in March 2018. Overall, the composite Five-year-Ahead median Singapore Index of Inflation Expectations (median SInDEx5) declined in June 2018 to 3.71% from 3.94% in March 2018, still substantially lower than its historical average of 4.07%. The 5- year ahead median inflation expectations (excluding accommodation and private road transportation), after adjusting for behavioural biases, was recorded at 3%, was unchanged from the survey polled in March 2018. These unchanged inflation expectations despite the price risk of global trade wars also indicate signs of anchoring of long-term inflation expectations.

“The primary objective of the SInDEx survey and the resultant measures of inflation expectations has always been to aggregate and summarise consumers’ perceptions and expectations to provide useful information about the potential outlook for the economy and facilitate the anchoring of inflation expectations. However, individuals’ understanding of economic variables and their interpretations of questions play a very significant role in their responses.

“In a recently completed study with the Behavioral Insights Team and the Monetary Authority of Singapore, SMU researchers performed a controlled trial on the impact of questionnaire design on responses, drawing from the work of behavioural scientists like Professor Richard Thaler, the 2017 Nobel Laureate in Economics. The current survey accommodated for some such behavioural biases by providing current economic information for respondents to form opinions. We have identified some factors that can potentially reduce the so-called ‘anchoring bias’ that appears when respondents latch onto visible pieces of information that may influence their stated opinion about economic variables. We are addressing some of these issues in the current and future surveys through changes in the questionnaire design in addition to asking about both components and aggregate inflation expectations. Our results show that Singaporeans’ median inflation expectations both in the medium and long term seem to be fairly well anchored or grounded.” 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 behaviour and expectations.

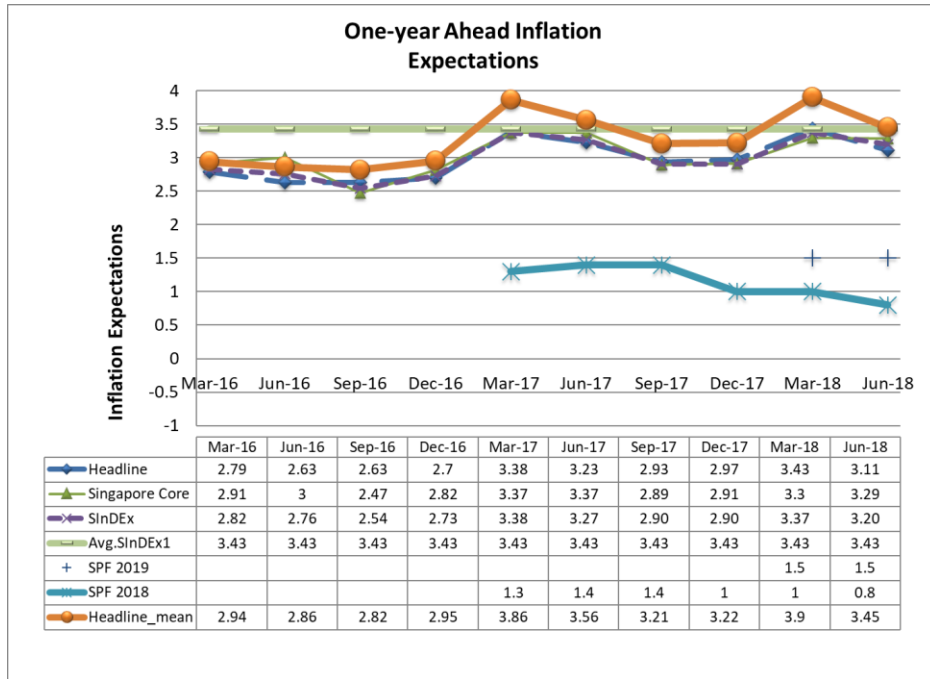


Figure 1: One-year-Ahead-inflation expectations in Singapore

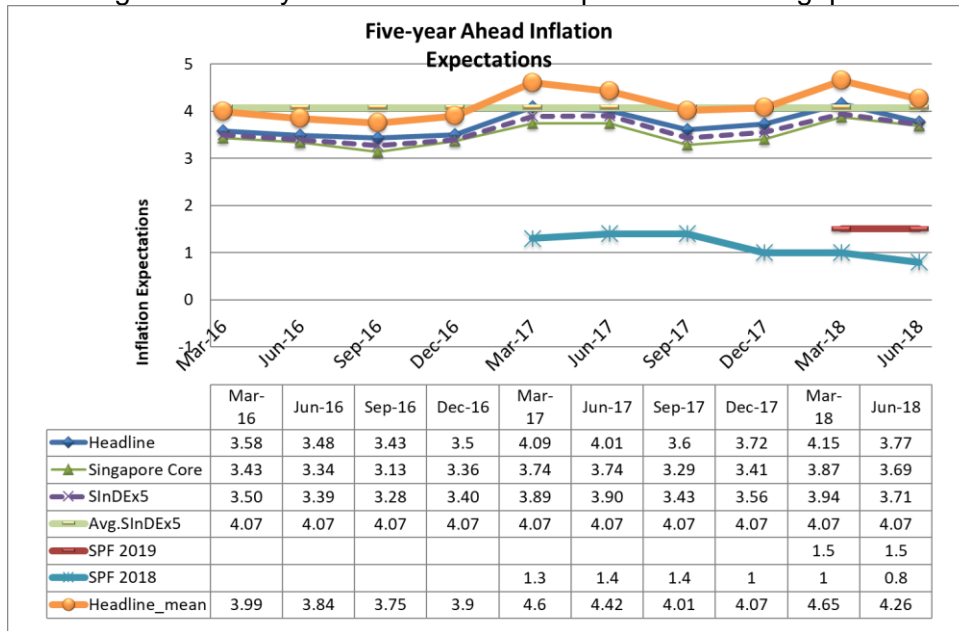


Figure 2: Five-year-Ahead-Inflation Expectations in Singapore

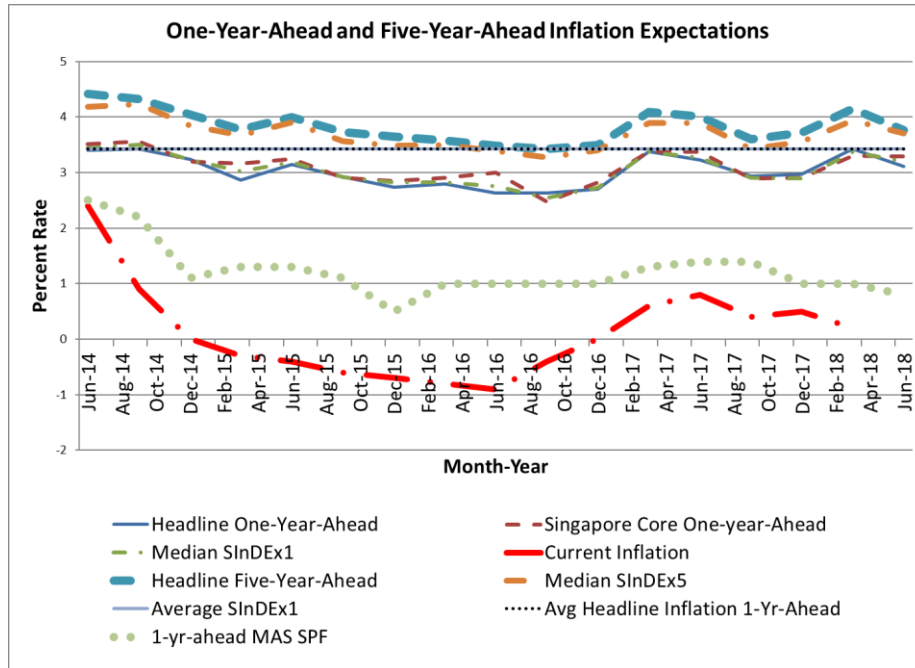


Figure 3: One-Year and Five-Year Ahead Inflation Expectations

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About Singapore Management University

A premier university in Asia, the Singapore Management University (SMU) is internationally recognised for its world-class research and distinguished teaching. Established in 2000, SMU's mission is to generate leading-edge research with global impact and to produce broad-based, creative and entrepreneurial leaders for the knowledge-based economy. SMU's education is known for its highly interactive, collaborative and project-based approach to learning

Home to over 10,000 students across undergraduate, postgraduate professional and post-graduate research programmes, SMU, is comprised of six schools: School of Accountancy, Lee Kong Chian School of Business, School of Economics, School of Information Systems, School of Law, and School of Social Sciences. SMU offers a wide range of bachelors', masters' and PhD degree programmes in the disciplinary areas

associated with the six schools, as well as in multidisciplinary combinations of these areas.

SMU emphasises rigorous, high-impact, multi- and interdisciplinary research that addresses Asian issues of global relevance. SMU faculty members collaborate with leading international researchers and universities around the world, as well as with partners in the business community and public sector. SMU's city campus is a modern facility located in the heart of downtown Singapore, fostering strategic linkages with business, government and the wider community.

About Sim Kee Boon Institute for Financial Economics

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.

Supported by SMU faculty and in collaboration and partnership with industry experts, relevant government bodies, and other world-renowned research agencies, the Institute conducts fundamental and applied research which aims at solving real-world issues. Besides research, SKBI also actively engages in training and consultancy, executive education and research dissemination in top tier journals, organising courses, seminars, and conferences. Our purpose-oriented activities are designed to bridge the gap between theory and practice and to act as accelerators with regard to financial policies and regulations.

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