Prices likely to go up before adjusting

Economists say rise of between 3% and 4% expected in next few years

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Higher inflation is likely to stick around for a few more months as Singapore’s economy undergoes a structural shift to lower productivity, said economists yesterday.

Prices should be still rising between 3% per cent and 4% per cent in the next two to three years, but inflation is unlikely to stay at the current 1% per cent rate.

Eventually, inflation will return to the 2% to 3% per cent range, but it may take a while, said economists.

Last year, inflation hit 5.2 per cent per for the whole year and continued to hover around that level for the first three months of this year. It eased off in April.

The persistence in higher prices has led to the central bank raising its inflation forecast this year to between 3.5 per cent and 4.5 per cent.

OCBC economist Selena Ling said that a number of factors are combining to make the current inflation environment “exceptional”.

First, there are only three other instances of inflation rising past the 5 per cent rate in the past 30 years. One was in 2008, when the cost of food soared as a result of bad weather, and back in 1999 and 2000, when there was a spike in rents and wages by 20 per cent over these two years.

This time, Singapore faces price pressures both internally and externally.

Interest rates are depressed globally, so investors are moving funds to emerging markets in search of better returns.

For instance, there are policies to deal with the inflationary pressure, people’s inflationary expectations may change if these policies continue to tighten, with the Government cutting back on the supply of foreign workers and the number of cars.

Already, basic services such as education, housing, transport and prices of food and fuel are up, and workers to raise wage demands.

“The persistence in higher prices has led to the central bank raising its inflation forecast this year to between 3.5 per cent and 4.5 per cent,” she said.

Last year, inflation hit 5.2 per cent per cent for the whole year and probably closer to the 3% per cent level.

OCBC’s Ms Ling said: “I think we will start to see core inflation come down closer to 2 per cent levels when productivity gradually improves and everybody is set to benefit.

For instance, with inflation at 5 per cent, landlords renewing their leases with tenants could raise rents by a similar amount. This is a justification for sellers to lift prices and make the current inflation environment ‘extraordinary’.

But over-reaction to inflation caused by higher wages may help to keep down headline inflation numbers, but if the re-selling impact, on aggregate, demand goes up, it ultimately goes against the broader objective of raising median wages and the wages share of gross domestic product,” she said.

For the current pace of inflation, at about 5 per cent, it is unlikely to last for long, as the current rise is on a temporary basis of accommodation costs and certificate of entitlement payments,” she said.

Accommodation and private car transport account for more than half of core inflation, and this will remain high, unless inflation rate now could feed into itself, persist, and not disappear any time soon.“

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But Dr Chua was less sanguine about the prospects of falling inflation.

“This is probably an extraordinary time. A confluence of forces is coming together to observe this inflation,” he said.

“But the problem is that productivity may persist, and not disappear any time soon.”

There is also a small risk that the high inflation rate now could feed into itself, raising inflation expectations and disrupting price stability.

But a stronger Sing dollar cools the local economy by making exports more expensive, which in turn reduces demand for resources at home.

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