Headline: Rising Sing$ may not keep prices low
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ASK: NUS ECONOMISTS

Rising Sing$ may not keep prices low

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Why are consumer prices rising while the Singapore dollar is appreciating and import prices are falling?

FROM 2006 till last year, consumer prices rose by 3.1 per cent annually while import prices fell by 2.3 per cent. Last year alone, import prices fell by a hefty 8 per cent, while consumer prices went up by 0.6 per cent. The general trend of import prices since 1981 has been downwards and consumer prices upwards. Given Singapore's extreme dependence on imports, this has puzzled some.

My co-researcher Choy Keen Meng and I examined this puzzle and found, somewhat unexpectedly, that non-tradeables account for 55 per cent of Singapore's consumer price inflation, while import prices account for the rest.

To understand what this means, consider the following example: An imported item from China that costs $3 is sold for $10 in Singapore. One would immediately assume the Singapore importer is making super profits. However, competitive forces (with more importers entering the business) should have brought such profits down to the bare minimum required for the importer to stay in business.

Suppose the importer made only $1 in profit. What happened to the other $6? This less visible component consists of non-tradeables: labour costs, rental and storage costs, government fees and charges and so on.

With import prices accounting for only 45 per cent of consumer price inflation, we can see that the cost of non-tradeables must have gone up by 7.5 per cent a year from 2006 till last year.

An appreciating Singapore dollar does lower consumer prices. It should be noted, however, that Singapore dollar appreciations do not immediately pass on to lower import prices. How quickly an appreciation gets passed on depends on many factors such as transaction invoicing procedures and the responsiveness of demand to prices.

Calculations show that, depending on the import category, about 30 per cent to 50 per cent of an appreciation may pass on to import prices within three months; sometimes it may take more than a year for an appreciation to pass on fully. And even if 100 per cent of an appreciation is passed on, a 1 per cent appreciation of the dollar can bring consumer prices down by only 0.45 per cent.

This shows that trying to combat consumer price inflation by letting the Singapore dollar appreciate is, in the jargon of economists, like fighting two targets (the price of imports as well as the price of non-tradeables) with one instrument.

We know that the excessive appreciation of the Singapore dollar is not desirable because of its negative effect on service exports. (An appreciation has a somewhat offsetting effect on merchandise exports because of their heavy import content.) The challenge that policymakers face is that we need one more instrument to keep consumer prices low – that being keeping the cost of non-tradeables low.

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