

Question 6

“Higher oil costs, rising housing rents, more expensive private transportation and unemployment near a three-year low have led the Monetary Authority of Singapore to raise its 2012 inflation forecast.”

Source: Bloomberg, May 23, 2012

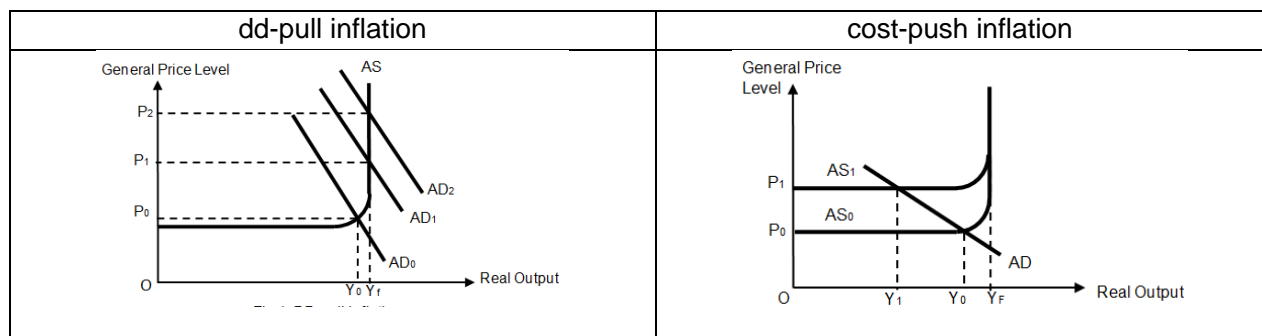
Discuss the view that Singapore’s ability to achieve price stability is determined by her economic integration with the rest of the world. [25]

Introduction:

- Inflation refers to a sustained, inordinate and general increase in the prices of g+s.
- Achieving low and stable rate of inflation is one of four important macroeconomic objectives
- In the S’pore context, the consumer price index (CPI) tracks the changes in the average price of a basket of g+s consumed by a typical household with housing, transport and food given higher weights due to the higher proportion of household income spent on these g+s. Hence, increase in CPI is indicative of inflationary pressures in S’pore.
- Globalisation refers to the increasing integration of national economies in terms of growth of international trade in g+s, greater mobility of capital and movement of labour across national boundaries.
- S’pore’s small and open economy has been consistently ranked amongst the most globalised in the world
- The increased economic integration has brought about both positive and negative impact on S’pore’s ability to achieve price stability.
- Besides economic integration, the choice and effectiveness of policy tool to address the root cause of inflation is also an important factor determining the ability to achieve price stability.

Main:

- Major causes of inflation in S’pore: both internal and external factors due to dd-pull or cost-push reasons.
- Explanation of dd-pull and cost-push inflation



Thesis: S’pore’s ability to achieve price stability is determined by her economic integration (i.e. economic integration/globalisation affects the ability of S’pore to achieve price stability.)

Positive and negative impact of 3 aspects of economic integration on GPL

	Economic integration improves S’pore’s ability to achieve price stability	Economic integration constrains S’pore’s ability to achieve price stability
Increased volume of trade in g+s	<p>Sg economy: poor factor endowment, import factor i/p and fin gds, import-reliant</p> <ul style="list-style-type: none"> ▪ ↓P of imported r.m. and fin gds from countries with CA in the prodn. ▪ Greater trade links has allowed for diversification of the sources of 	<ul style="list-style-type: none"> ▪ Greater vulnerability to supply shocks. Import-reliant, susceptible to imported inflation (external, cost-push inflation) when prices of basic necessities e.g. food and crude oil prices increase. ▪ Diversification may not ↓GPL in the event of global ↑ in commodity prices

	<p>imported r.m. and other commodities. Reduce risk of over-dependence on one market and able to procure at the lowest cost possible</p> <ul style="list-style-type: none"> ▪ $\rightarrow \downarrow \text{COP} \rightarrow \uparrow \text{SRAS} \rightarrow \downarrow \text{GPL}$ (refer to cost-push inflation diag) ▪ With access to > exports mkts, S'pore dom firms can expand o/p, tap on eos $\rightarrow \downarrow \text{AC}$ of prodn $\rightarrow \downarrow \text{P}$ of g+s ▪ Trade \uparrow competition $\rightarrow \downarrow$ mkt dominance. Firms incentivised to keep prices and cost low $\rightarrow \downarrow \text{GPL}$ 	<ul style="list-style-type: none"> ▪ \uparrow volume of trade \rightarrow Sg X-driven $\rightarrow \uparrow \text{NX} \rightarrow \uparrow \text{AD}$ (dd-pull inflation if operating near Yf) $\rightarrow \uparrow \text{GPL}$
Increased Capital flow	<ul style="list-style-type: none"> ▪ \uparrow capital flow e.g. FDI $\rightarrow \uparrow$ qty + qly of FOPs (\uparrow fixed capital formation, training, technology transfer) $\rightarrow \uparrow$ productive capacity \rightarrow LRAS shifts right $\rightarrow \downarrow \text{GPL}$ (diagram to illustrate) 	<ul style="list-style-type: none"> ▪ $\uparrow \text{FDI} \rightarrow \uparrow \text{AD} \rightarrow$ dd-pull inflation $\rightarrow \uparrow \text{GPL}$ ▪ \uparrow capital flow, QE in US/UK $\rightarrow \downarrow i/r$ + excess liquidity ▪ inflow of funds due to S'pore's openness to capital flow $\rightarrow \uparrow \text{DD}$ for property by foreigners \rightarrow asset price inflation. (dd-pull inflation)
Increased Labour mobility	<ul style="list-style-type: none"> ▪ Given S'pore small population size, \uparrow inflow of FW has allowed firms to tap on a ready pool of labour and kept COP low. ▪ Augment the qty and qly of workforce $\rightarrow \uparrow$ productive capacity \rightarrow LRAS shift right $\rightarrow \downarrow \text{GPL}$ 	<ul style="list-style-type: none"> ▪ \uparrow no of FWs in S'pore $\rightarrow \uparrow \text{DD}$ for dom g+s e.g. housing, transport which are heavily weighted in the CPI $\rightarrow \uparrow \text{GPL}$ (dd-pull inflation)

Anti-Thesis: S'pore's ability to achieve price stability is determined by other factors (i.e. other factors affect the ability of S'pore to achieve price stability.)

Positive and negative impact of government policies on GPL

Govt policies improve S'pore's ability to achieve price stability	Govt policies constrain S'pore's ability to achieve price stability
<ul style="list-style-type: none"> ▪ Exchange rate policy: gradual appreciation. \uparrow ex rate $\rightarrow \downarrow \text{NX} \rightarrow \downarrow \text{AD} \rightarrow \downarrow \text{GPL}$ (dampen dd-pull inflation arising from \uparrow foreigners' dd for sg g+s) ▪ \uparrow ex rate $\rightarrow \downarrow \text{Pr}$ of import $\rightarrow \downarrow \text{COP} \rightarrow \downarrow \text{GPL}$ (dampen cost-push inflation) ▪ Macroprudential policies: cooling measures e.g. additional sellers' stamp duty, lowering of LTV ratio to reduce speculative dd in the housing market $\downarrow \text{GPL}$. (dampen dd-pull inflation) 	<ul style="list-style-type: none"> ▪ Economic restructuring and pursuit of productivity-driven growth has led to tightening of FW policy ▪ E.g. FW levy, lowering of dependency ratio ceiling ▪ \uparrow labour costs $\rightarrow \uparrow \text{COP} \rightarrow \downarrow \text{SRAS} \rightarrow \uparrow \text{GPL}$ (cost-push inflation)

Conclusion:

- Critical for the S'pore economy to remain open and integrated with the world economies to tap on the benefits of globalisation which in turn has significant impact both the internal and external sources of inflation.
- How well S'pore can achieve price stability then hinges on the type and frequency of review of policy measure to enhance their responsiveness and inflation targeting

Knowledge, Application, Understanding and Analysis

L3	<p>Developed discussion of how economic integration, as opposed to other factors, affect S'pore's ability to achieve price stability</p> <ul style="list-style-type: none"> ○ Detailed explanation of how <u>all</u> the 3 characteristics of economic integration (increase trade in goods & services, capital and labour mobility) can both improve <u>and</u> constrain S'pore's ability to achieve price stability ○ Detailed explanation of how other factors e.g. government policies can both improve <u>and</u> constrain S'pore's ability to achieve price stability ○ Detailed diagrammatic explanation of the causes of demand-pull and cost-push inflation 	15 - 21
L2	<p>Undeveloped discussion of how economic integration, as opposed to other factors, improves and constrains S'pore's ability to achieve price stability</p> <p>Or developed explanation of how economic integration, as opposed to other factors, improves (or constrains) S'pore's ability to achieve price stability</p>	10 - 14
L1	Smattering of valid points i.e. answers show some knowledge of inflation and economic integration.	1 – 9

Evaluation		
E2	For an evaluative discussion of the determinants which affect S'pore's ability to maintain price stability and based on economic analysis.	3 – 4
E1	Unexplained judgment or one that is not supported by economic analysis.	1 – 2