Switch to interest rate policy as inflation tool debated again

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***The Business Times,* 29 May 2012**

Singapore may need to rethink its choice of the exchange rate as its monetary policy tool, some economists argued yesterday.

Interest rates - which most other economies use to conduct monetary policy, could prove more effective in curbing price pressures from the non-tradeable sector which is increasingly driving inflation here, they said during the 17th Singapore Economic Roundtable yesterday.

But this was by no means a consensus view - others among the 35 market economists, academics, and policymakers participating in the twice-yearly Institute of Policy Studies event spoke up against such a move.

One issue to consider is whether or not non-tradeables driven inflation is a one-off phenomenon or a longer-term structural issue, said Ramkishen Rajan, visiting professor at the Lee Kuan Yew School of Public Policy, without professing to know the answer.

"But in so far as it's a longer-term structural issue, you've to start thinking about changing the model, about moving to greater interest rate management," said Prof Rajan, stressing the need for an analytical monetary policy framework that is coherent and consistent.

His fellow speaker at the forum, held under the Chatham House rule which forbids attribution of views without consent, noted that non-traded goods' rising share of GDP means an exchange rate policy will have to rely more on its indirect effect on domestic demand to affect the price level, limiting efficacy.

While Singapore's economy remains more sensitive to the real exchange rate than to interest rates, the question is, for how long, he added.

Low interest rates globally, a "supply side shock to the labour market" in measures to slow foreign workers' inflow, and ramped up social expenditure on the fiscal front combine to present a "worrying" scenario for Singapore, retired economist Adam Le Mesurier said in the discussion that followed presentations.

A long-time advocate of a switch to interest rate policy, Mr Le Mesurier observed that over the past 15 years, regional economies which made that switch have seen better macro-stability outcomes than Singapore has.

"It's been done and it has worked," he said.

Other participants were less certain. "Let's not make a hasty recommendation to change the entire monetary policy framework, just because the government has maybe been a bit slower in building houses for the increased population," one said, noting that two thirds of inflation now stems from accommodation and housing. That shortage has been recognised and increased supply in the pipeline will take time to affect prices, he added.

One complication of switching to an interest rate-based policy is that Singapore is still very dependent on exports. The rise in interest rates such a switch implies would cause the Singapore dollar to appreciate and slow trade significantly, one speaker said.

If Singapore were to switch, it might also need to consider capital controls. This may not diminish its role as a financial centre, the speaker said, as he thinks that the evolution of finance in the G3 economies will make capital controls a more prevalent feature of the global financial system in future.

There was broad acknowledgement of the adjustment costs accompanying any shift, though some, such as Mr Le Mesurier, think the costs of not switching may be higher in the long run.

Last month, the Monetary Authority of Singapore signalled a faster pace of appreciation of the Sing dollar to curb inflation. It said earlier this month that this monetary policy stance remains appropriate.