Policymakers face a tough juggling act

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Low inflation or tight labour market? Strong S$ or competitiveness? Conflicts abound.

Singapore's policymakers face conflicting challenges in the year ahead, participants at the 18th Singapore Economic Roundtable agreed. More debatable though, was the extent to which rising business costs and a stronger Singapore dollar might hurt the economy's competitiveness.

"There is a short-term conflict between the authorities' desire to manage inflation over time and the strategy to encourage tightness in the labour market in order to achieve structurally increased productivity and incomes," said Edward Teather, economist at UBS Investment Research, a speaker at the twice-yearly conference last week.

The government's policy effort on the labour market "is far from complete", he added.

Mr Teather explained that despite lacklustre GDP growth, Singapore's labour market has stayed buoyant. Employment growth in Q3 was an estimated 3.8 per cent year-on-year, far above the pace of output growth. It is also close to multi-year averages and at the high-end of employment growth in other small economies globally such as Malaysia, New Zealand and Hong Kong over the past three decades. "Singapore's supply of labour is not yet tight on an international scale," Mr Teather said.

Also, recent comments from the government suggest that the rising number of foreigners entering Singapore on S-passes, issued to mid-level workers earning at least $2,000 a month, may prompt further tightening of the rules in 2013.

Mr Teather points out that the government's targets and rhetoric imply that 2 per cent employment growth should be the norm for Singapore. This will require adjustments to both the supply of and demand for labour, assisted by government policy in 2013 and beyond.

"This extends a phenomenon the authorities have been wrestling with since 2010. A combination of high labour demand and weak productivity growth; which, in turn, has strained the city state's resources and led to social complaints associated with the required influx of foreign workers," said Mr Teather.

A tighter labour market will put upward pressure on wage costs, adding to the host of other factors - primarily the cost of housing and cars - which have kept inflation elevated. He expects inflation to be the "swing factor" in monetary policy setting next year, and forecasts no change in the current stance of "modest and gradual appreciation" of the Singapore dollar at the next review in April.

But some participants questioned the exchange rate's efficacy as a monetary policy tool given that much of inflation now stems from domestic factors. This is a debate that has arisen several times in the past two years.

"I'm not sure if it should be described as a sacred cow or lame duck, but it's not having much effect stemming inflation. And perhaps in the new environment different monetary policy tools are needed," said one economist. The roundtable was held under the Chatham House rules, which forbid the attribution of comments to participants to encourage freer discussion.

However, others think that using the interest rate as a monetary policy lever, as many other economies do, may not work for Singapore. "If you want to use the interest rate to kill the property market, you'd need to raise it extremely high, from zero now to about 5 or 6 er cent. Can we afford that as an open economy? There would be massive capital inflows, the collateral damage would be huge," another participant said.

"Asset price inflation cannot be dealt with effectively by either the exchange rate or interest rate, and has to be addressed separately by macro prudential tools," he added.

With inflation still high, Bank of Singapore currency strategist Sim Moh Siong thinks that monetary policy communication can be improved to help anchor inflation expectations. "There is room for clearer guidance, such as that adopted by the US Federal Reserve, to work into the monetary policy statement more forward guidance," he said. The government expects inflation to come in at slightly above 4.5 per cent for 2012 and 3.5 to 4.5 per cent for 2013.

For one member of the business community, the strong Singapore dollar has affected competitiveness, since most of his company's earnings are from outside of Singapore. But he added that having a tighter monetary policy to fight inflation has enabled Singapore to stomach lower interest rates, benefiting corporations too.

Mr Teather said that the combination of tighter labour market policy and an appreciating exchange rate will put pressure on the competitiveness of segments of corporate Singapore. This may lead to more outsourcing of firms and industries still engaged in low-value-added production here, to Malaysia's Iskandar Development region in Johor or other industrial parks in the ASEAN region.

Relocation, as well as the possibility of firms having to fold, are outcomes the business community has warned of in response to the pace at which foreign manpower inflows are being tightened.

But the demise of some firms may be necessary for the economy, says Nanyang Technological University assistant professor of economics Leong Kaiwen. "There is a continuous increase in the number of new companies... but there's a need for creative destruction too, so that the weaker ones are not using up finite resources that more productive companies need to grow," he said.

Mr Teather expects targeted policies to help Singapore firms cope with competitive pressures and does not expect broad loosening of fiscal policy at next year's Budget. That "would simply add to conflicts already inherent in the co-existing tighter labour market and counter inflation policy," he said.

Still, looser fiscal and monetary policies remain options if growth outcomes are considerably worse than expected due to the macroeconomic environment or fiscal difficulties in the developed economies, he added.

Labouring on: A tighter labour market will put upward pressure on wage costs, adding to the host of other factors.