4 Singapore is facing significant challenges in the new era of slow growth, quantitative easing and rock-bottom interest rates in the US and UK that will have knock-on effects on the general price level.

a) Explain the effects of “quantitative easing and rock-bottom interest rates in the US and UK” on the general price level in Singapore. [10]
b) Discuss the effectiveness of exchange-rate centred monetary policy in Singapore to overcome the twin challenges of slow growth and inflation. [15]

Part (a)

Suggested outline

Introduction

- Introduce Singapore as a small and open economy which allows capital flows into and out of the country
- Because of this openness, any changes in monetary policy decisions abroad will have an impact on Singapore’s economy.
- Introduce US and UK’s monetary policy decisions in the context of slow growth performance

Development

Explain how quantitative easing in US and UK led to rising general price level in Singapore

- Explain how rock-bottom interest rates and the increased liquidity abroad due to quantitative easing in the US and UK led to inflow of hot money into the Singapore’s property market, driving up property prices.
- Explain that housing has a high weighting in the computation of CPI and hence led to asset inflation.
- Explain how rising property prices led to increased consumption spending because of the wealth effect
- Explain that the large inflow of hot money due also placed a downward pressure on domestic interest rates, causing a “property bubble”.
- Explain how the increased consumption and investment spending resulted in demand-pull inflation using AD-AS analysis

L3	A clear and well-explained answer of the effects of the policies on the general price level in Singapore, with an understanding that inflation has shifted from imported inflation to a domestic one.	8-10
L2	An undeveloped explanation of the effects of the policies on the general price level in Singapore An attempt is made at explaining the effects of the events on the general price level in Singapore	6-7 4-5
L1	Explanation of the causes of inflation in Singapore without reference to the context	1-3

Part (b)

Suggested outline

Introduction

- Singapore uses an exchange-rate centred monetary policy which is adjusted according to the MAS' assessments of the risks to inflation vs. growth
- Exchange-rate policy alone cannot tackle the twin challenges of slow growth and inflation at the same time due to the conflict in macroeconomic goals, and also because it is a blunt tool in dealing with the main causes of inflation facing Singapore currently.

Development

- Explain that the use of exchange rate policy will lead to a conflict between economic growth and low inflation, making it ineffective in tackling the twin challenges of slow growth and inflation in Singapore.
  - Appreciation of the exchange rate lowers inflation but results in a fall in net exports, leading to a further fall in GDP which is undesirable given the context of already slow global growth.
  - On the other hand, depreciation leads to higher rates of inflation, yet is not very effective in stimulating net exports given the climate of slow global growth

- Moreover, explain that exchange rate policy is not effective in targeting the main causes of inflation that Singapore currently faces.

- Explain, however, the reasons why it is still relevant and important to maintain a gradual appreciation of the exchange rate in Singapore

- Explain how the use of other policies – supply-side policies and macroprudential policies – are more effective in overcoming both the challenges of slow growth and inflation

Conclusion

Singapore's exchange-rate centred monetary policy is unable to overcome the twin challenges of slow growth and inflation. This is because the use of exchange rate policy will lead to a conflict between the macroeconomic goals of low inflation and economic growth. Furthermore, given the main causes of inflation that Singapore faces, exchange rate is a blunt tool in targeting the root of the problem. The use of supply-side and macroprudential policies, on the other hand, are more effective in tackling both the challenges of slow growth and inflation.

L3	A coherent discussion of the effectiveness of the exchange rate policy, with a clear explanation of the conflict between the macroeconomic goals of economic growth and low inflation.	9-11
L2	A clear explanation of how exchange rate policy is able to tackle the twin challenges, with some idea of the trade-off between the macroeconomic goals. Explanation of how exchange rate policy works and its limitations	6-8 4-5
L1	A sketchy answer that attempts to explain how exchange rate policy works.	1-3

E2	A well-reasoned conclusion about the effectiveness of exchange rate policy in tackling the twin challenges of slow growth and inflation	3-4
E1	A judgement is provided but without supporting reasons	1-2