

## Singapore: USD/SGD Poised for More Downside

### MAS Tightens SGD Policy for the Second Consecutive Meeting in April

On 10 April, the MAS announced that it will re-centre the exchange rate policy band at the then prevailing level of the S\$NEER which is at the stronger side of the pivot point. There will be no change to the slope or width of the policy band. This is effectively a 2.5% appreciation of the SGD NEER given our assumption of 2.5% band width on each side of the pivot point. We continue to estimate the annual SGD NEER appreciation pace at 2.5%. This was the second consecutive meeting that the MAS has tightened its SGD policy. In October 2007, the tightening was through a 'slight increase in the slope of the band'.

In its monetary policy statement, the MAS noted that inflationary pressures have remained high despite the downside risks to economic growth and the S\$NEER has fluctuated in the upper half of the policy band since the last policy review.

### Motivations Behind the Tightening

The one-off tightening in the SGD policy highlighted overriding inflation concerns compared with growth. There were two key factors which led up to the move: (1) Inflation risk has become more significant with headline inflation rising to 25-year high of 6.6%/y/y in Jan-Feb, sharply higher compared with average of 4.1% in 4Q07. We expect the inflation rate to average 5.2% this year compared with 2.1% in 2007. This will be one of the highest headline inflation rate in Asia this year after countries such as Indonesia and China. Of course, domestic inflation is skewed higher due to the revision to the annual values of homes in January, which is estimated to add around 1ppt to the inflation rate this year.

Indeed, there is now widespread concern that the surge in food prices such as rice, wheat etc and continued uptrend in oil price have raised the cost of living in Singapore significantly. Core inflation - which excludes private transport and accommodation - has risen sharply to an average of 5.1% in the first two months of the year, up from 3.5%/y/y in 4Q07. A stronger SGD will help to cap imported inflation although we will continue to see upward pressure on prices in the non-tradable sectors. For instance, higher education fees, medical costs and road usage costs will not be alleviated by firmer SGD. However, we expect basis effect will bring the inflation rate lower to 3.0%-3.5% by 4Q08. The higher base in 2H07 was due to the 2ppt hike in the GST rate in July 2007.

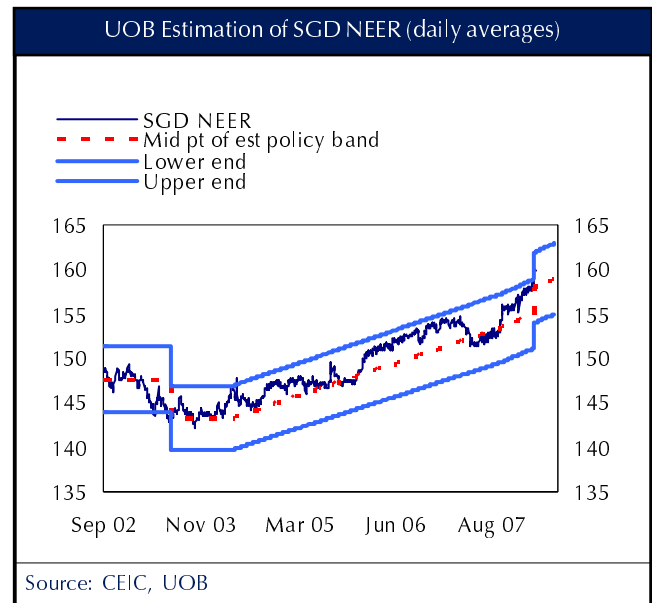
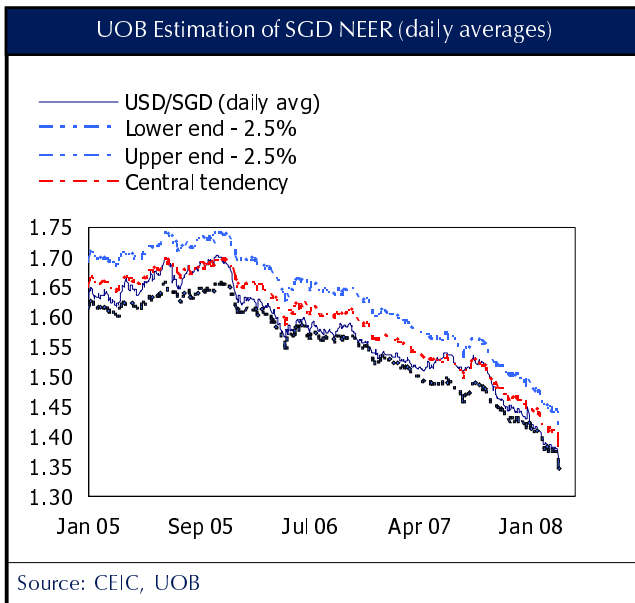
(2) It is also becoming more evident that Asian central banks are more willing to allow their currencies to appreciate at a faster pace to combat higher food and commodity prices. With the exception of the KRW, PHP and INR, other Asian currencies have appreciated substantially against the USD since the start of the year. In particular, the RMB closed at 6.9916/USD last Thur, the strongest since 1993, taking the cue from PBoC's guidance of the central parity setting. Since the start of the year, the RMB has appreciated more than 4% against the USD which has prompted us to revise up our forecast for the full-year RMB appreciation to 11% this year from 7% made at the beginning of the year. The faster pace of RMB appreciation will be the catalyst for stronger Asian currencies this year.

#### Our New USD/SGD Forecast for the Next 12 Months

	<u>End-2Q08</u>	<u>End-3Q08</u>	<u>End-4Q08</u>	<u>End-1Q09</u>
USD/SGD	1.34	1.33	1.32	1.31
Source: UOB				

### SGD to Strengthen Further Near-term

USD/SGD dropped sharply by 1.8% to a fresh record low of 1.3551 on Thur (10 April) from Wed's close of 1.38 following the surprise MAS' monetary policy announcement. YTD, the SGD has appreciated by as much as 6% against the USD. On the same day, the MTI released the advance estimate for 1Q08 GDP growth which came in well-above consensus expectation at 7.2%/y vs 5.4% in 4Q07. With the domestic economy holding up better-than-expected and the surprise SGD policy tightening, we have lowered our USD/SGD forecast slightly. Our year-end forecast for the pair is now at 1.32 compared with 1.34 previously. With the re-centering, SGD NEER has shifted to 1.4% above the new pivot point after hovering at the top of the band for most of the first three months this year.



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