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Singapore: April 2010 Monetary Policy Preview - MAS Likely to Tighten

- We expect MAS to normalize monetary policy through a one-off shift upwards of the policy band, in line with the stronger recovery in the economy and to pre-empt quickening pace of inflation

- The 2 prior policy decisions saw MAS undertake an easing stance since Oct 08, an upwards shift in the policy band is just a step towards normalization, rather than a tightening monetary policy per se.

- SGD NEER index, which is hovering at about 2% above the midpoint, very close to the upper limit of the policy band, and has been for the past few weeks. A move up on the policy band would relieve pressure on the trade-weighted index and also allow further room for the USD/SGD to move lower without hitting near the top of the policy range.

- On our anticipated monetary policy normalizing by the MAS, we are projecting a relatively flat USD/SGD. Our outlook for the SGD is that there will be very marginal strength against the USD, before flattening out, with the USD/SGD reaching 1.38 in the 2Q and 3Q of this year of this year, and then to 1.37 in the 4Q.

The bounce-back in the Singapore economy and a pick up in inflation rate, we think should prompt the Monetary Authority of Singapore to normalize monetary policy this coming April meeting. Admittedly, the decision to do so is not clear cut, seeing as to how the recovery is still very much dependent on how the recovery in the US and Europe turns out.

A tightening policy could be done via 2 methods, via a gradual appreciation, by changing the slope of the policy band towards one of gradual appreciation, from the current policy stance of a zero appreciation. The other option is through a one-off re-centring upwards of the policy band, without any change to the width of slope of the band. Between the two options, we think the one-off shift is more appropriate, although market consensus is tilted towards changing the slope of the band. We feel that although changing the slope of the band might seem like a more gradual appreciation of the SGD in the immediate term, but over the long term, the signal that MAS is sending is one of setting the SGD on an appreciation path. This would imply a more aggressive form of tightening, especially over the longer term, compared to a one-off re-centring in the policy band. With a one-off shift, at first, this might seem to be a sudden tightening measure, but over time, the SGD does not necessarily have to appreciate, especially if the economic recovery does not warrant a SGD appreciation stance in the future, owing to the uncertainty of the economic recovery.

The 2 prior policy decisions saw MAS undertake an easing stance since Oct 08, amidst a sharp deterioration in the external economic environment. In Oct 08, the MAS moved to a zero appreciation neutral stance, from a previous policy of modest and gradual appreciation. Then in Apr 09, MAS undertook a one-off re-centring of the policy band downwards, following a collapse in trade, and disruption in the financial markets. Now, with financial markets back to normalcy, trade revving up, and Singapore potentially posting a robust headline growth of about 12% for 1Q10, an upwards shift in the policy band is just a step towards normalization, rather than a tightening monetary policy per se.

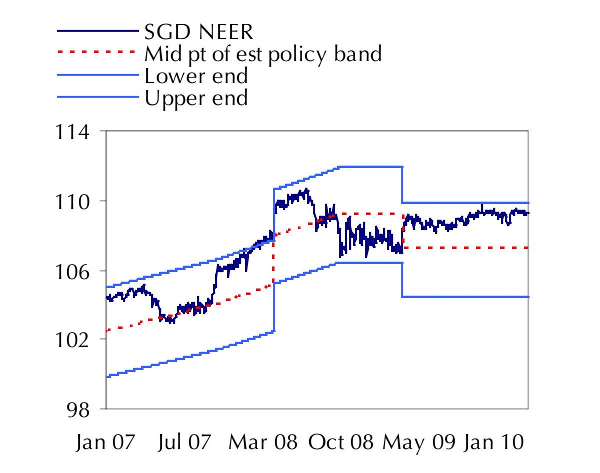
The central bank also needs to act to pre-empt the potential quickening pace of inflation. With Singapore's economic growth GDP surging up, and also the unemployment rate at a fairly low 2.1% at the end of Dec, demand-side inflation should come back strongly. Crude oil price has also started trending up past the $80 level, with global consumption making a comeback. Other major components of the CPI basket have also started heading north. Transport costs, food prices and accommodation costs are all climbing up. Electricity tariffs for the next quarter have also been hiked. On the supply side, drought in the agricultural countries has caused prices of commodities to spike up. All this should prompt MAS to move to prevent inflation from spiraling upwards.

Another point to note would be the SGD NEER index, which is hovering at about 2% above the midpoint, very close to the upper limit of the policy band, and has been for the past few weeks. A move up on the policy band would relieve pressure on the trade-weighted index and also allow further room for the USD/SGD to move lower without hitting near the top of the policy range.

MAS' move to normalize policy would not be without precedent. We have seen the willingness of the other central banks in the region, to up interest rates quickly to normalize in the rebound of the economies. Australia was the first G20 nation to raise rates by 25 bps last Oct, with the RBA citing strong domestic economic conditions, improvements in financial markets, and low unemployment. The Australian central bank has since hiked rates a total of 5 times, with its main lending rate now at 4.25%, when other central banks were still extremely cautious. India also raised its benchmark reverse repurchase rate to 3.5% from a record-low of 3.25% around mid-Mar, in a surprise move. Closer to home, Malaysia's Bank Negara increased its benchmark rates by 25bps to 2.25%, moving towards normalisation.

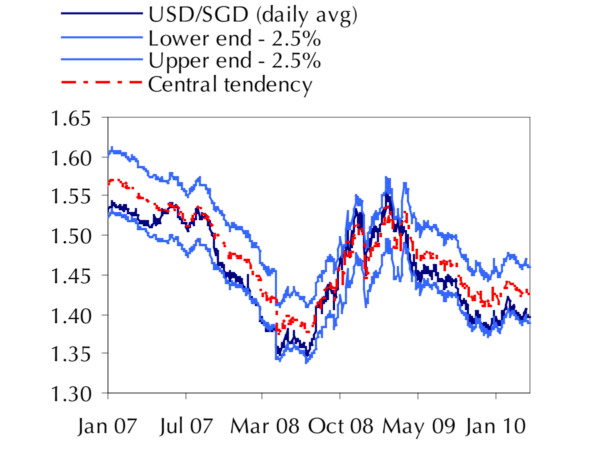
Majority of the market however, is expecting MAS to play it cautious this Apr, and stay put on monetary policy, which has some justification. Although monthly economic indicators such as industrial production and non-oil domestic exports are showing very strong headline growth, a reading of the NODX nominal value however, rather than the y/y growth rates, shows recovery inching upwards, rather than a rebound. Also, currently, with inflation level at a still mild 0.95% y/y pace in Feb, there is currently no urgent need to tighten monetary policy. With the recent CPI rebasing exercise, headline inflation would probably come in lower than our initial forecasts of 3.5% for 2010, before the rebasement. Hence, any move by the MAS to tighten monetary policy would be more of a pre-emptive measure to bring down inflation before it strikes.

SGD NEER Trending at the Stronger End of the Policy Band



Source: UOB's Estimation of SGD NEER

USD/SGD to Weaken Slightly



Source: UOB's Estimation of SGD NEER

USD/SGD

On our anticipated monetary policy normalizing by the MAS, we are projecting a relatively flat USD/SGD. Problems such as sovereign debt still persist in the Eurozone, which could result in volatility and choppiness in the USD, as a result of the waxing and waning of risk appetite. Our outlook for the SGD is that there will be very marginal strength against the USD, before flattening out. Also, with the SGD taking following the movement of the RMB (which is expected to remain flat), we see USD/SGD reaching 1.38 in the 2Q and 3Q of this year of this year, and then to 1.37 in the 4Q.

Announced MAS Monetary Policy Statements/Actions Since 2003

Date	Scheduled Meeting ?	Decision			Factors / Outlook Affecting Decision					
		Bias	Pivot Point	Width	External Econ	Global Electronics	Domestic Econ	Imported Inflation	Domestic Inflation	Labour Mkt
10 Jul 03	yes	neutral stance, 0% app	at Jul 03 level		signs of pickup, but downside risks	tentative improvement	modest H2 recovery	muted	muted	significant slack
10 Oct 03	yes	neutral stance, 0% app	at Jul 03 level		clearer signs of upturn	continued improvement	outlook improved, modest recovery	benign	subdued into next year	slack
12 Apr 04	yes	modest & gradual app	from Jul 03 level		synchronised upturn,	pickup in global IT demand,	outlook improved, likely to exceed official forecast	risk of rising inflation pressure	subdued, but could intensify	strengthen (output gap turn positive by yr-end)
11 Oct 04	yes	modest & gradual app	from Jul 03 level		greater uncertainty	greater uncertainty	growth momentum easing	risk of rising inflation pressure	subdued, but could intensify	continued improvement
12 Apr 05	yes	modest & gradual app	from Jul 03 level		growing at healthy pace	modest recovery in H2	slowing to potential growth rate	risk of rising inflation pressure	subdued, but could intensify	continued improvement
11 Oct 05	yes	modest & gradual app	from Jul 03 level		growing at steady pace	modest expansion	potential growth in 2005 & 2006	risk of rising inflation pressure	subdued, but expected to pick up in 2006	continued improvement
11 Apr 06	yes	modest & gradual app	from Jul 03 level		holding up, downside risk in 2H	steady pace of expansion	positive outlook	risk of second round inflationary pressure	some upward pressure but well-contained	remains strong
10 Oct 06	yes	modest & gradual app	from Jul 03 level		healthy 1H, moderation in 2H	peaked, 2H demand moderation	strong 1H, moderation in 2H	benign	subdued	record job gains, some wage pressures
10 Apr 07	yes	modest & gradual app	from Jul 03 level		holding up but US-realted risks emerging	easing in 1H, recovering by 2H	slower growth but outlook still positive	benign	higher by 0.5% point on GST	tight market, wage pressures in some sectors
10 Oct 07	yes	modest & gradual app, slightly steeper slope of S$NEER policy band	from Jul 03 level		downside risk has increased with fallout in US subprime housing	remained weak	strong 2007	upside risk	higher. GST rate hiked by 2ppt in July, higher asset prices	tight market, wage pressures in some sectors
10 Apr 08	yes	modest & gradual app	recentre at current level		downside risk	remained weak	stronger-than-expected 1Q08, moderation ahead	upside risk	remains high	tight market but wage growth easing
10 Oct 08	yes	neutral stance 0% app	from Apr 08 level		deteriorated sharply	expected to weaken	technical recession in 3Q08, growth to to remain below potential over the next few quarters	oil prices ease	peaked but remains high	expected to ease
14 Apr 09	yes	neutral stance 0% app	recentre at current level		sustained weakness	could weaken further	growth downgraded sharply	muted	full-year deflation expected	job losses
12 Oct 09	yes	neutral stance 0% app	from Apr 09 level		signs of recovery, but downside risks remain	continued improvement	out of technical recession, outlook improved, growth in 2010	upside risk	eased, but picking up	jobs remained fairly resilient
Apr 10	yes	neutral stance 0% app	recentre at current level		recovery in place, some downside risks remain	continued improvement	outlook for 2010 good, expected 5.8% growth rate	upside risk	on the uptrend	jobs growth, unemployment low at 2.1%