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Friday, 07 October 2011

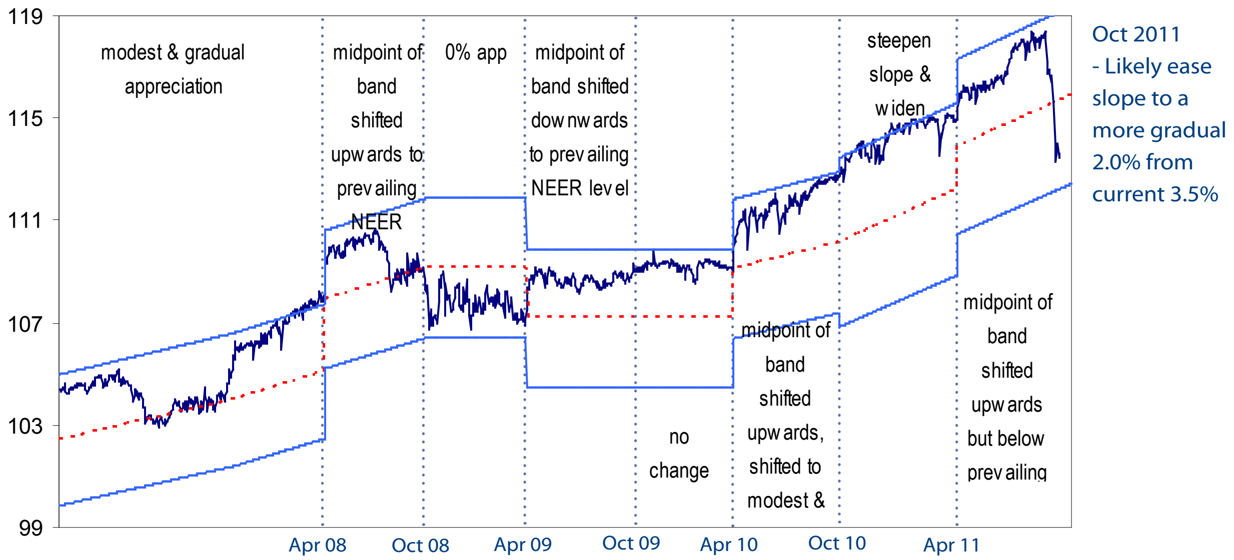
Flash Notes

Singapore: MAS Likely To Ease Monetary Policy, Shift To Gradual SGD NEER Appreciation

- MAS will be releasing its monetary policy statement on 14 Oct at 8am Singapore time.
- Our call is for MAS to shift the SGD NEER slope back to a gradual and modest appreciation. Our current estimation of the SGD NEER slope is at 3.5%, and we project that it could be moved back to 2.0%.
- We also think the risk of a downward recentring has increased, with the SGD NEER having weakened rapidly and is now hovering at the bottom part of the policy band, at around 2.0-2.5% below the band's midpoint.
- We are maintaining our forecast for the USD/SGD to reach 1.29 by year end.

MAS will be releasing its monetary policy statement on 14 Oct at 8am Singapore time. In the past few weeks, the situation in the global economy has deteriorated sharply, exacerbated by stalling recovery in the US and the ongoing uncertainty in Europe. Singapore's economy will be adversely impacted via the manufacturing and some trade-related service sectors. As we have earlier highlighted in our quarterly global outlook for 4Q2011, we expect MAS to ease monetary policy by moving the SGD NEER stance to a more gradual appreciation. We think a technical recession in the 3Q for the domestic economy could be narrowly averted given the strong Aug manufacturing numbers boosted by pharmaceutical production. We are projecting 3Q GDP to grow 5.6% y/y, 0.7% q/q saar.

MAS Policy Decision - On Hold Or Easing?



Source: CEIC, UOB Economic-Treasury Research

Beginning in Apr last year, MAS undertook a series of aggressive tightening measures including an upward recentring and gradual appreciation (Apr 2010), slope steepening and widening the bandwidth (Oct 2010), and one more partial upward recentring (Apr 20111). Our call is for MAS to shift the SGD NEER slope back to a gradual and modest appreciation. Our current estimation of the SGD NEER slope is at 3.5%, and we project that it could be moved back to 2.0%. Inflation is still elevated, so we don't expect the slope to be eased significantly. With full year GDP growth still respectable at 4.8% (our estimate) and a technical recession likely to be averted, we think a SGD NEER appreciation of 2.0% is appropriate given still high inflation and growth in the economy. We do not expect any change to the bandwidth, which we have pegged at 3.0% at the upper and lower limits, to take into account the heightened volatility.

We also think the risk of a downward recentring has increased, with the SGD NEER having weakened rapidly and is now hovering at the bottom part of the policy band, at around 2.0-2.5% below the band's midpoint. Our SGD NEER model showed the trade-weighted index going below the midpoint of the policy since Sep 20. There could be a case for a downward recentring, given that the SGD NEER is likely to stay weak for the next few months.

A shift to neutral (0% appreciation) is also not a likely scenario, in our opinion, since we do not expect GDP to turn negative on a y/y basis. Historically, in past MAS policy decisions, a shift to a neutral stance was undertaken when GDP contracted, such as in Jul 2001, and maintained throughout 2002 and 2003, where there were periods of slow or negative growth. Likewise, during the financial crisis in 2008 and 2009, the MAS also shifted to a 0% appreciation stance.

Impact On USD/SGD

There could be further downside for the SGD, given the current flight to safety. During the global financial crisis in 2008/2009, the SGD depreciated about 15% against the USD from Jul 08 to Mar 09. So far, the SGD has lost about 9.1% against the USD since the pair reached a low of 1.2007 in Aug earlier this year. A 15% depreciation in the SGD suggests that it could reach 1.38 against the USD. But between now to the end of the year, some measures cobbled together by European leaders to stem the European crisis could see the SGD swing back. We are maintaining our forecast for the USD/SGD to reach 1.29 by year end. Next year will be marked by volatility, with USD/SGD likely to trade in a wide range, pending the outcome of the situation in Europe, but we think the pair might end 2012 at 1.25.

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