

Singapore: SOR Rates Head to Negative

Today, short term Swap Offer Rates (SOR) plunged, with the 1-day, 2-month, 3-month and 6-month SORs heading to record lows, and going into negative territory for the first time ever, at -0.02764%, -0.03163%, -0.0119% and 0.06622% respectively.

SOR is the cost of borrowing SGD synthetically by borrowing USD for the same tenor and swapping out the USD in return for SGD. This interest rate is a function of foreign interest rate, forward exchange rate and spot exchange rate. SOR, unlike SIBOR is heavily dictated by the foreign exchange component, generally the forward exchange rate of the USD/SGD. SIBOR and SOR are usually correlated during normal times, but the correlation has broken down in recent times due to the uncertainty and sharp movements of the variables that determine SOR. Today saw forward exchange rates plunge across the short-term tenors, for example, 6M SGD forward plunged 43.75 points from 17.75 points yesterday, with the market expecting USD weakness, which caused the SOR to fall.

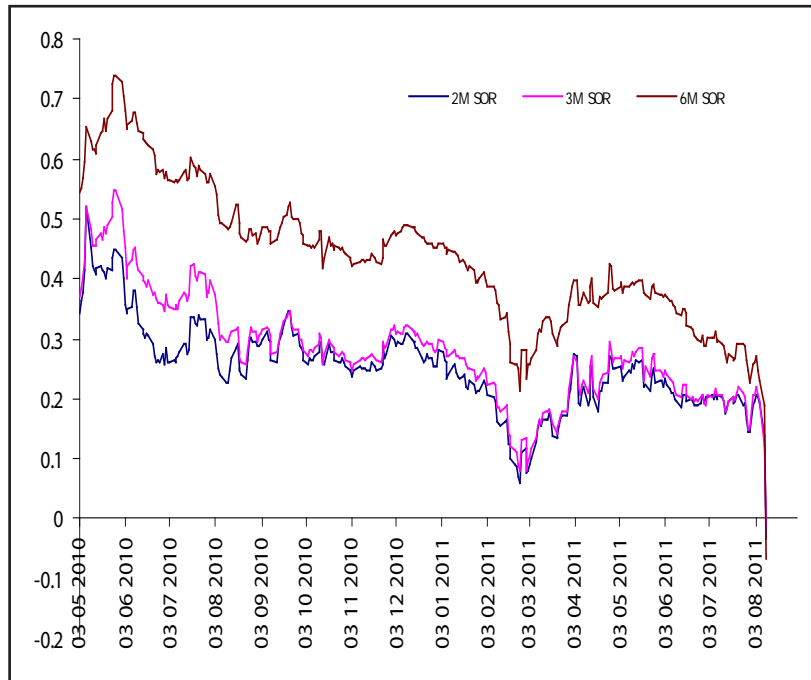
There are some possible explanations for this current phenomenon. A confluence of factors is exerting downward pressure on SOR. Firstly, the US is mired in deep structural growth problems, and yesterday, Fed Reserve Chairman Ben Bernanke took the unprecedented step of stating that US interest rates will be kept low till mid 2013. With US fed funds rate continuing to be kept low, local rates –which tend to follow US fed funds rate closely- will not be rising.

Secondly, USD/SGD is expected to head down in the coming months, which will see the FX component of the SOR dropping. The USD is facing significant headwinds owing to its fiscal deficit position, debt ratings downgrade and stalling growth. And given MAS' current monetary policy stance of a steeper SGD appreciation, and Singapore's relative domestic economic strength, SGD should continue to firm against the USD. We are maintaining our call for the MAS to keep its current monetary policy stance of a steeper appreciation in the upcoming Oct monetary policy, and expecting the USD/SGD pair to end the year at 1.19.

Thirdly, with USD having lost its AAA credit rating for the first time, investors are looking for other safe havens to park their money. Singapore is among 18 sovereigns retaining their top AAA ratings, and regarded as one of the safest by Standard & Poor's. This status will see Singapore continuing to attract inflows, thereby keeping interest rates low.

With all these concerns still likely to persist in the short to medium term, this will exert a downward pressure on SOR. As for SIBOR, there will not likely be any significant change to the current rate unless Fed funds- which the SIBOR tracks- moves up. As such, we see 3M SIBOR likely to stay low for an extended period of time, at its current 0.44% rate, into 2013, mirroring the Fed funds rate.

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Source: Bloomberg

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