

- *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

# Singapore

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.

## 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.

