

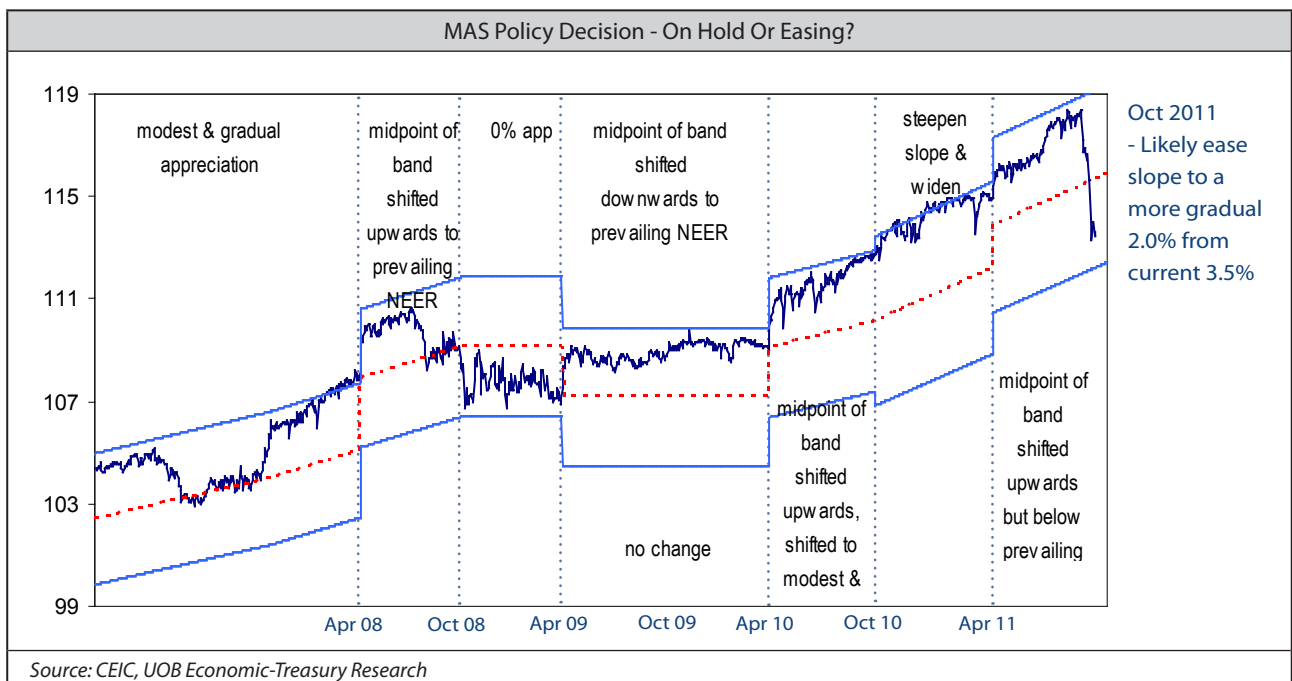
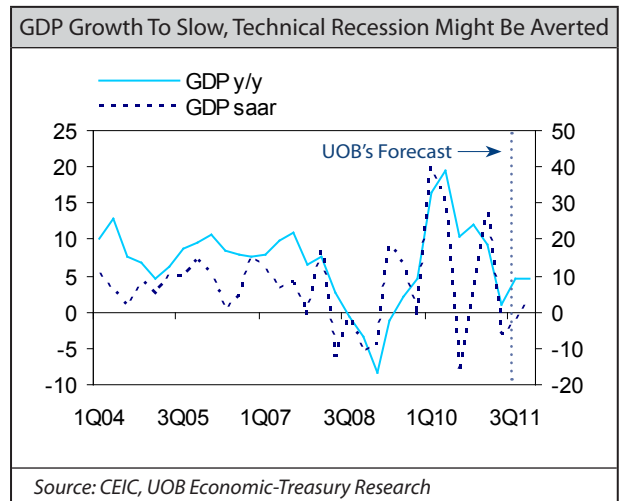
# Singapore Focus I

## MAS Likely To Ease To A Gradual SGD Appreciation

- Against the backdrop of a sharp deterioration in the global economy exacerbated by stalling recovery in the US and the ongoing uncertainty in Europe, Singapore's economy is likely to be adversely impacted. Although we think a technical recession in the 3Q for the domestic economy could be averted due to the strong August IP numbers, even in the event of one, we are not expecting the recession to be prolonged, with the 4Q swinging back to growth on a q/q saar basis, with full year growth at 4.8% and 2012 GDP expanding at 4.5%.
- MAS could loosen monetary policy by moving to a more gradual appreciation stance. Our current estimation of the SGD NEER slope is at 3.5%, and we project that it could be moved back to 2.0%, with no change in band width or mid-point. Domestic inflation is likely to ease from the first half of the year but still remain elevated.
- More weakness could be in store for the SGD on USD funding concerns and the deterioration in Europe. We are revising our USD/SGD forecasts to 1.29 for end- 2011. Risks are tilted towards SGD weakening further on the possible worsening conditions in Europe.

Against the backdrop of a sharp deterioration in the global economy exacerbated by stalling recovery in the US and the ongoing uncertainty in Europe, Singapore's economy is likely to be adversely impacted. However, a technical recession in the 3Q for the domestic economy now looks unlikely. The global slowdown should impair the local manufacturing sector and some spillover into some trade-related service sectors. Even in the event of a technical recession, we are not expecting it to be prolonged, with the 4Q swinging back to growth on a q/q saar basis, with full year growth at 4.8% and 2012 GDP expanding at 4.5%.

Amid this easing in growth outlook, and the rapid deterioration in the markets, Oct's monetary policy will



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be closely watched. MAS could loosen monetary policy by moving to a more gradual appreciation stance. After several rounds of unprecedented tightening measures beginning in Apr last year, including recentring, slope steepening and widening the bandwidth, we think MAS could shift its monetary policy back to a gradual stance. 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 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. The expected loosening of monetary policy by MAS would also be congruent with central bank actions around the region, where domestic central banks in South Korea, Indonesia, the Philippines and Malaysia kept their rates unchanged in light of a slowdown in growth globally and in the region.

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. As for a recentring of the midpoint, that could happen should the SGD NEER start to hover in the lower half of the policy band. According to our SGD NEER model, the SGD trade weighted index has weakened rapidly in the past week, and is now hovering 2.0% to 2.3% below the midpoint, compared to 2.0% above the midpoint as recently as Sep 9.

A recentring downwards might also be likely given that the SGD NEER is now trading at the bottom half of the policy band. GDP growth is still fairly strong at 4.8% for full year 2011. 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.

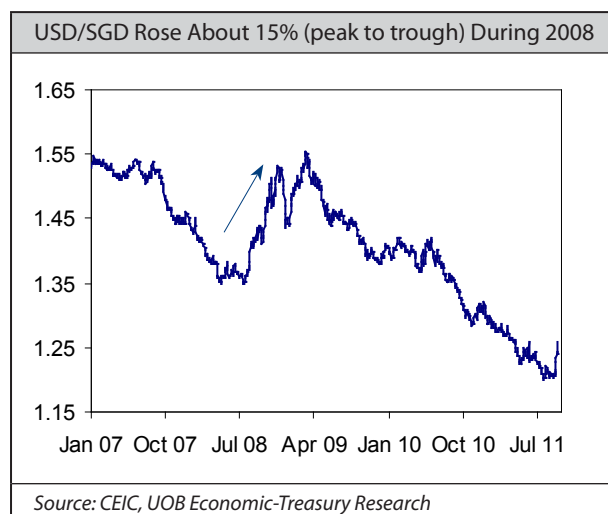
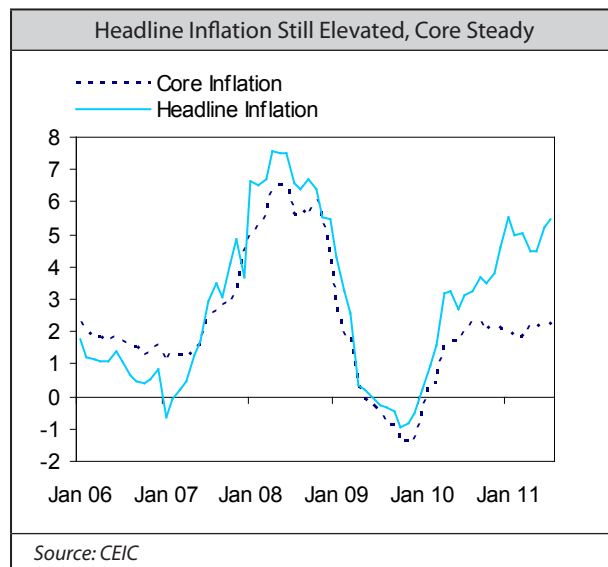
### Inflation To Moderate, But Still High

Turning to the outlook for inflation, headline inflation is still elevated, at 5.7% in Aug, largely pushed up by the resetting of rents at higher levels and COE prices, we should start to see some easing of CPI given the global slowdown. The latest COE prices are starting to show some signs of moderation, and commodity prices should also see some easing on lower demand. As such,

inflation could be less of a bugbear for policy makers. Lower commodity prices resulting from reduced demand could also see CPI inflation ease. But there is still risk of inflationary pressure stemming from the tight domestic labour market, with unemployment rate still low at 2.1% where wage cost pressures are still apparent. For the full year, we are maintaining our forecast for CPI inflation at 4.6%.

### USD/SGD Outlook: Could Be Re-Visiting 2008

The expected easing in monetary policy should give rise to a slower rate of appreciation for the SGD against the USD. Coupled with the extreme volatility and fear in the markets currently, which has seen a flight to safety in USD as a safe haven, we are revising our forecast for the USD/SGD to reach 1.29 by year end, from our earlier forecast of 1.19. The main catalyst for the revision in USD/SGD is the sharp deterioration in Europe's debt crisis, with the market increasingly pricing in a Greek default. It currently

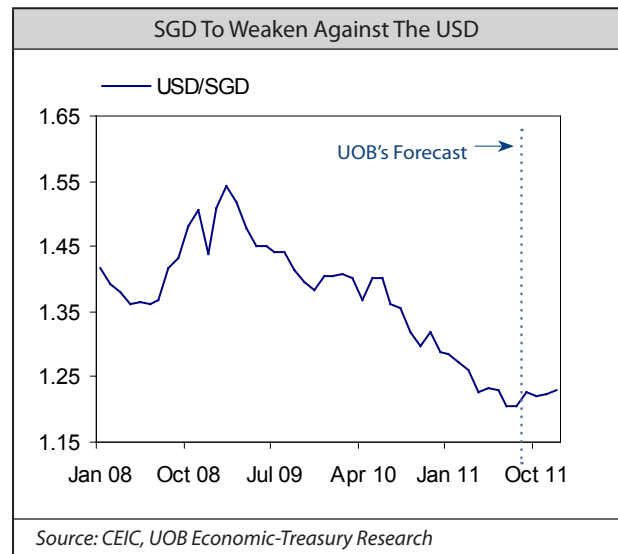


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looks like USD/SGD could surge higher on the unwinding of risk. While we had previously advocated SGD strength, the local unit however has weakened against the USD recently, on the back of Europe situation. One trigger is USD funding, reflected in recent SGD negative SOR. All the problems stemming from the European debt problem could persist for awhile, seeing as to how European leaders do not have a co-ordinated and unified solution to tackling the crisis. As such, we see continued weakness in the SGD for the remainder of the year.

### Looking Back At 2008 – SGD Depreciated 15%

To ascertain how severe it could be, we look back at the Lehman episode. 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 5.1% against the USD since the pair reached a low of 1.2007 in Aug earlier this year. It does suggest that there is some room for the SGD to weaken further. A 15% depreciation suggests that the USD/SGD could reach 1.38. 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.