

Singapore Economy: Firing on All Cylinders

UOB Economics Projections	2008	2009	2010 (F)	2011 (F)
GDP	1.4	-1.3	9.0	5.0
CPI (average, y/y)	6.6	0.6	3.0	3.5
Unemployment Rate (%)	2.7	2.3	2.3	2.5
Current account (% of GDP)	18.5	17.8	13.0	12.5
Fiscal balance (% of GDP)	0.09	-1.1	-1.1	2.3

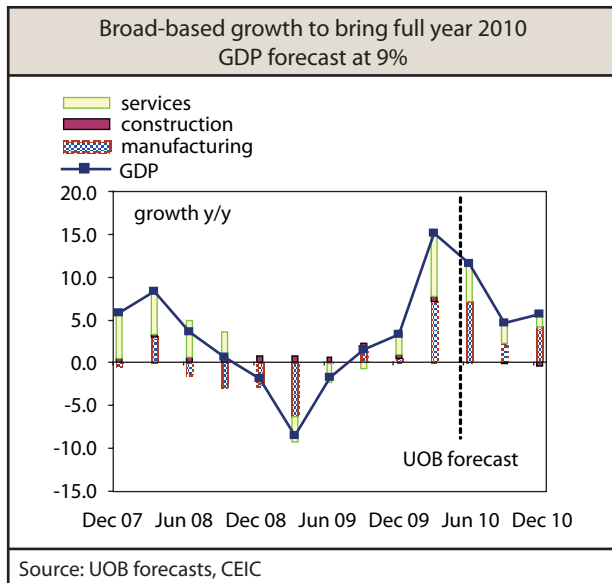
- *Looking ahead, we are projecting some weakness in Singapore's exports arising from the Eurozone problems, and are forecasting some contraction in GDP on a q/q saar basis in the 2Q and 4Q. But after the economy exhibited exceptionally strong gains in the 1Q, and 2Q GDP looks on track for another double-digit growth, we think full year growth looks closer to 9%. We are thus revising up our GDP forecast for 2010 to 9.0%, up from our original 7.5% estimate.*
- *With the announcement of the RMB exchange rate regime reform, we think this will hasten the appreciation in the SGD. The RMB currently makes up about 10.9% of our SGD TWI, and with this adjustment in the RMB, the SGD is slated to strengthen. The risk of unresolved sovereign debt problems in the Eurozone still stand, and should also ensure that the gains in SGD will not be a straight path, with volatility interspersed. We see the USD/SGD going to 1.38 at the end of 3Q, and then moving lower to around 1.36 by year end, as the economic growth fundamentals in this region further give rise to inflows here.*
- *The unfolding developments in Europe might see some moderation in inflationary pressures. For now, MAS' tightening moves in Apr looks ahead of the curve, and it is very likely to stand pat on monetary policy come Oct.*
- *The biggest factor affecting Singapore's domestic interest rates, however, is still the US fed funds rate. Our view is that SGD interest rates will remain low for the remainder of the year. Beyond that, focus will shift to the Fed interest rate tightening bias. With our expectation of the Fed tightening monetary policy in the 1Q of 2011, the 3m SGD SIBOR should move up to 0.8% by 1Q 2011.*

Strong 2010 GDP boosted by manufacturing

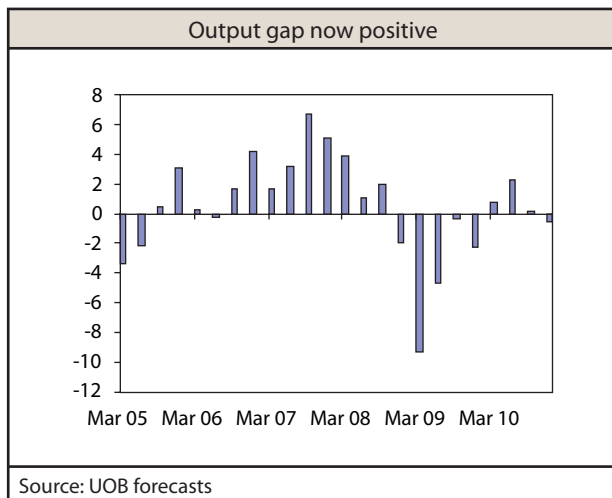
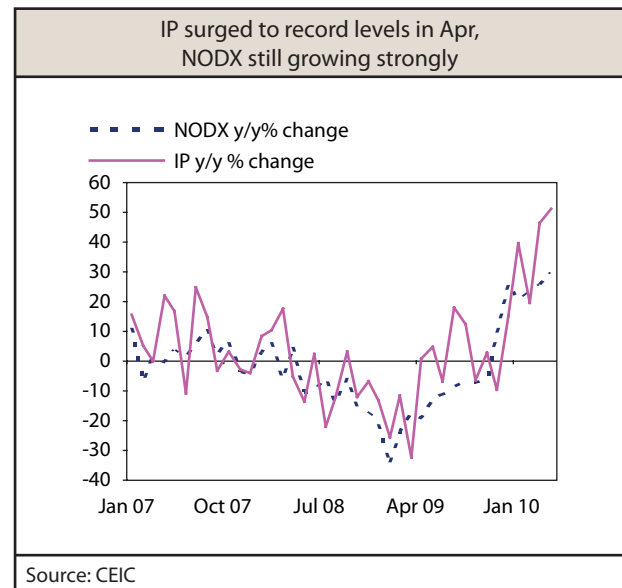
After the economy exhibited exceptionally strong gains in the 1Q, and 2Q GDP looks on track for another double-digit growth, Singapore's full year GDP looks robust. The recent NODX however possibly showed the beginnings of a slowdown in Singapore's exports, on concerns that the austerity measures in Europe will adversely impact the goods and services that Singapore exports to the EU. May's NODX although still strong, at 24.4% y/y, -0.1% m/m s/adj, was slower than the 30% rise in Apr. Notably, NODX to the EU saw a 5.7% y/y growth in May, compared to 25.1% in Mar and 21.3% in Apr. The EU 16 region accounts for about 14.5% of Singapore's total non oil domestic exports, larger than the share of the US, at 10.8%. We could see some slowdown in the second half of the year given the slow growth and fiscal austerity measures in Europe. Currently, the output gap turned positive in the 1Q, and is likely to stay in positive territory until the last quarter of the year, where it may see a slight contraction. This implies the economy is growing above potential and suggests inflation is likely to head higher this year.

Looking ahead, assuming there is no growth in the 2Q, 3Q and 4Q, on a q/q saar basis, the economy will still expand 10.7% for the full year. We are however, projecting some weakness in Singapore's exports arising from the Eurozone problems, and are looking at some contraction on a q/q saar basis in the 2Q and 4Q, bringing full year growth to 9%. We are thus revising up our GDP forecast for 2010 to 9%, up from our original forecast of 7.5%. The expansion looks likely to continue coming from the services sector, where the 2 IRs will keep the retail and hotel sectors buzzing. Manufacturing for now continues to benefit from the global demand for semiconductors and the launch of new consumer electronic products. Pharmaceutical production has been lifting the manufacturing sector and should continue for much of the year given new plants coming onstream. But whether this process of inventory rebuilding can be sustained as end-demand in Europe and US falters, is another issue. For 2011, we are still keeping to our forecast of 5%. 2011 will not have the benefit of a low basis effect and also with companies adjusting to the foreign worker levies and current productivity drive, we think there might be some impact on growth.

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above 30% for the quarter. This could imply 2Q overall GDP coming in at double digit growth rates, which will then push full year growth to our new forecast of 9.0%.



Monthly economic indicators continue to surge robustly, despite some concerns about softer exports and manufacturing due to the problems in the Eurozone. Recent data showed manufacturing output grew exceptionally strongly in Apr, on the back of pharmaceutical output, soaring to 51.0% y/y and 24.3% m/m s/adj in Apr, and exceeding all expectations, defying expectations that the low base effect to taper off, and headline growth rates would come down. Apr's growth pace was the highest on record, surpassing Mar's already robust growth rate of a revised 46.6% y/y. Excluding the volatile pharma segment, manufacturing output would have still grown a respectable 31.0% y/y, which shows that the expansion is broad-based, as electronics, chemicals, and most other sectors grew strongly. The vigorous Apr IP data bodes well for 2Q manufacturing sector growth, possibly pushing growth to

EU Crisis Impact on Singapore

Right now, the focus is on developments in Europe's sovereign debt risk, and how this could affect Singapore's growth prospects. Based on our calculations of output and price effect of the crisis in Europe, the output effects of the European crisis is more significant than the price effect. We estimated that a 1% drop in EU's GDP could also see exports to EU decrease by 2.8% ceteris paribus, while a 1% fall in EUR/SGD would lead to exports to EU falling 1.6% lower, ceteris paribus. Even though Europe accounts for about 10.4% of Singapore's total exports in 2009, compared to about 71.2% for Asia, and 11.2% for US, the hit in exports might be more far-reaching. Exports to America and Asia could be adversely impacted as well, if they import intermediate goods from Singapore, with end-demand in Europe, and thus should not be underestimated. Even with these risks factored in, the GDP figures are robust enough to be upgraded.

Output effect more significant than price effect

	Price effect- Assuming 1% ↓ in EUR/SGD	Output effect- Assuming 1% ↓ in EU GDP
Singapore's exports to EU	1.6% ↓	2.8% ↓

Source: UOB estimates

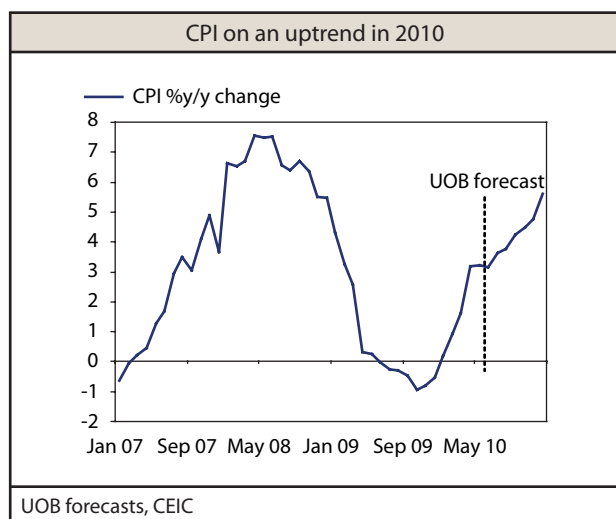
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% of Singapore's total exports

2009	
America	11.24
Asia	71.15
Europe	10.4
Oceania	5.36
Africa	1.93
Source: CEIC	

USD/SGD to trend down slightly towards the end of the year

With the announcement of the RMB exchange rate regime reform, we think this will hasten the appreciation in the SGD. The RMB currently makes up about 10.9% of our SGD TWI, and with this adjustment in the RMB, the SGD is slated to strengthen as a result. The risk of unresolved sovereign debt problems in the Eurozone still stand, and should also ensure that the gains in SGD will not be a straight path, with volatility interspersed. We see the USD/SGD going to 1.38 at the end of 3Q, and then moving lower to around 1.36 by year end, as the economic growth fundamentals in this region further give rise to inflows here.



Inflation and Impact on Monetary Policy in Oct

The CPI inflation rate continues to advance, increasing at its fastest rate in 14 months, in Apr. CPI inflation rose 3.2% y/y, and 0.9% m/m, as transport and accommodation costs fuelled the rise. Although some of the increase is less about demand and supply issues and more about one-off rebates given by the government which will end this year. Cost of housing, cars and fuel were the main reasons for the hike. We estimate that increases in CPI inflation should persist for the rest of the year, although there might be some tapering off of inflationary pressures, due to the ongoing

sovereign debt crisis in Europe. Already, most recently, crude oil prices have moderated, and we have also seen COE prices starting to level off in the latest exercise, which might imply demand-side inflationary pressure easing. However, higher food, housing and still-high transport costs will see inflation edge higher y/y. We are maintaining our CPI forecast of around 3.0% for 2010.

The assumption of higher inflation rate for the year had probably been built into monetary policy, culminating in the 2 tightening measures undertaken by the MAS earlier in Apr. The unfolding developments in Europe might see some moderation in inflationary pressures. For now, MAS' tightening moves in Apr looks ahead of the curve, and it is very likely to stand pat on monetary policy come Oct.

SIBOR Rates

As the SGD is set on an appreciating path, this would likely attract more capital inflows, thereby lowering cost of borrowing. The 'trilemma' faced by small open economy economies with free capital mobility, targeting FX as a monetary policy choice, is that policy makers have fairly little control over domestic interest rate and money supply. Thus, domestic interest rates are largely dictated by external factors, such as US interest rates. This also means that the impact of Singapore's central bank actions on interest rates is less direct. Generally, the uncovered interest rate parity rule holds in Singapore over the medium to long term. Under the UIP condition, the movement of domestic interest rates in Singapore is determined by the level of interest rates abroad, and market expectations of the direction of the Singapore dollar exchange rate. So, according to the UIP, holding everything else constant, we think Singapore's domestic interest rates should remain low, as the SGD continues climbing and capital inflows persist, on the back of expected appreciation in the SGD. The biggest factor affecting Singapore's domestic interest rates, however, is still the US fed funds rate. Our view is that SGD interest rates will remain low for the remainder of the year. Beyond that, focus will shift to the Fed interest rate tightening bias. With our expectation of the Fed tightening monetary policy in the 1Q of 2011, the 3m SGD SIBOR should move up to 0.8% by 1Q 2011.

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