# FX Insight

# SGDNEER Preview: Mitigating "Sticky" Inflation

Analysts
Saktiandi Supaat
(65) 6320 1379
saktiandi@maybank.com.sg

Shaun Lim
(65) 6320 1371
shaunlim@maybank.com

Fiona Lim
(65) 6320 1374
fionalim@maybank.com.sg

Alan Lau
(65) 6320 1378
alanlau@maybank.com

**SGDNEER Largely Remained in Our Projection Range Recently**

Back in mid-Oct (see here), we had maintained a modest bullish bias on the SGDNEER although we cautioned that the risk-reward to a tactical long SGDNEER was a tad asymmetric. We also saw continued likely support for SGD from "haven" characteristics versus its peers in a period of elevated uncertainty. Our Taylor Rule implied SGDNEER model showed that a potential re-centering was necessary to contain the inherent upwards pressures on the SGDNEER. The SGDNEER has since largely remained in the +1% region above the mid-point of the policy band (average: +1.21%), amid a lower USDSGD (1.4260 levels in mid Oct, vs 1.33 levels recently) as the market adjusted to the possibility that the Fed hiking cycle could be coming to an end. Moreover, concerns about the US banking system after Silicon Valley Bank's collapse weighed on the USD and provided greater credence to the end-cycle narrative.

**MAS Could Re-center the Policy Band this April**

The house view is for MAS to re-center the policy band to the prevailing level in mid-April (likely 14 Apr), given elevated inflation pressures. Core inflation remains sticky at levels well above MAS' comfort zone, with the latest Feb core CPI print coming at +5.5% YoY, with broad price increases across food, retail and services following a 1% hike in GST in Jan 2023 and a persistently tight labour market. This will be the sixth tightening move by MAS since Oct 2021. Our economists do not expect a "double move" (both steeper slope and re-centering) because of the rising risks of recession. In addition, they see this as the potential final move as economic prospects worsen and growth is expected to slow in 2024. Market expectations are tilted towards an MAS stand pat, given the responses to the latest MAS survey. We think that any tightening, be it in the form of a re-centering or steepening, would therefore be supportive of SGDNEER, given that neither are fully priced at this point and could induce a >1% gain in the SGDNEER if a tightening does materialize. The SGDNEER is currently estimated at +1.5% above the implied mid-point. **Our base case expectations for a re-centering could result in a tentative post-announcement trading range of +0% to +1.0% above the new (higher) policy mid-point**.

**Underpinning Our Core View for Lower USDSGD**

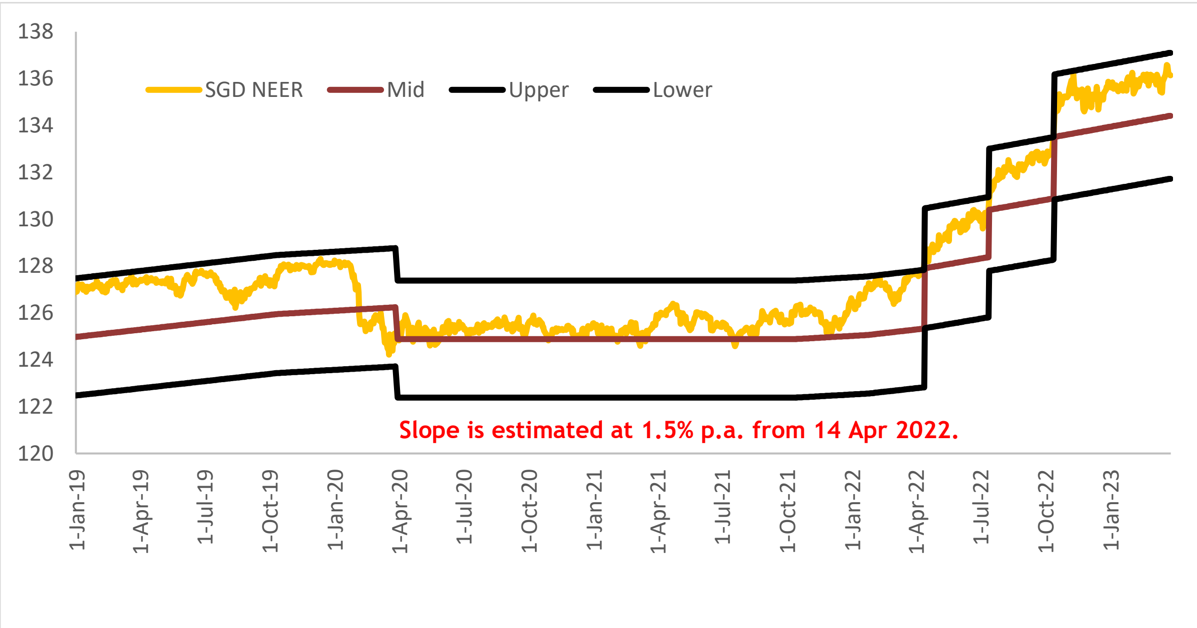
Singapore's robust macro fundamentals such as ample fiscal space, current account surpluses, healthy labour market and political stability etc., will continue to impart SGD some "safe haven" appeal. The Fed also looks to be coming to the end of the tightening cycle amid US financial stability woes that have weighed on the USD. In line with a stronger SGDNEER from MAS' tightening and an anticipated boost for Asian currencies from China's reopening, we look for USDSGD to end the year lower around 1.2850 levels.

### SGDNEER Traded Between +0.6% to +1.9% above the Mid-point since the Oct MAS Re-centering

**In Oct, MAS re-centered the SGDNEER in a move that was widely expected. The decision then was predicated on lingering inflation risks although economic growth was expected to slow.** MAS' Oct policy statement noted that core inflation was likely to remain at around 5% for the rest of 2022 and 2023. At the same time, growth momentum was likely to slow on softening global growth prospects and demand. Therefore, MAS projected below trend growth into 2023, expecting a mildly positive output gap to reverse. MAS also highlighted upside risks to inflation forecasts, including fresh shocks to global commodity prices and second-round effects associated with a prolonged period of high inflation.

Immediately post MAS decision, we had maintained a modest bullish bias on SGDNEER (see here) and cautioned against the tad asymmetry in risk-reward of a tactical long of the SGDNEER. We remained hopeful of the likely support for SGD from "safe haven" characteristics versus peers in this period of elevated external uncertainties. The path of the SGD and SGDNEER has largely been in line with these expectations, with the SGDNEER trading between +0.5% to +1.9% above the mid-point of the policy band (Chart 1). However, we did not expect USDSGD to come off by as tremendously as it has, with USDSGD at 1.4260 on 14 Oct and at 1.33 levels recently.

Chart 1: SGDNEER Largely Staying higher than +1.0% above Par in Oct to March

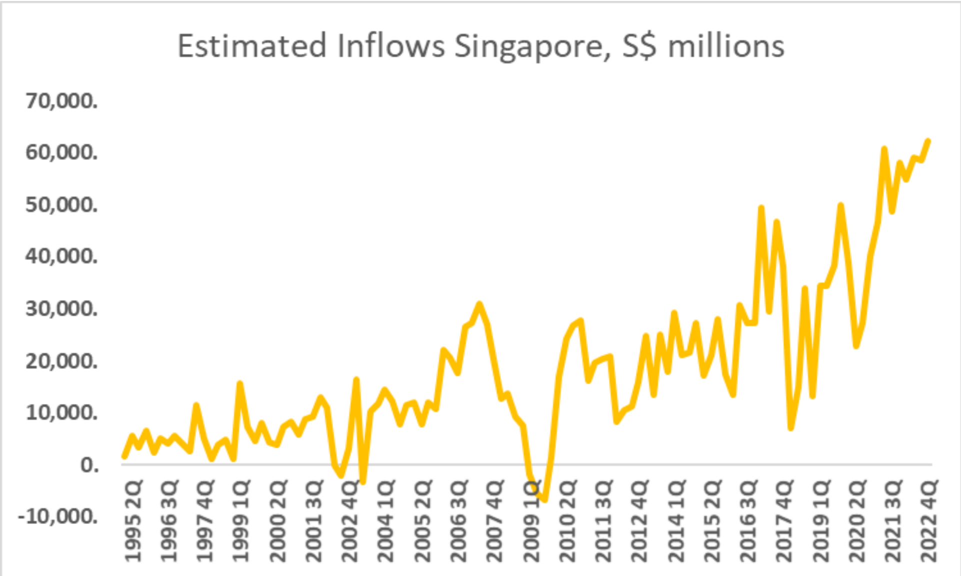



*Source: Bloomberg, Maybank FX Research & Strategy*

**Looking at actual outturns, SGDNEER traded at +0.73% the day of the policy decision. The SGDNEER has remained well-above the mid-point of the policy band since. Over mid-Oct to early Mar, the SGDNEER has mostly stayed above +1.00% (average: +1.21%) above implied mid-point (Chart 1).**

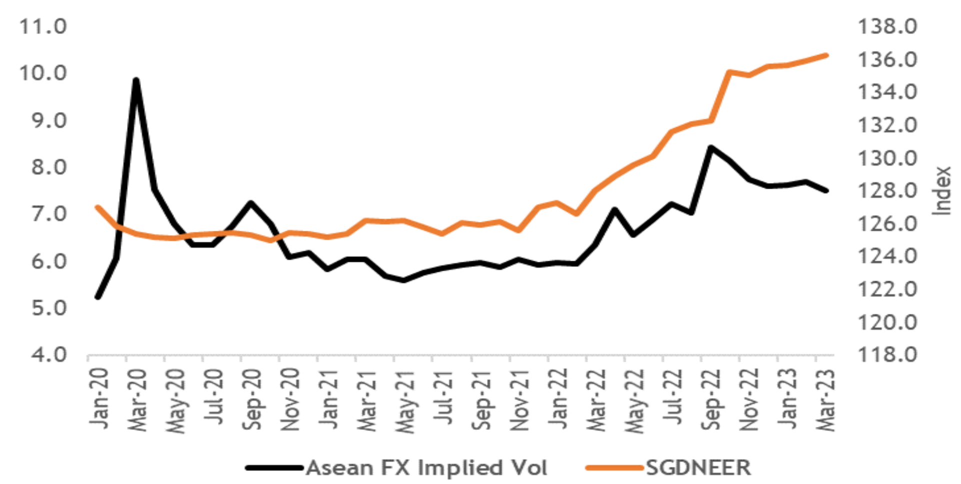
Over the period, we noticed that the SGD exhibited "safe-haven" characteristics in that it tended to be resilient on both a bilateral as well as a trade-weighted basis against most other currencies. Estimated gross inflows have increased over this period of time (Figure 2), underscoring the "safe-haven" properties of the SGD. This contributed to the strength in the SGDNEER as the SGD was a generally more stable store of value than other currencies amid market fluctuations (Chart 3). We think that Singapore's robust macro fundamentals and the credibility of MAS' unique exchange rate based monetary policy have contributed to this. In particular, the lack of an explicit interest rate policy and a strong correlation of SG rates to US rates sheltered the SGD from the widening yield differential issue that had plagued many other currencies in the Fed tightening cycle. The SGD was also further supported by the positive crawl (estimated at +1.5%) against the peers in the SGDNEER basket. We also note that the crawl has at worst been set at 0% and has never been negative, which adds credibility to MAS' policy and contributes to investor confidence in the SGD (Chart 2, 3).

**Chart 2: Recent Inflows Underscore SGD "Safe-Haven" Properties**



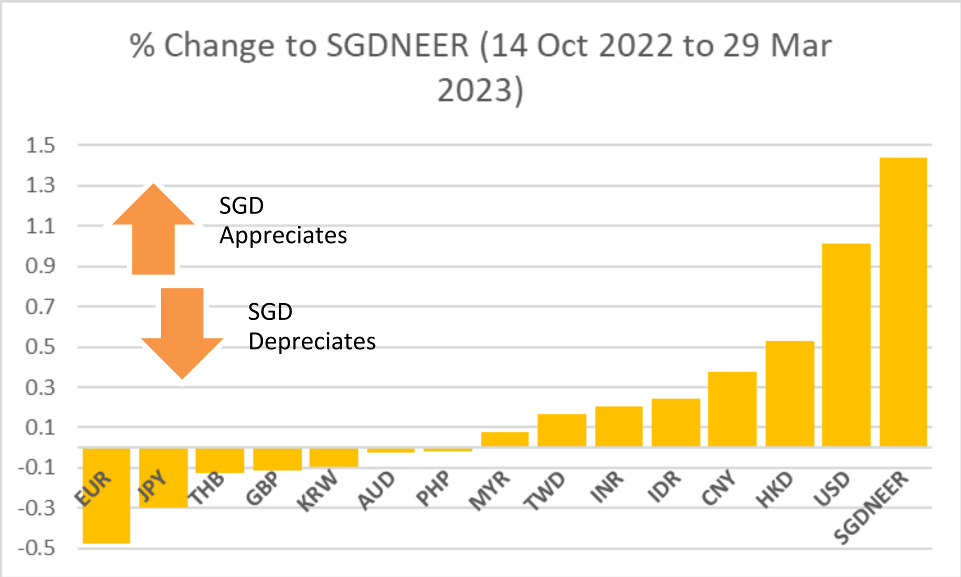

*Source: Singstat, Maybank FX Research & Strategy*
*Note: Quarterly Balance of Payments data from Singstat used as a proxy for gross inflows includes direct investment, portfolio investment and financial derivatives*

**Chart 3: SGDNEER (RHS) Rises in Times of Elevated ASEAN FX Volatility**




*Source: Bloomberg, Maybank FX Research & Strategy*

**Chart 4: Since Mid-Oct, SGDNEER appreciation was mainly due to USD, HKD, CNY and was moderated by EUR, JPY, THB**




*Source: Bloomberg, Maybank FX Research & Strategy*

Since the Oct MAS policy decision, the SGDNEER has appreciated mainly due to the SGD strengthening against the USD, HKD and CNY. Over the same period, the strength in the SGDNEER has mainly been moderated by the SGD weakening against the EUR and JPY (Chart 4).

**MAS Could Re-center the Policy Band This April (Likely 14 April)**

Our house view is for the MAS to re-center the policy band to the prevailing level, given persistently high core inflation that stays well above MAS' comfort zone. This will be the sixth tightening shift since Oct 2021 and could potentially be the final one as growth prospects slow significantly due to weakening external demand.

**Data releases saw Sep-Feb Core CPI Inflation remain persistent at elevated levels**. In the light of the recent surprise OPEC production cuts, MAS could become more inclined to tighten given the potential inflationary effects of the rise in oil prices on Singapore. The implication of this is that inflation could be even sticker than initially thought. Our economists now forecast average core inflation at 4.5% in 2023 (up from 4% previously) and headline inflation at 6.0% (unchanged). MAS will likely raise its 2023 core inflation forecast to 4% to 5% (from 3.5% to 4.5%) and maintain headline inflation forecast at 5.5% to 6.5%. Core inflation remains sticky at levels well above MAS' comfort zone, with the latest Feb core CPI print coming at +5.5% YoY, with broad price increases across food, retail and services following a 1% hike in GST in Jan 2023 and a persistently tight labour market. Our economists also expect a chance that the expansion of the Progressive Wage Model to food services could fan food price pressures. On the other hand, our economists also think the global banking turmoil could exert a deflationary impact on growth and prices if inflation falls more quickly than expected amid tightening global credit conditions and rising short-term interest rates that dampen investment and consumer spending. This implies that MAS may not have to tighten at the subsequent Oct policy meeting.

On growth, our economist team expects Flash 1Q22 GDP to come in at around +1.1% on a YoY basis. On a QoQ SA basis, GDP is expected to print at +0.5% (vs. +0.1% in 4Q 2022), skirting on a technical recession. The downturn is mainly due to a sharp manufacturing contraction and slowdown in the eternal-oriented services sectors, as global demand weakens.

Singapore's GDP growth has historically been highly correlated to US growth. Against a backdrop of recession risks in the US having risen significantly in the wake of the US banking crisis, with the probability of a US recession at 58% over the next 12 months, the probability of a Singapore recession has risen to 30%. These are based on our economists' estimates based on the 3M-10Y US yield curve and 3M-10Y yield curve spread for Singapore. However, China's reopening, while not having had a meaningful impact on manufacturing or exports thus far, is expected to have a more visible impact on growth from 2Q onwards, and our economist expect that this will help to cushion the impact of slowing US economy and decouple Singapore from a US recession. This is in line with our view for China's reopening to benefit Asian currencies broadly and the SGD specifically.

**While rising risks of a recession have yet to spill over to sentiment for the SGD, our house projection for 1.7% growth in 2023, and worsening prospects for future growth should be enough to discourage MAS from a double-tightening (i.e., slope increase + re-centering). That said, both our economists and us see MAS tightening via a re-centering given elevated inflationary pressures that keeps MAS' core inflation above the comfort zone.**

**Table 1: MAS Survey of Professional Forecasters (% of respondents)**

| MAS Actions | December Survey | | March Survey | |
|---|---|---|---|---|
| | 2023 April | 2023 Oct | 2023 Apr | 2023 Oct |
| Increase slope | 33.3 | 11.1 | 23.8 | 0.0 |
| Reduce slope | 0.0 | 0.0 | 0.0 | 0.0 |
| Flatten slope | 0.0 | 0.0 | 0.0 | 5.6 |
| Unchanged | 66.7 | 88.9 | 76.2 | 94.4 |
| Re-center higher | 11.1 | 0.0 | 23.8 | 0.0 |
| Re-center lower | 0.0 | 5.6 | 0.0 | 0.0 |
| Unchanged | 88.9 | 94.4 | 76.2 | 100.0 |
| Widen band | 0.0 | 0.0 | 0.0 | 0.0 |
| Narrow band | 0.0 | 0.0 | 0.0 | 0.0 |
| Unchanged | 100.0 | 100.0 | 100.0 | 100.0 |

*Source: MAS, Maybank FX Research & Strategy*

Market expectations appear to be tilted towards MAS standing pat (Table 1). In the latest MAS Survey of Professional Forecasters, 23.8% of respondents expect a tightening of monetary policy by MAS via a steepening and 76.2% of respondents expect MAS to stand pat (contrast to 33.3% steepen and 66.7% unchanged in Dec 2022). In a separate poll in the same survey, 23.8% of respondents expect a tightening of monetary policy by MAS via a re-centering and 76.2% of respondents expect MAS to stand pat (contrast to 11.1% re-center and 88.9% unchanged in Dec 2022). If we assume that no one is expecting a double tightening, i.e. the groups that expect MAS to tighten are mutually exclusive, then at the very least 52.4% of respondents expect MAS to stand pat. Should there be respondents that expect a double tightening from MAS, then correspondingly a larger percentage of respondents are expecting MAS to stand pat. In summary, it appears that the respondents have shifted to view MAS as being more dovish or coming to the end of the tightening cycle in the March survey. This is in contrast to the December survey, where a larger percentage of respondents thought that some form of tightening was necessary in April and saw MAS tightening through to even October. This is in line with the general market consensus that most central banks in the world are coming to an end of their tightening cycle.

We think that any tightening, be it in the form of a re-centering or steepening, would therefore be supportive of SGDNEER, given that neither are fully priced at this point and could induce a >1% gain in the SGDNEER if a tightening does materialize. The SGDNEER is currently estimated at +1.5% above the implied mid-point. **Our base case expectations for a re-centering could result in a tentative post-announcement trading range of +0% to +1.0% above the new (higher) policy mid-point**.

**Table 2: Past Episodes of Re-centering (Upwards) & Estimated Impact on SGD**

| | 1-Day | | 1-Week (5 Trading Days) | | 1-Month (21 Trading Days) | |
|---|---|---|---|---|---|---|
| **Past Episodes of Recentering Higher** | **Chg in SGDNEER (%)** | **Chg in USDSGD (%)** | **Chg in SGDNEER (%)** | **Chg in USDSGD (%)** | **Chg in SGDNEER (%)** | **Chg in USDSGD (%)** |
| Oct-22 | 0.7 | -0.3 | 1.0 | -0.5 | 1.6 | -4.1 |
| Jul-22 | 0.3 | 0.0 | 0.7 | -0.8 | 1.5 | -2.5 |
| Apr-22^ | 0.5 | -0.4 | 0.5 | 0.1 | 1.0 | 2.5 |
| Apr-11* | 0.7 | -0.8 | 1.0 | -1.5 | 0.9 | -1.4 |
| Apr-10 | 1.2 | -1.4 | 1.3 | -1.3 | 2.1 | -0.9 |
| Apr-08 | 1.3 | -1.4 | 1.6 | -1.8 | 1.4 | -0.3 |

* Re-centred below prevailing level of the SGDNEER.
^ Double-tightening involving slope steepening (estimated 1.0% p.a. increased to 1.5% p.a.).
Note: Changes are estimated versus SGDNEER or USDSGD levels just before the policy shift.
*Source: Bloomberg, Maybank FX Research & Strategy Estimates*

**From Table 2, we see potential for about 1.0% or greater boost to SGD in the case of re-centering higher in the policy band, to prevailing level, although it may take time for this support to fully emerge**. Notably in the most recent and more anticipated episode of re-centering on Oct-22 we saw the SGDNEER trade 1.6% higher one month after MAS' policy decision. We therefore think that our expectations for a stronger SGDNEER, given that this tightening would be less anticipated, are not unreasonable.

In the case of a slight (50bps) steepening, which we view as more unlikely given prevailing concerns about growth and MAS' mandate to achieve non-inflationary sustained economic growth, we think that effect on the SGDNEER would be more sustained over a period of time than in the case of a re-centering.

**Table 3: Past Episodes of "Slight" (50bps) Steepening & Estimated Impact on SGD**

| | 1-Day | | 1-Week (5 Trading Days) | | 1-Month (21 Trading Days) | |
|---|---|---|---|---|---|---|
| Past Episodes of 50bps Steepening | Chg in SGDNEER (%) | Chg in USDSGD (%) | Chg in SGDNEER (%) | Chg in USDSGD (%) | Chg in SGDNEER (%) | Chg in USDSGD (%) |
| Apr-22^ | 0.5 | -0.4 | 0.5 | 0.1 | 1.0 | 2.5 |
| Jan-22 | 0.2 | -0.2 | 0.1 | 0.4 | 0.0 | -0.1 |
| Oct-21 | 0.1 | -0.2 | 0.2 | -0.6 | -0.1 | 0.2 |
| Oct-18 | -0.1 | 0.1 | -0.2 | 0.4 | 0.0 | 0.2 |
| Apr-18 | 0.0 | 0.0 | 0.1 | -0.1 | -0.3 | 1.8 |
| Apr-12** | 0.5 | -0.5 | 0.3 | -0.2 | 0.5 | -0.1 |
| Oct-10* | 0.3 | -0.6 | 0.1 | 0.0 | 1.0 | -1.1 |

^ Double-tightening involving slope steepening (estimated 1.0% p.a. increased to 1.5% p.a.).
* Band also widened to accommodate volatility
**Band also narrowed from earlier widened band to accommodate volatility
Note: Changes are estimated versus SGDNEER or USDSGD levels just before the policy shift.
*Source: Bloomberg, Maybank FX Research & Strategy Estimates*

Looking at past episodes of 50bps steepening (Table 3), we see that the immediate impact on the SGDNEER tends to be smaller in magnitude than in episodes of re-centering (Table 2). This is in line with our expectations given that a slope steepening affects the daily crawl of the SGDNEER, which should have a less immediate impact than that of a re-centering but a more prolonged sustained impact over time. This is in line with MAS' justifications for slope steepening as addressing more persistent structural shifts in inflation. On the other hand, re-centerings could be viewed as one-off level changes to alleviate immediate price pressures. **To reiterate, we do not view a slope steepening as likely given the growth concerns.**

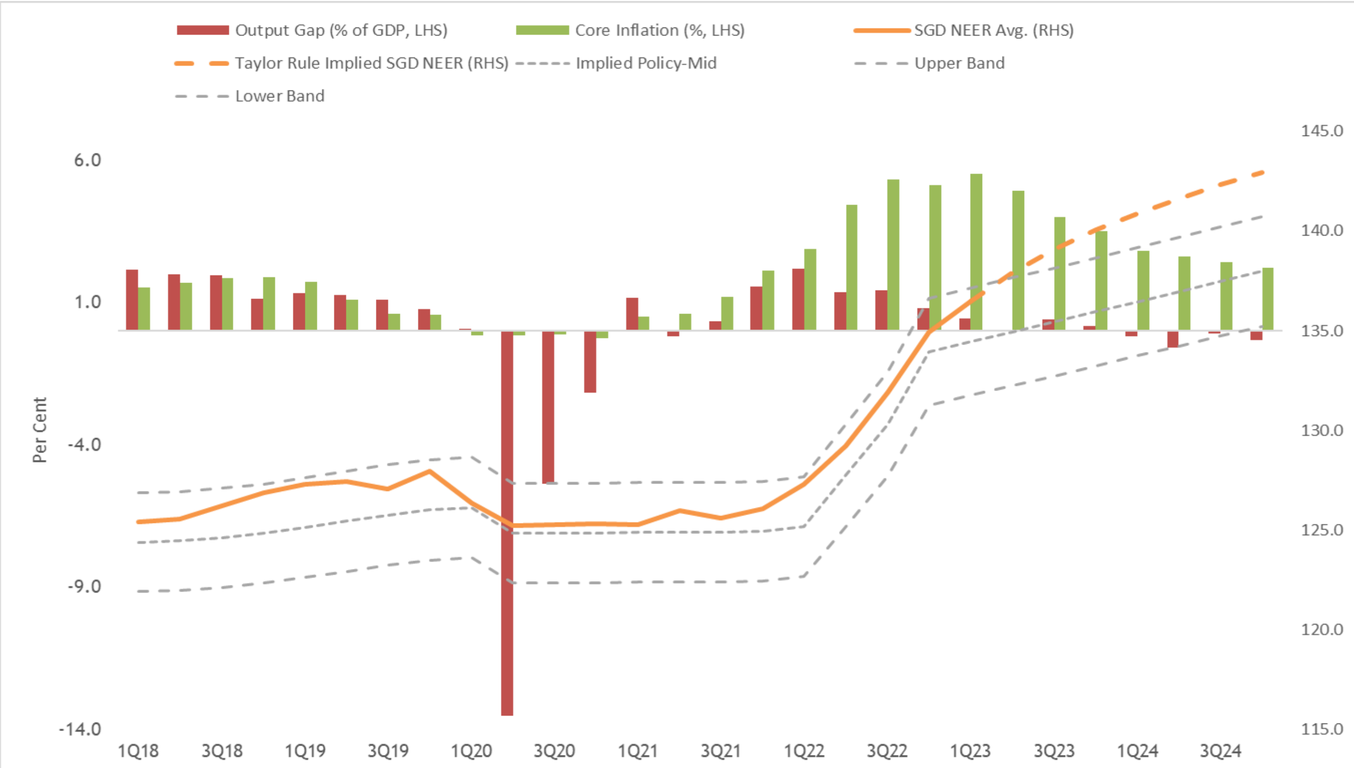
Lastly, while we think a double move is even less likely than a slope steepening, such a move could have an outsized market impact on the SGDNEER given its more hawkish signature. The market effect of such a move could be even more egregious considering the market views MAS as more dovish or coming to the end of a tightening cycle. Double moves also tend to be rarer as MAS tends to opt for policy calibrations that do not cause unnecessary market volatility. **Given that the market does not expect a double tightening move, and as the same growth concerns apply together with the more hawkish signature of a double move, we think that it is even less likely than a slope steepening.**

Although it is likely that USDSGD trades lower should MAS tighten, we remain cautious of being too certain on the USDSGD trajectory on the day of the policy announcement, given that the USDSGD is usually driven by broader USD biases at the point of time and could also be driven by MAS intervention should it feel the need to guide the market back to an appropriate level. Recall that MAS' primary tool for managing the SGDNEER is by intervening in the spot FX market and the preferred intervention pair is USDSGD. Also, we note that from MAS' monograph that MAS refrains from intervening unnecessarily as far as possible. At this point, we see good two-way price action in USDSGD and should current macro narratives hold till the policy announcement we should see USDSGD trade within a 1.32 to 1.3350 range. Should broad USD-weakness themes drive FX, we see USDSGD as low as 1.30 and if USD-strength themes come into play we see USDSGD trade at up to 1.35 levels.

For a check on the potential trajectory for SGDNEER going forward, we turn to our Taylor rule model to derive an implied SGDNEER (Chart 5). Given the drags on growth, the current mildly positive output gap (red bars) are expected to turn mildly negative in 2024. Core inflation (green bars) has exceeded 2% since Dec 2021 and looks to remain sticky above 2% till 2024. Our economist team's latest forecasts for core inflation and headline inflation in 2024 are 2.5% and 2.8%, respectively.

Given these macro conditions, our Taylor rule implied SGDNEER estimates (dotted orange line in Chart 5 below) suggest that SGDNEER is likely to continue seeing upward pressures in the coming quarters. Notably, our estimates imply that **the current upper bound of the policy band may not be able to contain the inherent upward pressures on SGDNEER and therefore provide further justification for a re-centering.**

**Chart 5: SGDNEER Could See Upward Pressures to 2024 (Taylor Rule Estimates)**




*Source: Bloomberg, Maybank FX Research & Strategy Estimates*

As mentioned earlier, we do see the potential for a lower USDSGD on announcement day should MAS choose to tighten. Robust macro fundamentals in Singapore such as ample fiscal space, current account surpluses, healthy labour market and political stability etc., will continue to impart SGD some "safe-haven" appeal, and this is still likely to be reflected in SGDNEER strength. However, we also see the Fed coming to an end of the tightening cycle and are looking for the USD to weaken gradually through the year as the market pares back on USD assets. In addition, we expect China's reopening effects to be beneficial for Asian currencies and specifically for the SGD, with its close trade linkages to China. This is in line with our economists views that a China recovery later in the year could potentially decouple Singapore's growth prospects from a possible recession in the US. In addition, we are expecting MAS to tighten and for this to underpin SGD strength vs its peers in the basket, which includes the USD. We therefore maintain our bearish view on the USDSGD and our USDSGD forecasts. We see USDSGD lower at 1.2850 levels at the end of the year (Table 4).

**Table 4: Quarterly USDSGD Forecasts**

| Forecast | 2Q 2023 | 3Q 2023 | 4Q 2023 | 1Q 2024 |
|---|---|---|---|---|
| **USDSGD** | **1.3000** | **1.2900** | **1.2850** | **1.2850** |

*Source: Maybank FX Research & Strategy Estimates*

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Malayan Banking Berhad
(Incorporated In Malaysia)


### Foreign Exchange

Singapore

Saktiandi Supaat
Head, FX Research
saktiandi@maybank.com.sg
(+65) 6320 1379

Fiona Lim
Senior FX Strategist
Fionalim@maybank.com.sg
(+65) 6320 1374

Alan Lau
FX Strategist
alanlau@maybank.com
(+65) 6320 1378

Shaun Lim
FX Strategist
shaunlim@maybank.com
(+65) 6320 1371

Indonesia

Juniman
Chief Economist, Indonesia
juniman@maybank.co.id
(+62) 21 2922 8888 ext 29682

Myrdal Gunarto
Industry Analyst
MGunarto@maybank.co.id
(+62) 21 2922 8888 ext 29695

### Fixed Income

Malaysia

Winson Phoon
Head, Fixed Income
winsonphoon@maybank.com
(+65) 6340 1079

Se Tho Mun Yi
Fixed Income Analyst
munyi.st@maybank-ib.com
(+60) 3 2074 7606

### Sales

Malaysia

Zarina Zainal Abidin
Head, Sales-Malaysia, Global Markets
zarina.za@maybank.com
(+60) 03- 2786 9188

Singapore

Janice Loh Ai Lin
Head of Sales, Singapore
jloh@maybank.com.sg
(+65) 6536 1336

Indonesia

Endang Yulianti Rahayu
Head of Sales, Indonesia
EYRahayu@maybank.co.id
(+62) 21 29936318 or
(+62) 2922 8888 ext 29611

Shanghai

Joyce Ha
Treasury Sales Manager
Joyce.ha@maybank.com
(+86) 21 28932588

Hong Kong

Joanne Lam Sum Sum
Head of Corporate Sales Hong Kong
Joanne.lam@maybank.com
(852) 3518 8790

Philippines

Angela R. Ofrecio
Head, Global Markets Sales
Arofrecio@maybank.com
(+632 7739 1739)