

FX Insight

SGD Preview: Upward Pressures Remain

MAS is Likely to Stand Pat in Oct

Our house view is for MAS to maintain the prevailing slope at the upcoming Oct policy meeting. Core inflation, while easing, remains at levels above MAS' comfort zone. In addition, price pressures are re-emerging in terms of higher food and energy costs. Wage pressures are likely to be sustained by the Progressive Wage Model, while the 1% GST hike and increase in carbon tax scheduled in Jan-24 are likely to have direct and indirect effects on inflation. These factors are likely to be part of policymakers' considerations for the Oct decision. However, given the potential for growth stagnation, our economists ascribe a small (20%) probability that MAS could surprise by a "slight" (assumed to be 0.5%) easing the slope of SGDNEER appreciation. **We contend that the SGDNEER is likely to continue outperforming, and would suggest to buy the SGDNEER basket on dips.**

SGDNEER Likely to Outperform

Back in mid-Apr (see [here](#)), we maintained a bullish bias on the SGDNEER and suggested that the SGDNEER could outperform. We saw continued likely support for the SGDNEER from "haven" characteristics versus its peers in a period of elevated uncertainty and our Taylor Rule implied SGDNEER model showed that a potential re-centering was necessary to contain the inherent upwards pressures on the SGDNEER. Although MAS stood pat against our expectations, the SGDNEER has since largely remained in the upper half of the policy band (average: +1.51%), despite USDSGD moving higher (from 1.32 levels to 1.37 levels) over the same period. The current narrative for US rates being higher for longer fuelled by a more hawkish Fed has resulted in the outperformance of the SGDNEER as the non-USD currencies in the SGDNEER basket have largely fared worse than the SGD. We think that Singapore's robust macro fundamentals and unique exchange rate policy, which results in SG rates being highly correlated with US rates, will underpin a continued likely outperformance of the SGDNEER against the backdrop of US rates being higher for longer.

However USDSGD Could Be Higher for Longer

While we do believe that the SGD could outperform on a trade-weighted basis, we also think that USDSGD could remain higher for longer. This is reflected in our recently revised forecasts and is in line with our broad view for other currencies, and specifically Asian currencies. We believe that the Fed remaining as the most likely DM central bank to continue to hike should lead to higher for longer US rates and more persistent USD strength.

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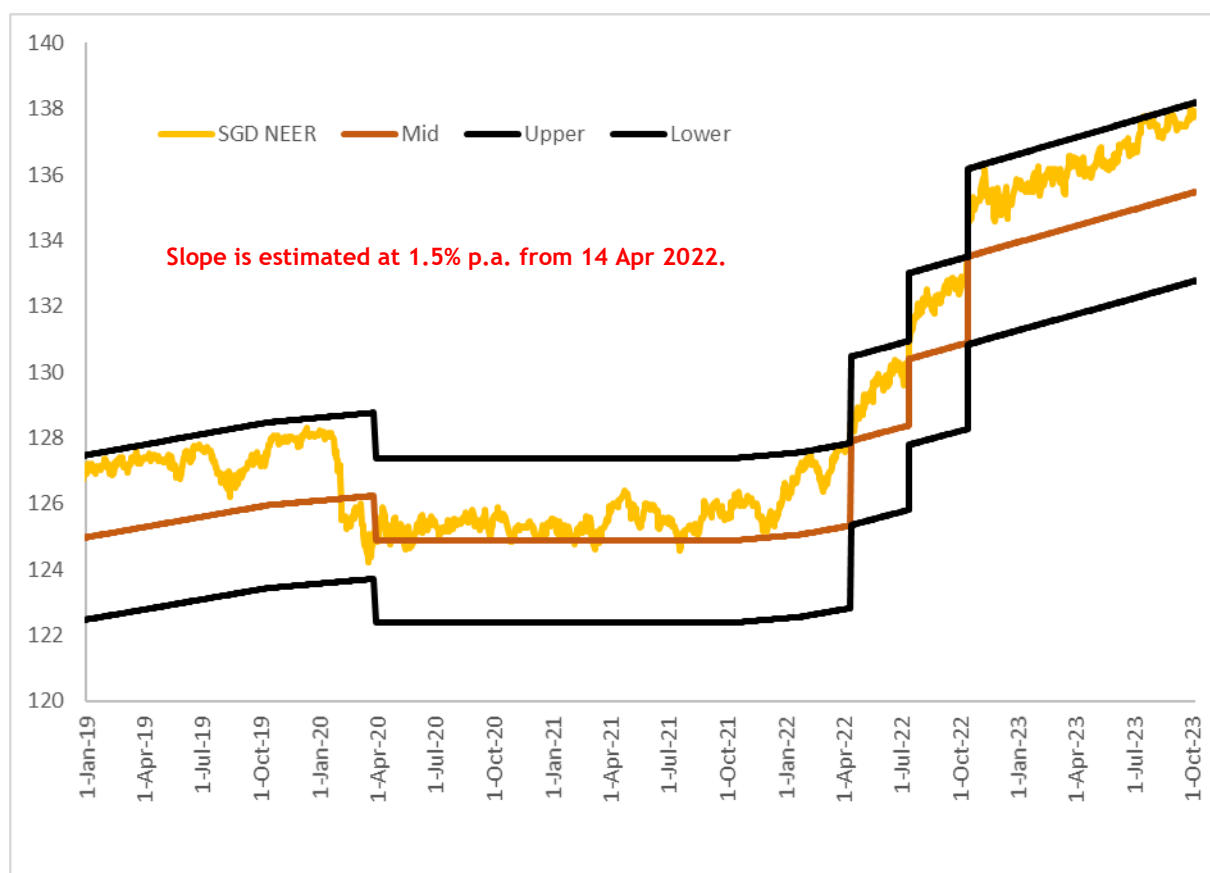
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SGDNEER Traded Between +0.99% to +2.03% above the Mid-point since Apr Stand Pat

In Apr, MAS stood pat, declining to adjust policy settings on the belief that policy was sufficiently restrictive and inflation would come off later in the year. Inflation has indeed come off in line with MAS' expectations, although notably core inflation remains above MAS' comfort zone. Our expectation in Apr was for a tightening and while this did not materialize, the SGDNEER has remained firmly in the upper half of the policy band since the decision.

Immediately post MAS decision, we had maintained a modest bullish bias on the SGD (see [here](#)) and emphasized our belief on the continued resilience in the SGDNEER. While the USDSGD has gone higher (weaker SGD), largely due to China's reopening flattering to deceive, the SGDNEER has been resilient and traded firmly above the mid-point of the policy band (Chart 1). The average value of the deviation from the mid-point has been 1.52% since Apr. In our base case expectation for MAS to stand pat in Oct, we expect SGDNEER resilience to continue.

Chart 1: SGDNEER Largely Staying higher than +1.5% above Par from Apr to Oct

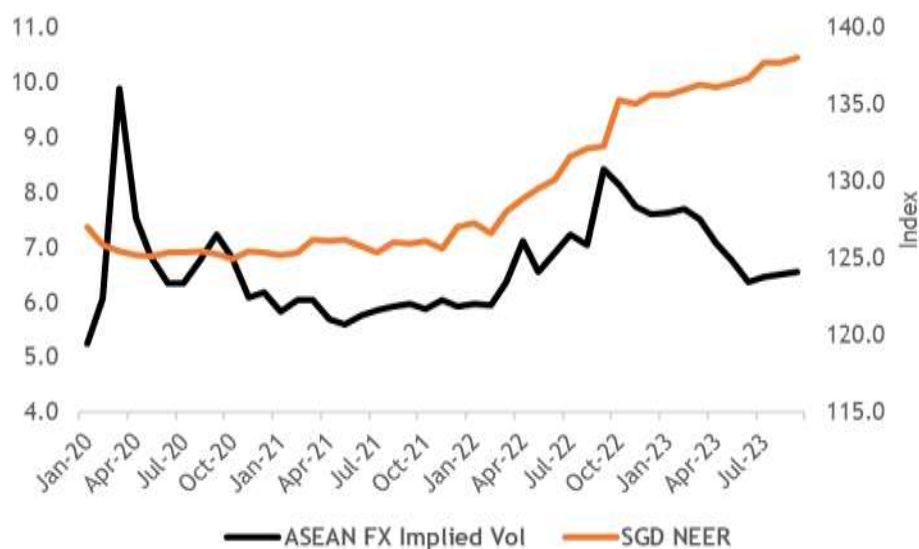


Source: Bloomberg, Maybank FX Research & Strategy

Over time, we observed the SGD displaying its "safe-haven" qualities, showing resilience both in bilateral and trade-weighted contexts against most other currencies (Chart 2, Chart 3). This robustness in the SGDNEER was due to the SGD serving as a more stable store of value compared to most other basket currencies amidst market fluctuations (Chart 3). Singapore's strong macro fundamentals (i.e. fiscal resilience) and the credibility of MAS' unique exchange rate-based monetary policy played a significant role in this phenomenon. Unlike many other currencies affected

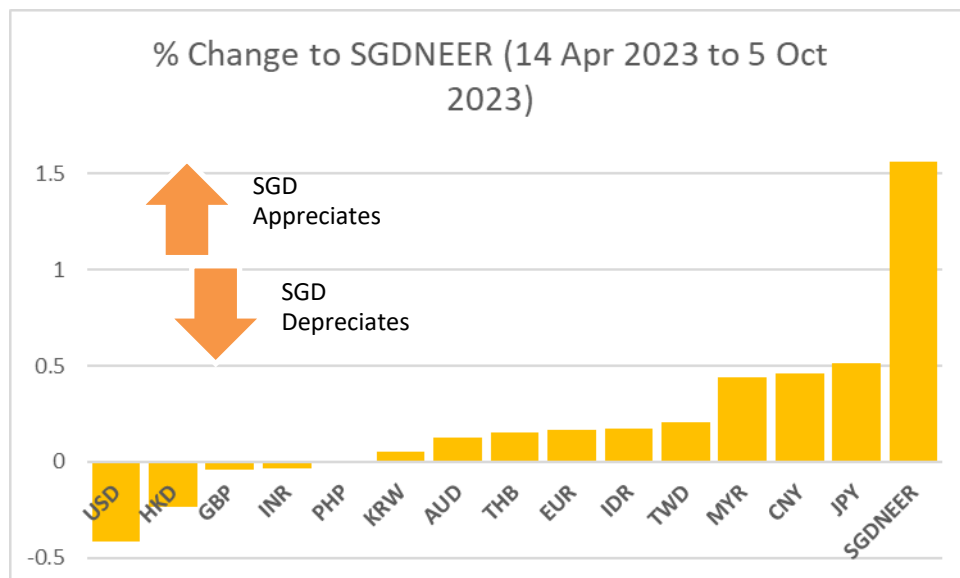
by the widening yield differentials amid a more hawkish Fed, Singapore was sheltered by the absence of an explicit interest rate policy and a robust correlation (est. 97.33% correlation) of SG rates with US rates (Chart 4). Additionally, the SGD received support from a positive crawl rate (assumed to be +1.5%) against its peers in the SGDNEER basket. It's noteworthy that this crawl rate has never been set below 0%, further enhancing investor confidence in the SGD and adding credibility to MAS' policy.

Chart 2: SGDNEER (RHS) Rises as ASEAN FX Volatility Moderates



Source: Bloomberg, Maybank FX Research & Strategy

Chart 3: Since Mid-Apr, SGDNEER appreciation was mainly due to JPY, CNY and MYR and was moderated by USD-bloc (incl HKD), GBP and INR



Source: Bloomberg, Maybank FX Research & Strategy

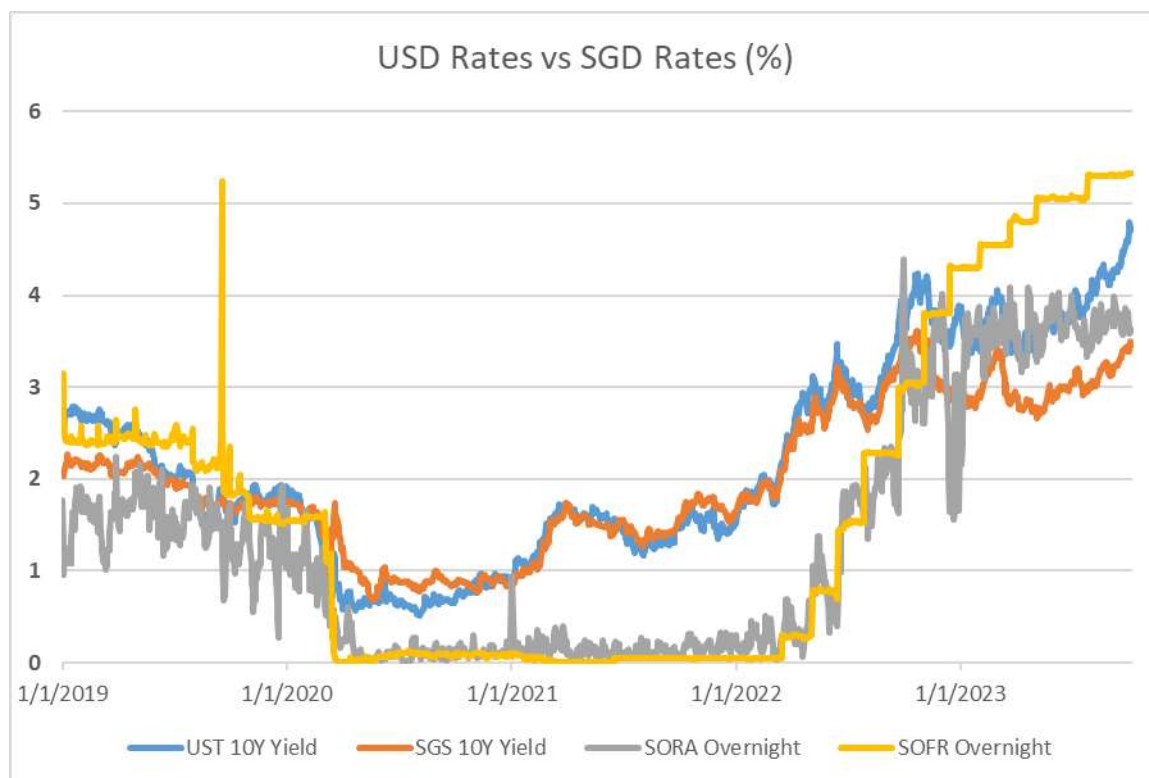
Since the Apr MAS policy decision, SGDNEER appreciation has been due to the SGD appreciating against most of the currencies in the basket, in particular the JPY, CNY and MYR. Over the same period, the strength in the SGDNEER has mainly been moderated by the SGD weakening against the USD, HKD and GBP (Chart 3).

We look for the SGDNEER to remain resilient, given that the SGD should remain better sheltered than other Asian currencies in an environment of high US yields, given the correlation of SG rates to US rates (Chart 4) due to the lack of an interest rate policy.

Higher global and domestic interest rates (Chart 4) have contributed to tighter financial conditions. This has also manifested in negative growth rates of commercial bank loans and advances (Chart 5). Tighter financial conditions could also have a dampening effect on domestic inflation, which could support MAS' expectations for inflation to come off and support the case for MAS to stand pat and not tighten policy further. Our fixed income analysts are expecting US rates to decline in 2024 which should be supportive of SGD strength in 2024.

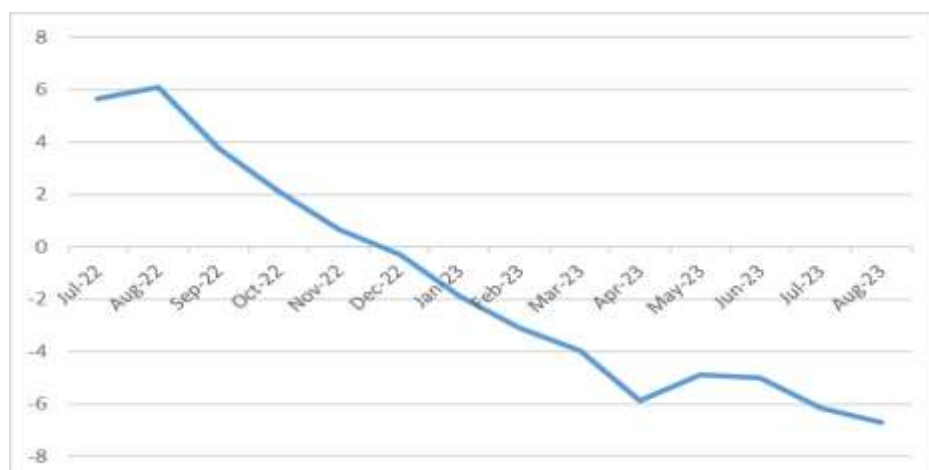
Our assessment is that MAS is likely to stand pat in Oct, and the continued appreciating stance (assumed to be +1.5% p.a.) in the SGDNEER should provide plenty of support for the SGD.

Chart 4: USD Rates and SGD Rates Are Highly Correlated



Source: Bloomberg, Maybank FX Research & Strategy

Chart 5: Growth Rates of Commercial Bank Loans and Advances have turned Negative (%)



Source: MAS, Maybank FX Research & Strategy

MAS is Likely to Stand Pat in Oct (Likely 13 Oct)

Our view is that MAS is likely to stand pat, as while inflation has come off in line with MAS' expectations, core inflation remains above MAS' comfort zone (of around 2%). In addition, upside risks to inflation still exist, and these factors should be major considerations for policymakers'. MAS previously referred to the policy stance as "sufficiently tight" and "appropriate" and we think the language supports the case for a stand pat, given the actual outturns in inflation and growth thus far. However, our economists ascribe a 20% probability for a "slight" easing of the SGDNEER appreciation slope, given the potential for growth stagnation in Singapore.

On inflation, both headline and core inflation have gradually decreased through the year, reaching +4% and +3.4% respectively by August. Our projections indicate that the average core inflation for 2024 will be around +2.8%, while headline inflation is anticipated to be +2.9%. We expect core inflation to decrease to approximately +3% by the end of the year due to declining import prices and reduced service costs. However, it's possible that inflation might remain resistant to significant decreases and could pick up again in 2024.

The downward adjustment in commodity prices has largely stabilized, with recent months witnessing a rebound in oil and food prices. Despite global food prices being 24% lower than their peak in March 2022, disruptions in agricultural output caused by El Nino and climate change have led to a broader increase in food costs. Additionally, the implementation of a 1% GST hike and a fivefold increase in the carbon tax rate (from S\$5 to S\$25) on Jan 1, 2024, could directly and indirectly impact consumer and business expenses.

Wage pressures are expected to persist due to mandated increases under the Progressive Wage Model, higher qualifying salaries for S Pass and Employment Pass holders, and an elevated wage ceiling for CPF contributions starting from September 1, 2023. The labor market remains tight, characterized by low unemployment rates and a high number of job vacancies, with improving job prospects. Rising costs in private transportation, including higher COE prices, ERP rates, and fuel expenses,

will contribute to headline inflation. However, inflation in accommodation may ease due to slowing rental growth and an increase in housing supply.

On growth, our economist team expects advance estimates for 3Q22 GDP to come in at around +0.1% on a YoY basis (2Q2023: +0.5%) as a slightly narrower manufacturing contraction is outweighed by easing services growth. Full-year GDP growth of +0.8% in 2023 and +2.2% in 2024 is estimated. Growth in the upcoming year will be underpinned by a manufacturing and trade recovery, easing domestic interest rates alongside the Fed, and moderate reopening tailwinds in tourism and construction. MTI will likely set the full-year GDP forecast range of +1% to +3% in 2024, when final 3Q GDP growth is published in late November.

As MAS has signalled that it is not switching from “inflation-fighting mode” to “growth-supporting mode” at this juncture, we think it is important to note that the 20% probability ascribed to a surprise MAS easing is not a base case scenario and is something that our economists cannot rule out at this point. In addition, our economists note that there is sufficient fiscal space for the government to do the heavy lifting to support growth if the economy stagnates or contracts. Our economists assess that there is ample fiscal space to deploy additional support, given strong revenue growth that will likely exceed MOF’s projections in FY23/24. The government recently announced the Majulah Package (S\$7bn) and Cost-of-Living Support Package (S\$1.1bn), which included an S\$800mn top-up to the S\$9.6bn GST Assurance Package.

When combined, these factors should suggest that the most likely outcome is for MAS to stand pat. Although a surprise easing cannot be ruled out, it is far less likely that MAS chooses to tighten policy at the upcoming Oct meeting, given that actual outturns for growth and inflation have largely been in line with MAS’ expectations. From the market’s perspective (Table 1), the prevailing view also appears to be unanimously in favour of MAS standing pat at the Oct-2023 meeting, with about a quarter of respondents suggesting that MAS could look to ease via a slope reduction at the following meeting in Apr-24.

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

MAS Actions	Jun Survey		Sep Survey	
	2023 Oct	2024 Apr	2023 Oct	2024 Apr
Increase slope	0.0	0.0	0.0	5.6
Reduce slope	0.0	26.3	0.0	27.8
Flatten slope	0.0	0.0	0.0	0.0
Unchanged	100.0	73.7	100.0	66.7
Re-center higher	0.0	0.0	0.0	0.0
Re-center lower	0.0	5.3	0.0	5.6
Unchanged	100.0	94.7	100.0	94.4
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

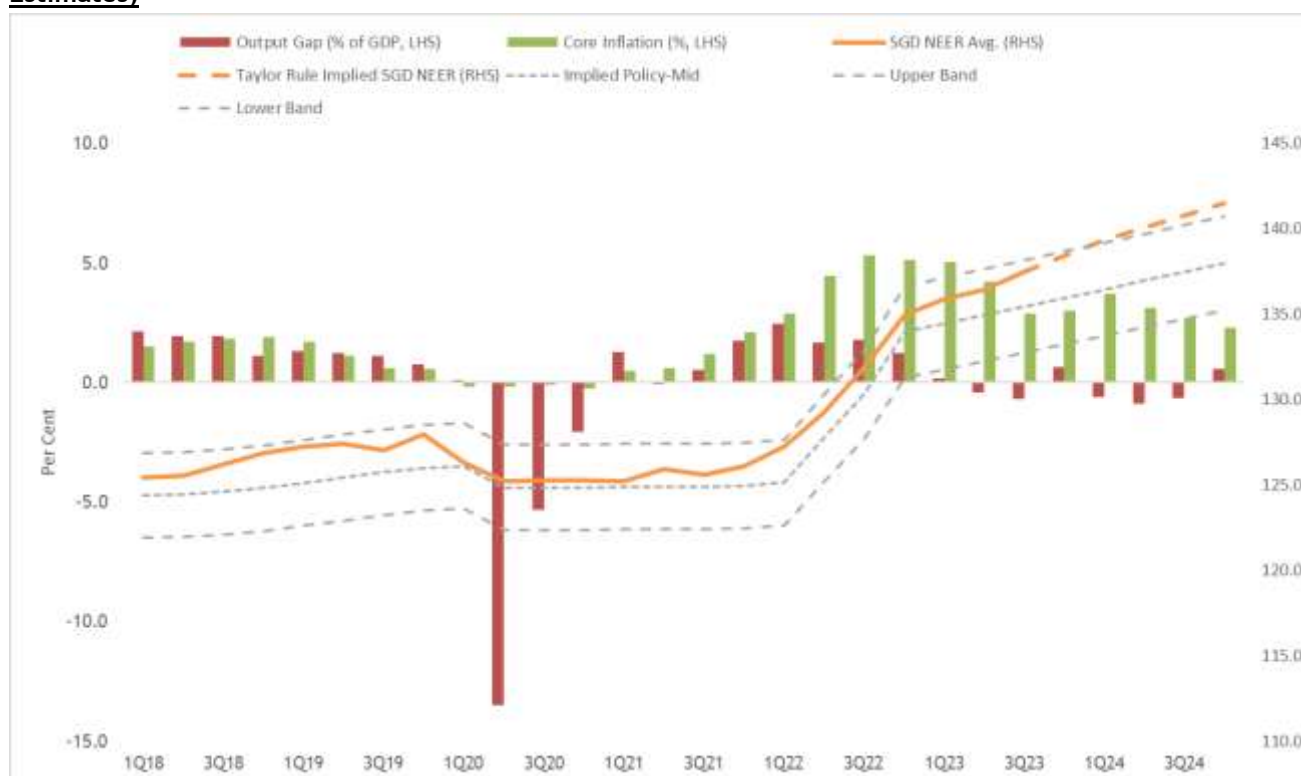
Source: MAS, Maybank FX Research & Strategy

SGDNEER Likely to Outperform

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 2.8% and 2.9%, 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 SGDNEER could continue to see upward pressures into 2024.

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



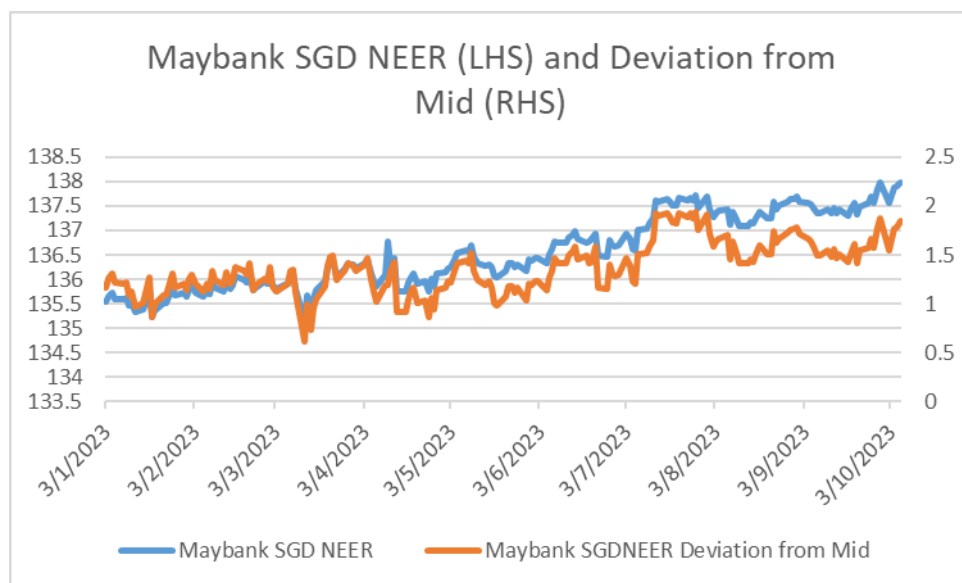
Source: Bloomberg, Maybank FX Research & Strategy Estimates

As mentioned earlier, the SGD has outperformed on a trade-weighted basis YTD, reflected in SGDNEER moving higher (Chart 6). YTD the SGDNEER has appreciated by about 1.82%. In terms of deviation from the mid-point of the policy band, the SGDNEER has remained firm and is currently at 1.85%. The SGD should remain better sheltered than other Asian currencies in an environment of high US yields, given the correlation of SG rates to US rates due to the lack of an interest rate policy (Chart 4). Our assessment is that MAS is likely to stand pat in Oct, and the continued appreciating stance (assumed to be +1.5% p.a.) in the SGDNEER should provide plenty of support for the SGD and result over time in a lower USDSGD.

Our assessment is that MAS is likely to stand pat in Oct, and the continued appreciating stance (assumed to be +1.5% p.a.) in the SGDNEER should provide plenty of support for the SGD and result over time in a lower USDSGD (Table 2). On the off chance that MAS should ease policy at this Oct 6, 2023

meeting, we still think that the SGDNEER should remain resilient in the medium-term. Singapore's robust macro fundamentals remain intact, and the stance after a "slight" slope reduction should still imply a +1.0% p.a. appreciation in the SGDNEER. This should continue to be supportive of the SGDNEER in the medium-term and would still remain convicted to buy the SGDNEER basket on dips even if MAS should conduct a surprise easing.

Chart 6: SGDNEER Performance and Deviation from Mid (%) YTD



Source: Bloomberg, Maybank FX Research & Strategy

However USDSGD Could Be Higher for Longer

While we do believe that the SGD could outperform on a trade-weighted basis, we also think that USDSGD could remain higher for longer. This is reflected in our recently revised forecasts and is in line with our broad view for other currencies, and specifically Asian currencies. We believe that the Fed remaining as the most likely DM central bank to continue to hike should lead to higher for longer US rates and more persistent USD strength. This is reflected in the higher USDSGD levels and the more gradual downward trajectory of USDSGD in our recent forecast revision (Table 2).

Table 2: Quarterly USDSGD Forecasts

Forecast	4Q 2023	1Q 2024	2Q 2024	3Q 2024
USDSGD	1.3650	1.3650	1.3550	1.3450
	(1.3500)	(1.3400)	(1.3250)	(1.3150)

Source: Maybank FX Research & Strategy Estimates

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