FX Global

FX Flash

SGD: Recalibrating our SGDNEER Model

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A Recap on MAS SGDNEER Policy

MAS manages the SGD against an undisclosed trade-weighted basket of currencies, or the SGDNEER index. This is the policy tool of choice to mitigate imported sources of inflation, which is a reasonable approach considering Singapore is a small and open economy. However, given the considerable uncertainty over the policy parameters, estimating the SGDNEER can be somewhat challenging.

MAS' Constructive Ambiguity

MAS now announces adjustments to its policy stance at quarterly meetings (previously semi-annually), although off-cycle decisions cannot be ruled out. The following parameters remain somewhat unknown, or are not fully disclosed by MAS:

- (i) Constituent currencies in the SGDNEER basket;
- (ii) Weights of the constituents;
- (iii) Width of the SGDNEER band;
- (iv) Mid-point of the SGDNEER band;
- (v) Appreciation of the SGDNEER (crawl); and
- (vi) Adjustments to SGDNEER policy e.g. recalibration of the SGDNEER basket or modifications to the constituents.

MAS believes that not fully disclosing policy parameters, along with not commenting on MAS operations allows it some constructive ambiguity in the management of the SGDNEER. This is a reasonable position given the considerable sensitivities of such an exchange rate policy and functions as a deterrence of unnecessary or excessive speculation in the SGD. This is also consistent with MAS' official position that they may tactically allow the SGDNEER to trade out of the band.

What Clues Do We Have?

There are certain clues that we can refer to when constructing a model to estimate the SGDNEER. These include MAS' quarterly statement, which may provide hints on the crawl, width and mid-point e.g. in Mar 2021, MAS declared that it reduced the slope to zero and re-centered the SGDNEER at the prevailing level or in Oct 2001 MAS announced widened the band to allow for increased volatility in the SGDNEER in the wake of Sep-11 terror attacks. MAS also releases the weekly average SGDNEER data to provide the market with more frequent reference points to recalibrate their SGDNEER models. However, certain assumptions and informed estimates are required in order to define certain model parameters, such as the constituents, weights of the basket, or the magnitude of MAS' policy adjustments. We try to explain the thinking and recent changes to our SGDNEER model.

The Maybank SGDNEER Model

The first and perhaps the most crucial step would to be to define the constituents in the basket of our model. We look at trade numbers of Singapore's largest trading partners and make an informed estimate as to what MAS would consider as a representative and effective trade-weighted index. This would also include looking at trade linkages and more recent trade data. Our current basket consists of the following 14 currencies: AUD, CNY, EUR, HKD, JPY, MYR, USD, INR, KRW, TWD, GBP, THB, IDR and PHP.

We then use statistical methods (typically regression techniques) to estimate the weights of these currencies against the weekly average SGDNEER data. These provide the building blocks for our SGDNEER model, which we then track and maintain.

Assumptions need to be made about the width (assumed to be +/- 2.0%), and crawl (we assume that every "slight" increase or reduction refers to a 0.5% change to the rate of appreciation). These are broadly in line with the assumptions of other market participants and SGDNEER watchers.

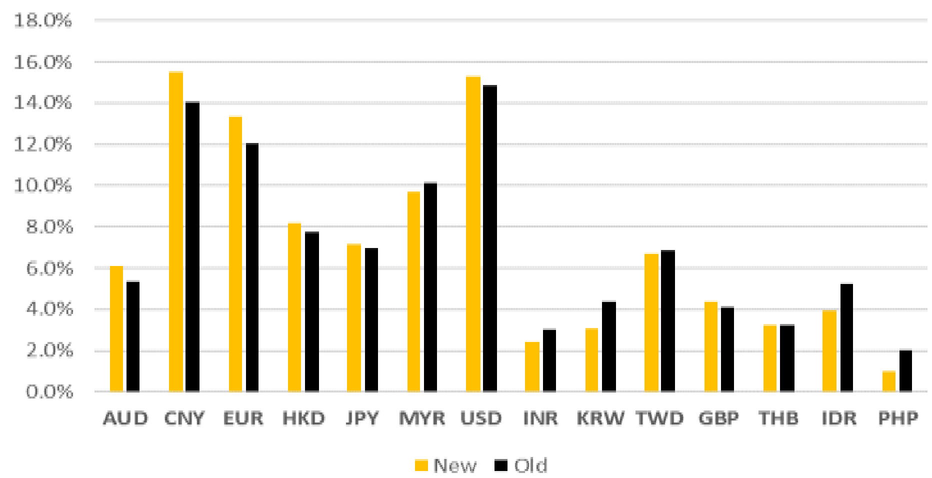
However, given the considerable uncertainty and the fact that MAS can neither confirm nor deny industry assumptions, periodic recalibrations and reviews of SGDNEER models are necessary in order for the model to maintain its relevance.

Recalibrating the SGDNEER Model

We have expected some SGDNEER strength as MAS maintains what we believe to be a 1.5% p.a. crawl. In addition, the SGD remains resilient on a bilateral basis against its counterparts. However, our old model was implying a deviation of the mid-point of >2% over an extended period. While the band could possibly be wider than +/- 2.0%, or MAS could have tactically allowed SGDNEER to trade out of the band, we decided to recalibrate our SGDNEER model for relevance and consistency with our beliefs and assumptions.

Chart 1 provides a comparison of our new vs our old SGDNEER weights. In summary, the USD-bloc (USD & HKD), CNY and EUR make up 52% of the basket. Notably, the weights of most Asian currencies save for the CNY, JPY and THB were adjusted lower.

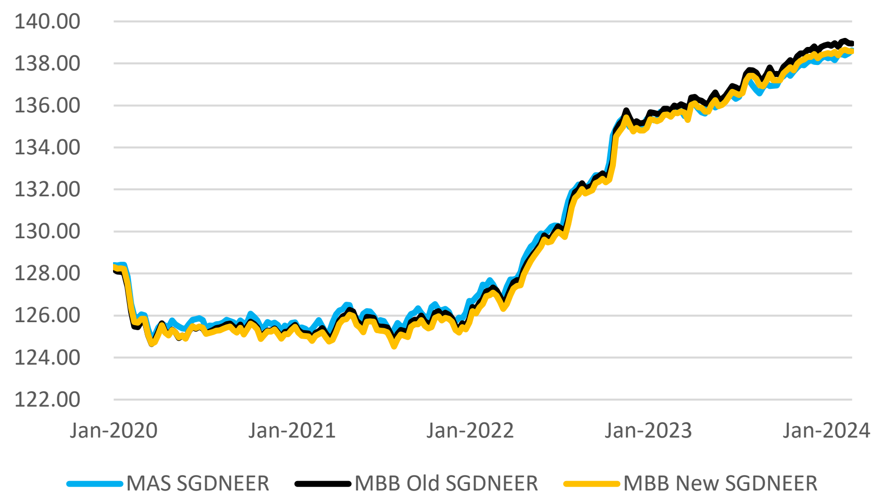
Chart 1: New vs Old SGDNEER Weights



Source: Maybank FX Research & Strategy

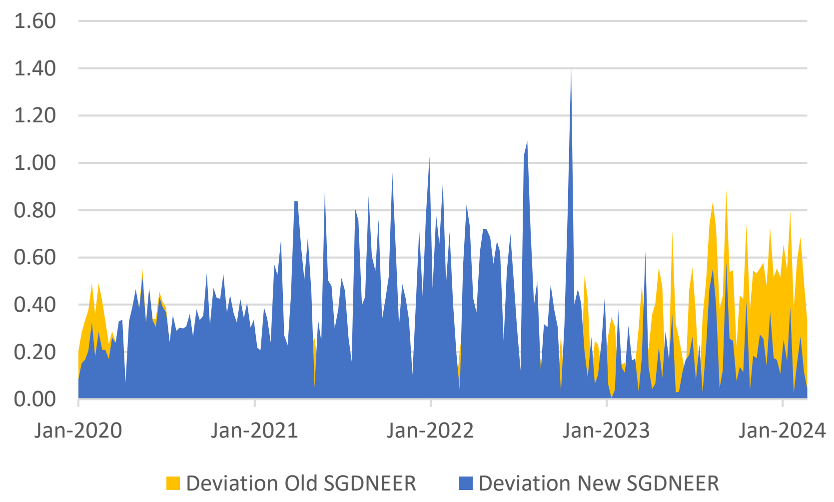
The adjusted basket on average implies a SGDNEER that is about -0.2% closer to the midpoint than our previous basket. It also tracks MAS' SGDNEER release more closely from 2023 onwards. Specifically, we see that deviations from MAS' weekly SGDNEER releases are smaller since 2023. This could be due to certain undisclosed policy tweaks such as changes to the weights or the basket.

Chart 2: MAS SGDNEER vs Maybank SGDNEER



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

Chart 3: Deviations from MAS SGDNEER



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

MAS to Hold in Apr

The new SGDNEER weights should track MAS' SGDNEER model more closely moving forward. We expect MAS to hold steady on its policy stance in Apr, and we think that the risk going forward is MAS may not be able to ease as easily or quickly as other central banks with interest targeting regimes (see MAS Chief Economist 6 Mar speech on "Inflation and Monetary Policy"). We think the SGD remains resilient on both a trade-weighted and bilateral basis and continue to look for the USD to weaken gradually against the SGD in 2024.

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