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Macro | FX Research and Strategy

Global

FX Flash

SGD NEER: Resilient Alongside MAS Standing Pat

SGD NEER Trajectory Recap; MAS to Stand Pat

Earlier this year on 30 Mar, MAS flattened the policy slope and re-centred the mid-point of the policy band downwards, on concerns over a contracting economy and softer price pressures. Since then, we estimate that the SGD NEER has been largely hugging the policy mid-point or trading modestly to the stronger side of band (i.e., -0.1% to +0.6% deviation from implied policy mid-point). In late Sep, SGD NEER showed signs of heading below implied policy mid-point again, on signs of USD recovery, but this move fizzled out by early Oct, and it is now estimated to be around +0.5% above implied policy mid-point. The implied policy mid-point could continue to be a strong support for SGD NEER moves in the interim. House view is for MAS to stand pat in the upcoming mid-Oct policy meeting.

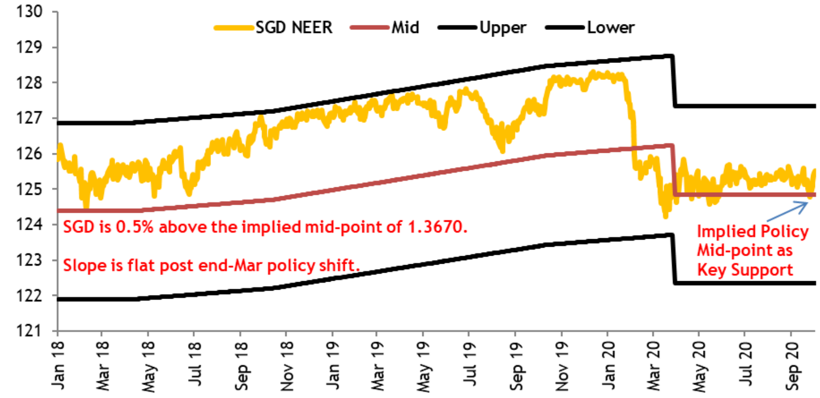
SGD NEER May Remain on Stronger Side of Band

The current recovery is sluggish, inflation has bottomed out but may remain negative near-term as slack in the labor market constrains demand, and fiscal policy is likely to continue playing the leading role in supporting households and corporates. Our economist team thinks that **the MAS will likely consider normalizing policy when the pandemic crisis is over, a vaccine is widely available and the economy is back above pre-pandemic levels** (see *MAS Preview: Waiting for Vaccine & Open Skies*). Historically, after shifting to a flat policy slope in 2001, 2008 and 2016, **the central bank has also been relatively patient in reverting to tightening stances** (maintained 0% app. for min. 6 qtrs).

Meanwhile, even as volatility associated with US elections in Nov remains a discernible risk, a (polls-suggested) Biden win should be on net positive for AxJ FX including SGD, when the "dust settles" from the elections wrangling. As long as the global recovery in activity and aggregate demand continues apace, **SGD NEER could remain (mostly) on the stronger side of the policy band in the interim**. We maintain USDSGD forecasts for end-2020 and end-2021 at 1.345, 1.31.

Alongside our expectations of a continued flat policy slope and benign performance for SGD NEER, **SG rates are unlikely to see significant premiums vs. US rates**. Given consensus expectations for lower-for-longer US rates, **SG short-term rates are unlikely to see upward pressures anytime soon as well**. House view of 3M SIBOR for end-2020 and end-2021 is at 0.4%.

Implied Policy Mid-Point Could Continue to Be Key Support



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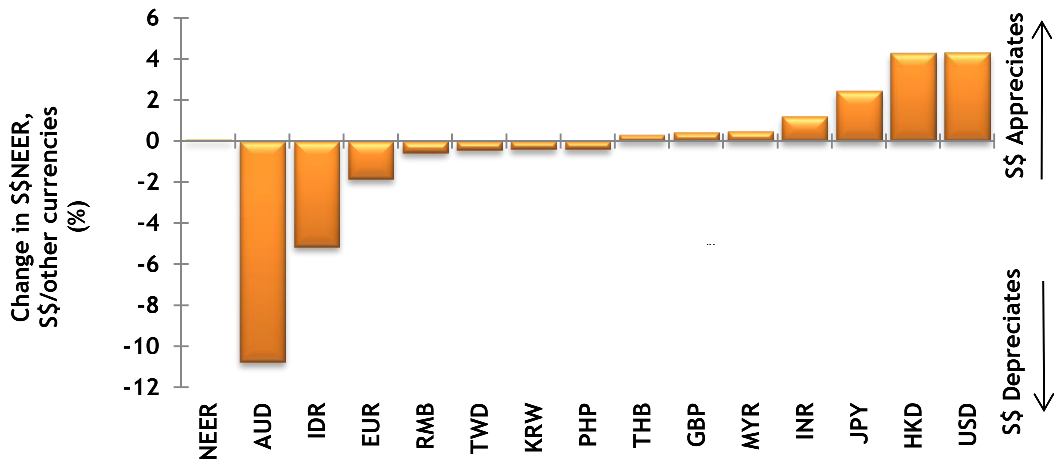
SGD NEER Stable After March Policy Easing

On 30 Mar, MAS flattened the policy slope and re-centred the mid-point of the policy band downwards, on concerns over a contracting economy and softer price pressures alongside the pandemic. Most of the decline in SGD NEER was in the lead-up to the policy decision. As we had cautioned in mid-March, easing expectations were expectedly priced in prior to the actual policy announcement.

Despite a recovery rally in AUD (and to some extent IDR, vs. its troughs), SGD NEER has been relatively stable since end-March, partly because IDR and AUD only hold modest weights in the NEER basket. SGD had also outperformed other FX such as USD and JPY over the period.

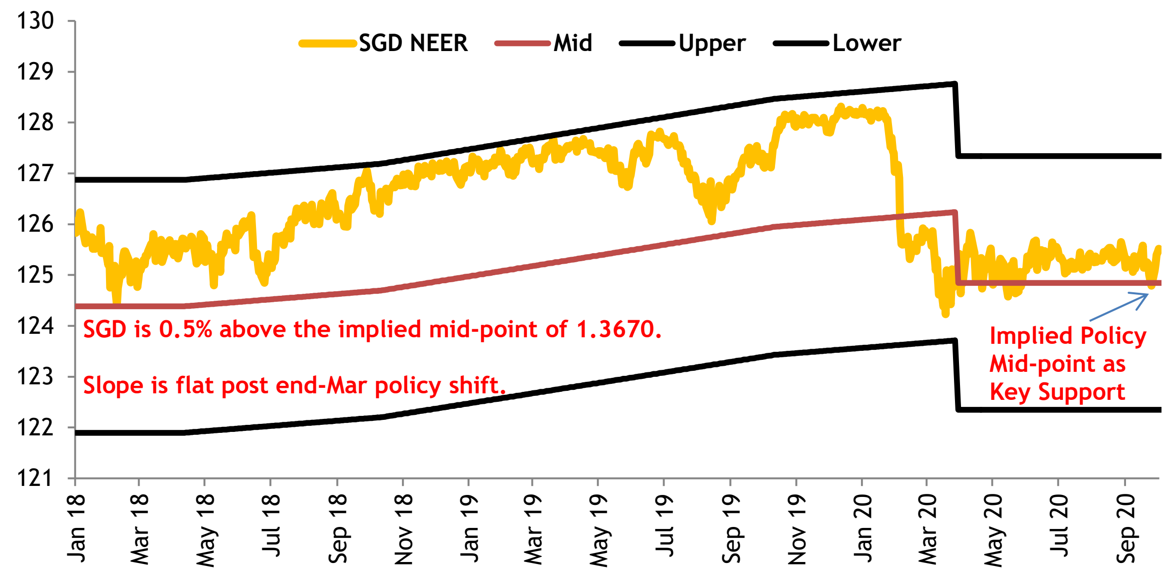
NEER Stable Since End-Mar; AUD Recovery Rally Offsets Softer USD



Source: Bloomberg, Maybank FX Research & Strategy Estimates

Since the March MAS easing decision, we estimate that the SGD NEER has been largely hugging the policy mid-point or trading modestly to the stronger side of band (i.e., -0.1% to +0.6% deviation from implied policy mid-point).

Recent SGD NEER Developments



Source: Bloomberg, Maybank FX Research & Strategy Estimates

In late Sep, SGD NEER showed signs of heading below implied policy mid-point again, on signs of USD recovery, but this move fizzled out by early Oct, and it is now estimated to be around +0.5% above implied policy mid-point.

We note that the implied policy mid-point (i.e., red line in chart above) has resisted multiple down-moves in recent months, and could continue to be a strong support for SGD NEER moves in the interim, especially as house view is for MAS to stand pat in the upcoming mid-Oct policy meeting.

MAS Likely to Stand Pat in Mid-Oct Meeting

The current macro recovery is sluggish and more U-shaped than V, inflation has bottomed out but may remain negative near-term as slack in the labor market constrains demand, and fiscal policy is likely to continue playing the leading role in supporting households and corporates.

Our economist team thinks that **the MAS will likely consider normalizing policy when the pandemic crisis is over, a vaccine is widely available and the economy is back above pre-pandemic levels** (see *MAS Preview: Waiting for Vaccine & Open Skies*).

Comparing historical MAS policy decisions, we also note that after shifting to a flat slope in 2001, 2008 and 2016, **the central bank has usually been relatively patient in reverting to tightening stances**. In past neutral-slope easing cycles, MAS has maintained zero percent appreciation for a minimum of 6 quarters.

Historical MAS Decisions Indicate Some Patience After Shifting to "Flat Slope" Policy Stance

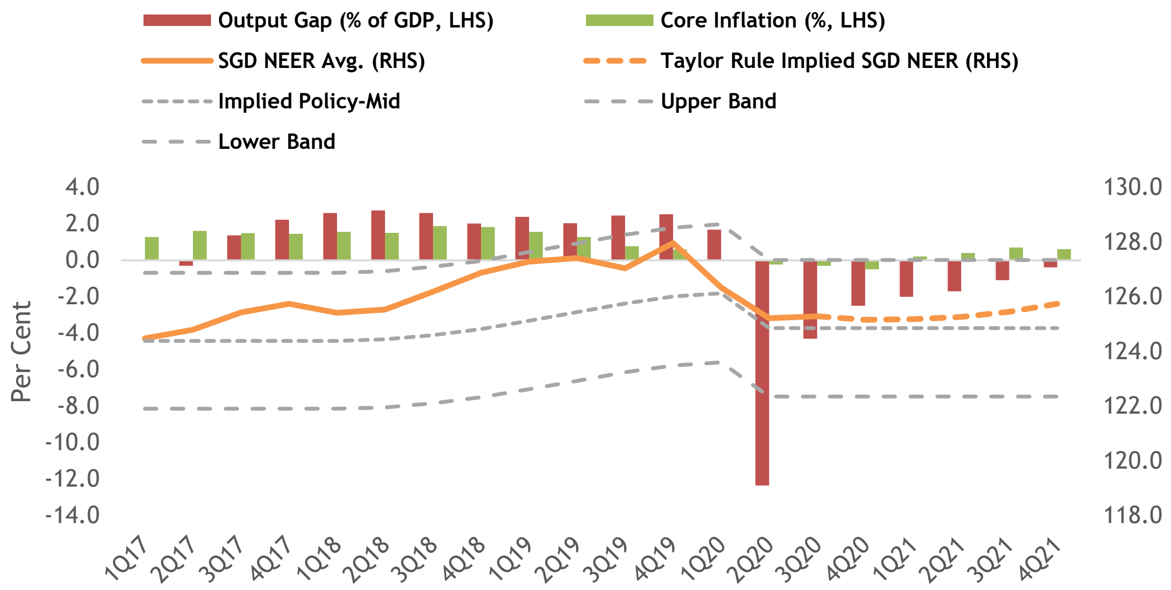
Start of "Flat Slope" Easing Cycle	No. of Qtrs Flat Slope Maintained
12 Jul 2001	11
10 Oct 2008	6
14 Apr 2016	8

Source: Maybank FX Research & Strategy Estimates

Given that output gap is estimated to remain negative (albeit narrowing over time) and core inflation is expected to still average significantly below 2% for most of 2021, our Taylor rule estimates suggest that a flat policy slope might be appropriate over the next several quarters still. (*See chart on next page*.)

These observations further support the house view that the MAS will likely stand pat this round.

<u>**Taylor Rule Derived Estimates Suggest Negligible Upward Pressures on SGD NEER Over Next Few Quarters**</u>



Source: Maybank FX Research & Strategy Estimates

Domestic Macro Fundamentals Remain Robust

Assuming no policy shocks from MAS, the trajectory of the SGD NEER may depend in part on the relative performance of Singapore vs. regional peers on the macro front.

Domestically, fiscal stimulus has been sizable and timely. In a speech on 5 Oct, DPM Heng laid out three prongs of Singapore's refreshed economic strategy, ahead of a third Supplementary Supply Bill which will provide for an extra S$8bn in Covid-19 support.

- Remake Singapore as a Global-Asia node of technology, innovation and enterprise;
- Redouble efforts on inclusive growth, via upgrading jobs and skills across all segments;
- Investing in economic resilience and sustainability as a source of competitive advantage, with a focus on local production of essential supplies and deployment of renewable energy.

Support will also not taper off too sharply. For instance, the Enhanced Training Support Package will be extended to June 2021, and the Temporary Bridging Loan Programme will continue until Sep 2021, albeit at reduced levels. Several grants and programmes, i.e., the Market Readiness Assistance Grant, Productivity Solutions Grant, Enterprise Development Grant and the Pact programme, which encourages collaborations between companies, will also be enhanced.

There are a few key takeaways on macro implications.

- On jobs, measures introduced thus far is estimated to save around 155,000 jobs over 2020-21, cushioning the rise in resident unemployment rate by about 1.7%-pt.

- On growth, a full-year recession is still seen this year, with authorities projecting a contraction of -7% to -5% in GDP. House view is for a -6% contraction in 2020, before a recovery to 4.0% growth next year. The MAS has estimated that the four combined Budgets is helping to prevent the economy from contracting by a further 5.6% of GDP in 2020, and 4.8% in 2021.
- On reserve buffers, additional measures in the Supplementary Supply Bill will be funded via reallocation of monies from earlier programmes, and there will not be any further drawdown on past reserves. The total drawdown remains at around S$52bn for now.

It is noteworthy that the estimated fiscal impulse for Singapore in 2020 (based on government projections of change in fiscal deficit pre-Covid vs. post-Covid), is at around 13.3% of GDP. This is more than twice or thrice that of most ASEAN peers, and could give Singapore an edge in the recovery phase. Notably, given abundant reserve buffers, there is also no need to aggressively ramp up debt issuance, and Singapore's fiscal metrics, including the triple-A sovereign credit rating, are likely to remain robust.

Key Upcoming Risk is US Elections

Meanwhile, key risk for SGD in 4Q would be volatility associated with US elections in Nov. We expect some volatility in the lead-up to the elections, especially as markets digest developments relating to Trump's health, mail-in voting and US stimulus prospects. Nonetheless, when the "dust settles" from the elections wrangling, our earlier findings suggest that a (polls-suggested) Biden win should still be on net positive for AxJ FX including SGD.

In an earlier research piece (*US Elections & Implications on AxJ FX*), we regressed returns in custom FX baskets vs. Biden's lead over Trump in polls, while controlling for (i) broad dollar strength (USD NEER) and (ii) cyclical market sentiments (using a proprietary risk sentiment proxy series).

Higher Biden Win Chances Benefit ASEAN, Commodity FX Modestly

FX Proxy Baskets	T-stat - Biden's Lead in Polls	T-stat - Broad Market Risk Factors
ASEAN (SGD, MYR, IDR, THB, PHP)	**3.2**	**5.1**
Commodity (AUD, NZD)	**2.6**	**8.5**
TECH (SGD, KRW, TWD)	1.4	**6.3**
OIL (CAD, MYR)	-0.2	**6.9**
CNY	0.9	**3.6**
Haven (JPY, CHF)	-1.2	**-4.5**

Source: Bloomberg, PredictIt, Maybank FX Research & Strategy
Note: Sample is from Mar to Aug. 5-day returns/changes used in regression. T-stats with magnitude >2 (bold) are considered relatively significant.

The larger the t-statistic (in magnitude), the more likely the factor in question (Biden lead, broad market risk sentiments) is to be significant to moves in the particular FX proxy basket. **From the results, the**

widening of Biden's lead over Trump appears to be modestly positive for ASEAN and commodity FX sentiments to some extent.

This could be due to expectations for more stable US policy stances on the international stage benefitting trade and investment dependent economies regionally. As mentioned earlier, if Biden is elected, we also note a higher likelihood of the US re-engaging in the Trans-Pacific Partnership (TPP; now Comprehensive and Progressive Agreement for Trans-Pacific Partnership, CPTPP), which could be positive for some ASEAN members (Singapore, Malaysia, Vietnam), as well as Australia and New Zealand.

On net, assuming (i) a Biden victory and no derailment of transfer of power from elections disputes, (ii) data releases in 4Q continue to support the narrative of a global macro recovery despite pockets of Covid-19 resurgence, **we expect SGD NEER to remain on the stronger side of the policy band in the interim.**

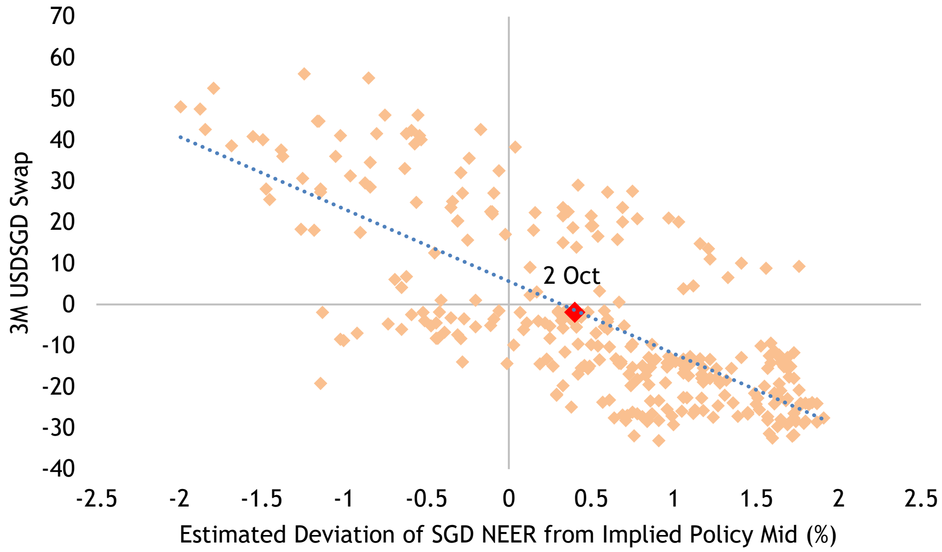
We maintain our USDSGD forecasts for end-2020 and end-2021 at around 1.345 and 1.31, respectively.

SGD NEER & FX Swaps

Given our expectations of a continued flat policy slope and benign performance for SGD NEER, the 3M USDSGD FX Swap—which also represents the differential between 3M SG-US rates—is unlikely to see upward pressures in the short run, i.e., **no discernible SG rate premiums over US rates.** (*See broad negative relationship between SGD NEER & rate differentials in chart below*).

In this case, if US rates remain low—consensus forecasts for Fed policy rate to remain near zero for the next two years at least—**SG short-term rates are unlikely to see upward pressures anytime soon as well.** House view of 3M SIBOR for end-2020 and end-2021 is at 0.4%.

<u>**3M USDSGD FX Swap Unlikely to See Significant Upsides in Interim**</u>



Source: Bloomberg, Maybank FX Research & Strategy Estimates
Note: Data is from 2015 till latest, in weekly frequency.

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