Macro | FX Research and Strategy

Global

FX Insight

SGD NEER: MAS to Stand Pat; Maintain +0.5% to 1.5% Range

SGD NEER Largely Remained in Our Forecast Range Since Apr

Our Apr 2021 preview note (see here) was of the view that if the MAS stood pat then, "+0.5% to +1.5% above policy mid-point could be a potential trading range for the SGD NEER before Oct". Except for a very brief period in Jul when SGD sentiments tanked (testing parity) on account of a renewed domestic lockdown, SGD NEER has been largely trading in a +0.4% to +1.3% above par range, largely validating our prior bias six months ago.

SGD NEER is last estimated at +0.7% above policy mid-point, easing from Sep high near 1.1%. SGD was not immune to recent bouts of broad dollar upswings, surge in UST yields, or concerns over global growth slowdown (given its procyclical nature), but solid macro fundamentals likely conferred the SGD certain haven characteristics. Resilient manufacturing and trade outcomes, robust current account surplus and abundant fiscal policy space helped buffer against larger SGD NEER declines.

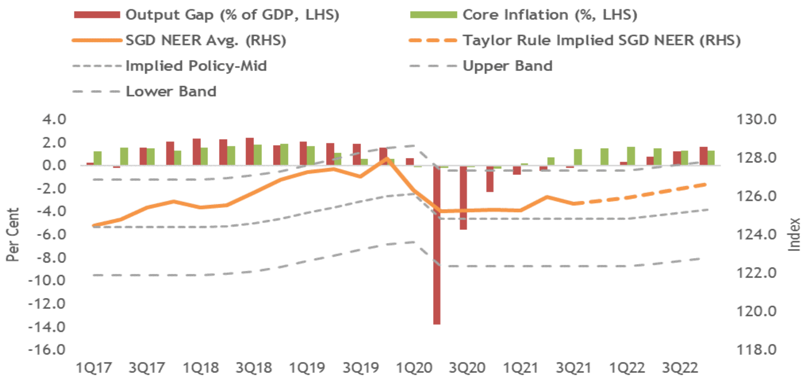
Expect Neutral Bias in Oct, Slight Appreciation in Apr 2022

House view is for the MAS to maintain the current neutral policy stance at the Oct meeting. (See our economist team's note here.) Recent domestic Delta surge could have introduced incremental near-term downside risks to growth. Other external risk drivers include Fed tapering and potential moderation in China's growth pace. The central bank can afford to be more patient this time round. Nonetheless, there are rising risks from inflation. Persistent supply chain disruptions could keep energy, food and freight costs elevated in 2022. It may be prudent for the MAS to begin policy normalization next Apr.

Maintain Interim Projection Range of +0.5% to +1.5% for SGD NEER

Output gap is now expected to return to a modest positive reading in 2022, while core inflation is expected to creep higher still. Given these macro conditions, our Taylor rule estimates suggest that SGD NEER is likely to see a modest upward bias over the next few quarters. Barring significant negative surprises (domestic lockdown, sharp China slowdown, Fed-induced dollar rally), we maintain our SGD NEER projection range at +0.5% to +1.5% above policy mid-point, in the period leading up to the next policy meeting in Apr. End-2021, 2022 USDSGD forecasts are at 1.345, 1.32, respectively. House view for end-2021, 2022 3M SIBOR at 0.45%, 0.62%..

Taylor Rule: Modest Upward Pressures on SGD NEER into 2022



Source: Maybank FX Research & Strategy Estimate

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SGD NEER Largely Traded in Line with Our Suggested +0.5% to +1.5% Range over Apr-Sep

MAS stood pat in Apr 2021, maintaining a zero percent per annum rate of appreciation of the policy band. The width of the policy band and the level at which it is centred were unchanged. The decision follows the stand-pat decision in Oct 2020 and the "double" easing move (slope and level) at end-March 2020.

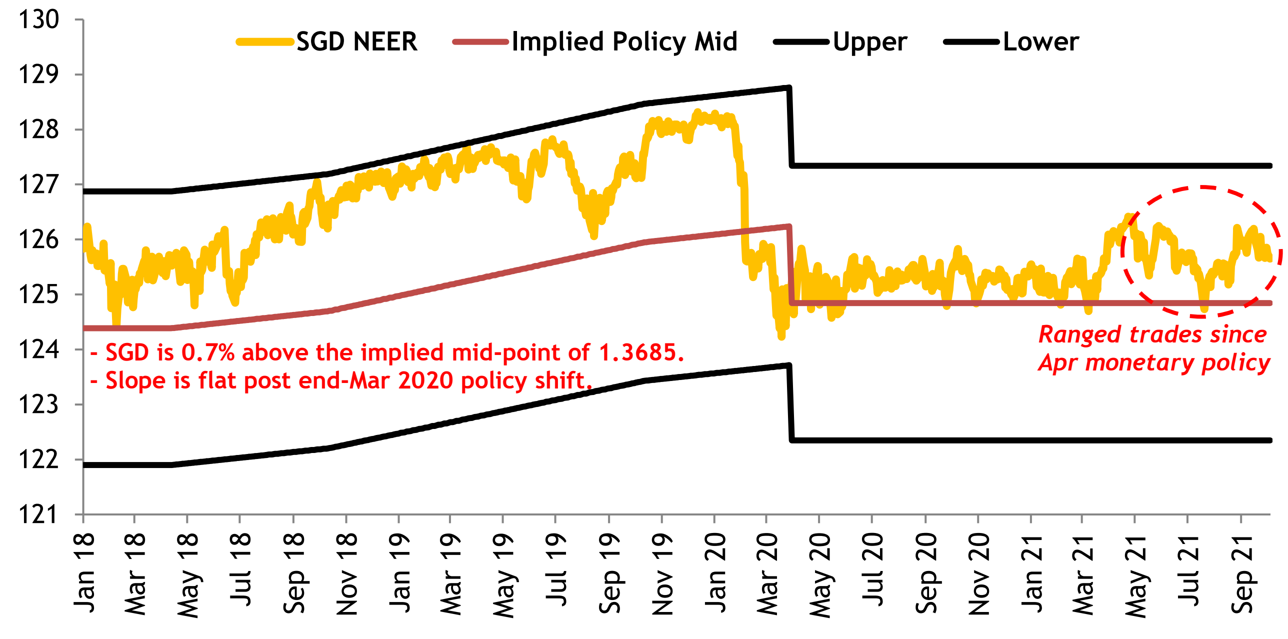
Back in Apr, MAS had explained that the decision was assessed to be appropriate in view of the "weak outlook" for core inflation. While it was expected to rise and turn positive in 2021, it would likely stay well below its long-term average this year. Core inflation did subsequently climb higher, rising from 0.2% average in 1Q 2021 to 0.7% in 2Q and then averaging 1.1% in Jul-Aug, and outturns are indeed still below the 2011-19 long-term average (excluding 2020 due to Covid impact) of 1.6%.

While the recent pace of increase in price pressures might have been boosted by energy price rallies due to global supply shortages, **broad developments in terms of (i) manageable domestic prices and (ii) above-trend economic growth in 2021 panned out largely as per the central bank's Apr expectations.**

Our Apr 2021 preview note (see here) was of the view that if the MAS stood pat then, "*our Taylor rule estimates suggest that SGD NEER is likely to remain supported over the next few quarters … +0.5% to +1.5% above policy mid-point could be a potential trading range for the SGD NEER before the next policy meeting in Oct*".

Except for a brief period in Jul when SGD sentiments tanked (testing parity) on account of a sudden domestic lockdown, SGD NEER has been largely trading in a +0.4% to +1.3% above par range, largely validating our prior bias six months ago.

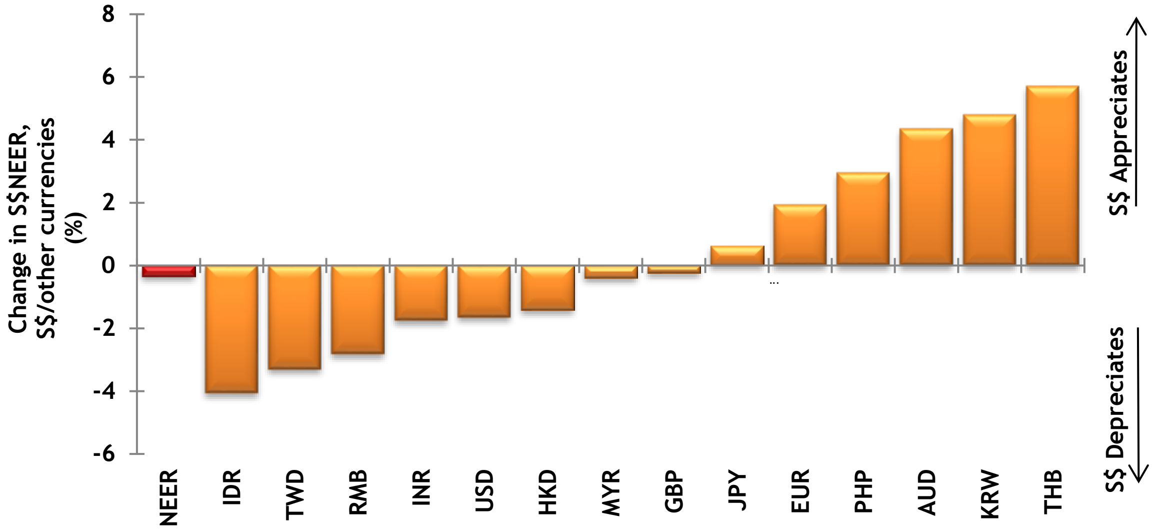
Recent SGD NEER Developments



Source: Bloomberg, Maybank FX Research & Strategy Estimates

We note that the implied policy mid-point (i.e., red line in chart above) has resisted multiple down-moves since the shift to a zero-appreciation bias in Mar-2020, and could continue to be a strong support for SGD NEER in the quarters ahead, particularly if expectations are for the next policy shift (possibly Apr 2022) to be a tightening move.

Modest Dip in SGD NEER (14 Apr 2021 to 6 Oct 2021) Masks Diverging Outturns Among FX Peers



Source: Bloomberg, Maybank FX Research & Strategy Estimates

Between 14 Apr and 6 Oct, we estimate that SGD saw modest depreciation (-0.3%) versus a basket of its trading peers' FX. SGD saw losses versus broad USD and RMB, both of which hold significant (trade proxy) weights in the SGD basket, and this more than made up for SGD gains versus EUR as well as regional peers AUD, KRW, PHP, THB.

To some extent, the differing FX paths may be attributable to divergent monetary policy stances among DM central banks—hawkish tilt by Fed vs. dovish leanings by ECB, RBA. Other ad-hoc factors include for instance the semiconductor chip correction and regional growth jitters (KRW), deteriorating tourism outlook and 3Q manufacturing disruptions (THB).

On net, the mixed but resilient performance of the SGD in the last six months could be due to a few factors:

- **SGD was not immune to bouts of broad dollar upswings, surge in UST yields, or concerns over global growth slowdown (given its procyclical nature), but solid macro fundamentals likely conferred the SGD certain haven characteristics.** Manufacturing and trade outcomes remained resilient in recent months despite moderating from prior highs, due to dissipating base effects. Current account surplus remained significant at 18.8% of GDP in 2Q. Fiscal policy space is still abundant with overall deficit at only around slightly more than 2% of GDP in FY2021.

- While authorities have warned of a potential "exponential rise" in Covid-19 cases of late, they have clarified that the overall stance of adapting to Covid-19 as endemic remains unchanged. Calibration of measures in the interim are meant to ensure that the health system can handle the increased number of daily cases. **In any case, the high fully-vaccinated rate of 83% of the populace should also help shield the economy from more aggressive/lengthy curbs.** Meanwhile, Covid-19 vaccine boosters have been made available for at-risk groups starting mid-Sep.

MAS Likely to Stand Pat in Oct, Potential Tightening in Apr 2022

House view is for the MAS to maintain the current neutral policy stance at the October meeting. (See our economist team's note here.) Recent domestic Delta surge could have introduced incremental near-term downside risks to growth, with several services segments struggling under social distancing rules and construction facing foreign worker shortages. Other external risk drivers include Fed tapering and potential moderation in China's growth pace. The central bank can afford to be more patient this time round.

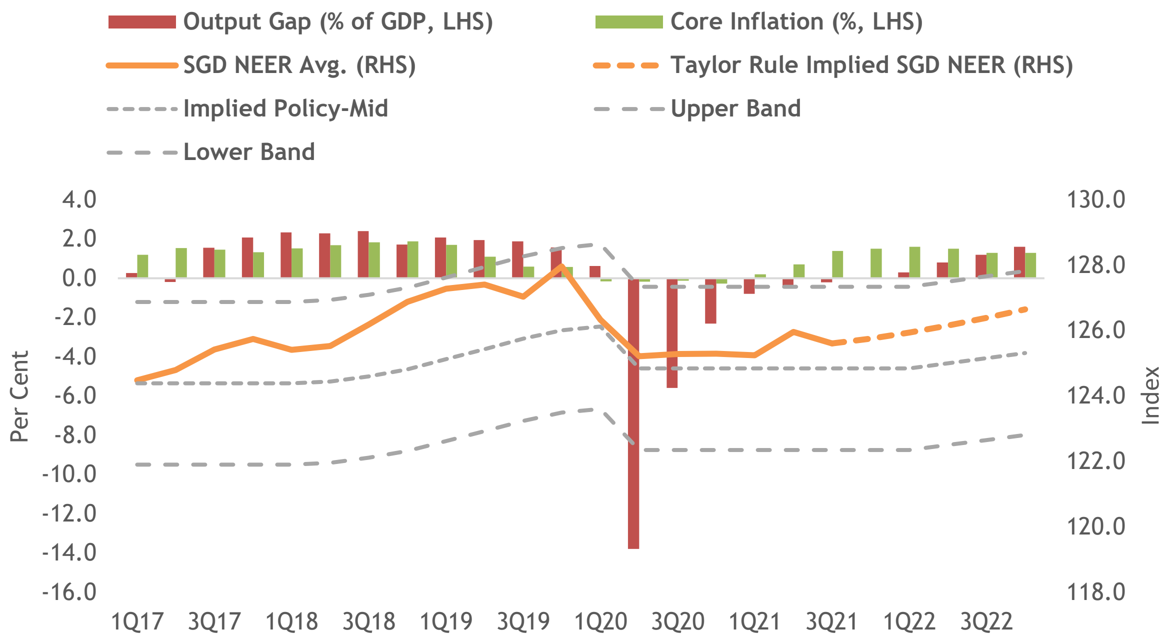
Nonetheless, there are rising risks from inflation. Persistent supply chain disruptions could keep energy, food and freight costs elevated in 2022. Our economist team assesses that the MAS could forecast a higher 0.5% to 1.5% range for core inflation in 2022 (up from 0% to 1% in 2021), while maintaining the current 1% to 2% range for headline inflation. Conditional on growth momentum remaining intact, it may be prudent for the MAS to tighten and shift to a slight appreciation bias of the SGD NEER at the April 2022 meeting.

SGD NEER Could See +0.5% to +1.5% Trading Range from Now till Apr 2022 Policy Meeting

For a more explicit forecast trajectory for SGD NEER, we turn to our Taylor rule model. The output gap (red bars) is now expected to return to a modest positive reading in 2022. Core inflation (green bars) is expected to creep up higher still next year—our economist team forecasts 2022 core inflation rising to 1.4% from 1% in 2021.

Given these macro conditions, our Taylor rule estimates (dotted orange lines in chart below) suggest that SGD NEER is likely to see a modest upward bias over the next several quarters.

Taylor Rule Derived Estimates Suggest Modest Upward Pressures on SGD NEER Over Next Several Quarters



Source: Maybank FX Research & Strategy Estimates

One key downside risk to SGD is the potential for runaway domestic Covid contagion. Prior announcements of sudden lockdowns have led to sharp declines in the SGD NEER previously. But we expect stronger policy resistance this time round on going back to lockdowns (i.e., heightened alert or circuit breaker phases), even as authorities will likely be data-dependent and these cannot be ruled out at this point. From the experience of other regional economies, Delta-led Covid waves tend to peak and taper off around two to three months post the initial surge. We are cautiously optimistic on this front.

On China/Evergrande spillovers, MAS has clarified that the Singapore banking system has “insignificant” exposures to Evergrande. While knock-on effects from a China slowdown scenario might be possible given heavy trade linkages, this has likely been priced to some extent among AxJ FX since growth jitters started emerging in early 3Q.

On Fed tapering, uncertainty associated with the tapering schedule was likely a larger risk factor prior to the Sep FoMC, but with markets having calibrated their expectations for a shorter tapering timeframe, incremental drags on SGD from this driver could be more contained.

On net, barring significant negative surprises on these fronts, **we maintain our bias for a +0.5% to +1.5% SGD NEER trading range before the next policy meeting in Apr 2022.**

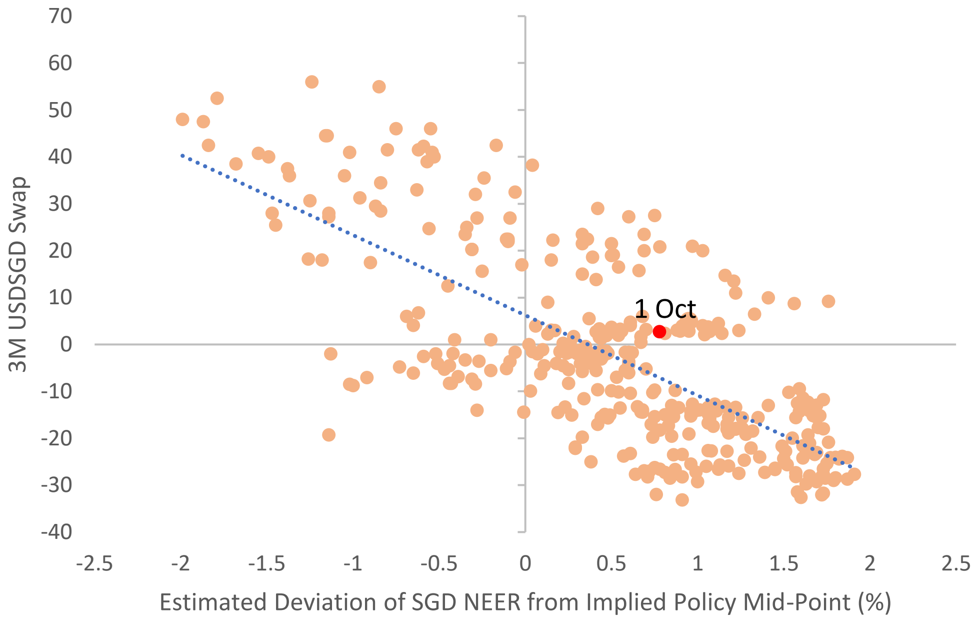
Concomitantly, our end-2021 and end-2022 USDSGD forecasts are at 1.3450 and 1.3200 respectively.

SGD NEER & FX Swaps

Given our expectations of a continued flat policy slope in Oct 2021 (before reversion to a mildly positive slope in Apr 2022), and positive trading range for SGD NEER over this period, the 3M USDSGD FX Swap—which also represents the differential between 3M SG-US rates—is likely to be negligible in the interim, i.e., **no large SG rate premiums over US rates**. (*See broad negative relationship between SGD NEER & rate differentials in chart below*).

In this case, if short-end US rates remain low for now—house view is for Fed to start its hike cycle in late 2022 with a 25bps hike—**SG short-term rates are unlikely to see upward pressures in the near-term.** House view of 3M SIBOR for end-2021 is at 0.45%, before climbing to 0.62% by end-2022.

3M USDSGD FX Swap Unlikely to See Significant Upsides in Interim



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

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