Maybank

Macro | FX Research and Strategy

Global

FX Insight

SGD - MAS To Play It Safe

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Economic/Market Considerations Do Not Suggest Tightening

The output gap will only be very mildly positive by end-2019 after remaining negative for most of the year, but upside pressure on prices are likely to be mitigated. Higher crude oil prices should be offset by escalating Sino-US trade tensions (as it should be deflationary for Singapore). Meanwhile, based on our house projections, the SGD is expected to weaken against most of its major trading partners, particularly the JPY, EUR, GBP, NZD, CNY, MYR and IDR. But it should appreciate against the AUD, INR, PHP and THB. Thus from a markets perspective, a further move to tighten policy now would be unnecessary as, on balance, this could lead to an undershoot resulting in a sub-optimal outcome in the economy. Based on the forward points for the SGD, the market is still positioned for SGD weakness ahead. However, the pace of SGD weakness that market is expecting has lessened. The 1-month, 3-month and 12-month forward points are now pointing upwards even as they remain in negative territory.

Taylor Rule SGD NEER On The Uptick; Within Policy Band

Our estimates for the SGD NEER using the Taylor Rule suggest that the SGD NEER should strengthen ahead and remain within the policy band in the forecast horizon. This suggests that the MAS has the policy space to maintain its current policy stance of "a slight appreciation bias" until its next meeting in Apr 2019. Furthermore, the band still allows for some level of flexibility for the SGD NEER. There is little likelihood of overheating risks with closing of the negative output gap and eventually turning positive only at end-2019. A more cautious approach is preferably going into 2019 given possible downside risks, particularly from geopolitical tensions and global trade disruptions from trade wars. Thus, the appropriate policy response would be for the MAS to maintain its current policy stance of a "modest and gradual appreciation".

No Change To Our USDSGD Forecast

We remain positive on the SGD underpinned by a more reduction in USD strength in the next 12 months with support from the EUR and CNY. While we cannot rule out possible further bouts of weakness in the SGD due to resurgence in the USD, we expect these downside pressures on the SGD to be short-lived. We maintain our forecast for the USDSGD end-2018 around 1.3650 and then to hover around that level by end-1Q 2019. Thereafter, we expect the USDSGD to be on a slow grind lower towards the 1.36-leels by end-3Q 2019. The difference between our implied USDSGD estimates and our USDSGD forecast suggests that a larger moderation in USD strength is in part embodied in our USDSGD forecast.

SEE PAGE 8 FOR IMPORTANT DISCLOSURES

MAS To Remain On Hold

We expect the MAS to maintain its current "slight appreciation bias" for the SGD NEER at its 12 Oct meeting. This is premised on more moderate growth in 2019, and the downside risks from escalating Sino-US trade tensions that could prove to be deflationary. Still, we cannot rule out the possibility of the MAS normalizing policy further by steepening the policy band should crude oil prices continue to climb towards the USD100/bbl levels and wage increases quicken.

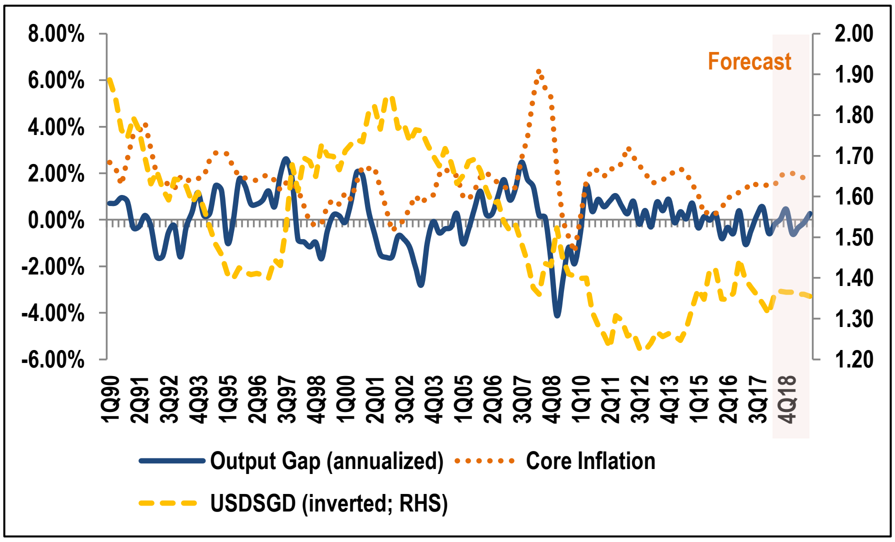
According to a Reuters' poll, most economists are looking for a further tightening move by the MAS at its Oct meeting on inflation concerns (due to elevated global oil prices) and rising global interest rates. They expect the MAS to slightly increase the slope of the SGD NEER policy band. This suggests some additional SGD weakness is possible as investors unwind long SGD vs. short-USD bets should MAS maintain its current policy stance.

Economic Considerations

The MAS' move in Apr to normalise policy was an insurance policy by the monetary authorities to upside risks to core inflation and economic growth amid a global synchronous recovery. With growth poised to slow amid a backdrop of slowing global growth, we do not expect the growth momentum to be sustained. In fact, our economic team is penciling a slowdown in full-year growth next year to 2.7% vs. this year's 3.5% amid slowing manufacturing activities and escalating Sino-US trade tensions.

Despite the more moderate growth expected in 2019, we expect mildly negative output gap to persist in the first three quarters of 2019. Our estimates suggest that the negative output gap will turn into a mild positive gap by year-end (Chart 1). As the output gap will only be very mildly positive by end-2019 after remaining negative for most of the year, upside pressure on prices are likely to be mitigated.

Chart 1: Output Gap Should Turn Mildly Positive By End-2019



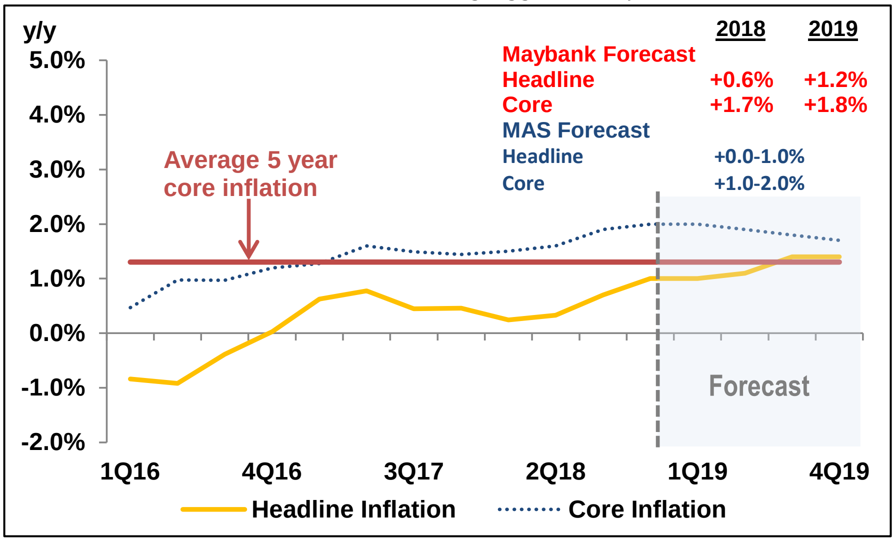
Source: Bloomberg, CEIC, Maybank FX Research

Of course higher crude oil prices are likely to translate into higher energy cost domestically since fuel and utility account for about 3-4% weight in the CPI basket. Brent oil has breached the USD85/bbl recently and some analysts see the potential for moves towards USD100/bbl. Nevertheless, our economic team is looking for oil prices to average around USD70/bbl for the full-year compared to USD54/bbl for 2017 (see Maybank IB Research, *2H 2018 Outlook & Lookouts, Malaysia Resets*, p.37). Aside from crude oil prices, labour market tightening could also put some upside pressure on wage inflation and hence consumer prices.

This higher average crude oil prices though are likely to be offset by escalating Sino-US trade tensions. Our economic team believes that a full-blown trade war will likely be deflationary for third countries like Singapore. This is because (1) business investment are likely to be scaled back; (2) diversion and "dumping" of Chinese and US goods to third countries will reduce imported goods prices; and (3) depreciating yuan should make Chinese exports cheaper.

Taking into account the two opposing forces, our economic team maintained its core inflation at 1.7% and 1.8% respectively for 2018 and 2019. Headline forecast was revised though. For 2018, our team expects headline inflation to average 0.6% (from 0.7% previously) and then for it to climb higher to 1.2% in 2019. MAS continues to expect core and headline inflation to come in 1-2% and 0-1% for both 2018 and 2019 respectively. Note that core inflation has breached its five-year historical average of 1.3% since 2Q 2012 but is likely to remain below the 2.0%-levels in the forecast horizon (Chart 2).

Chart 2: Core Inflation Not Seen Rising Aggressively In 2019



Source: CEIC, Maybank FX Research

Taylor Rule Estimates Suggest Mild SGD NEER Strength Ahead

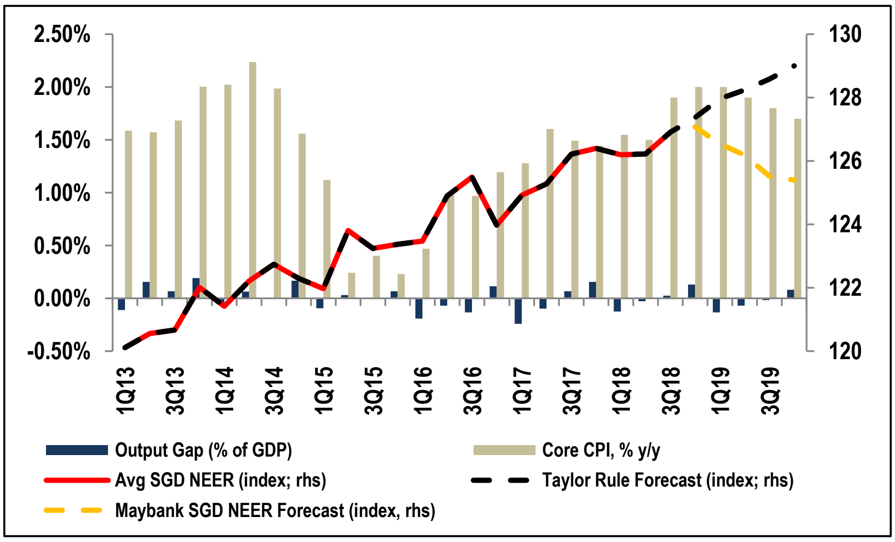
Our estimates for the SGD NEER using the Taylor Rule (growth and inflation trade-offs) suggest that the SGD NEER should strengthen ahead (Chart 3 & 4). SGD NEER is estimated to 2018 around 127.11. The Taylor Rule SGD NEER is expected to climb higher to 127.74 (1Q 2019), 128.03 (2Q 2019) and 128.39 (3Q 2019) before ending 2019 around 128.82. The implied USDSGD forecasts corresponding to these estimates are 1.3813 (end-2018), 1.3745 (1Q 2019), 1.3715 (2Q 2019), 1.3676 (3Q 2019) and 1.3630 (4Q 2019).

The Taylor Rule-SGD NEER estimates show that the SGD NEER will remain on the uptick and also remain within the policy band in the forecast horizon. This suggests that the MAS has the policy space to maintain its current policy stance of "a slight appreciation bias" until its next meeting in Apr 2019. Furthermore, the band still allows for some level of flexibility for the SGD NEER.

With growth likely to remain below potential for most of 2019, there is little likelihood of overheating risks with closing of the negative output gap and eventually turning positive only at end-2019. In addition, a more cautious approach is preferred going into 2019 given possible downside risks, particularly from geopolitical tensions and global trade disruptions from trade wars.

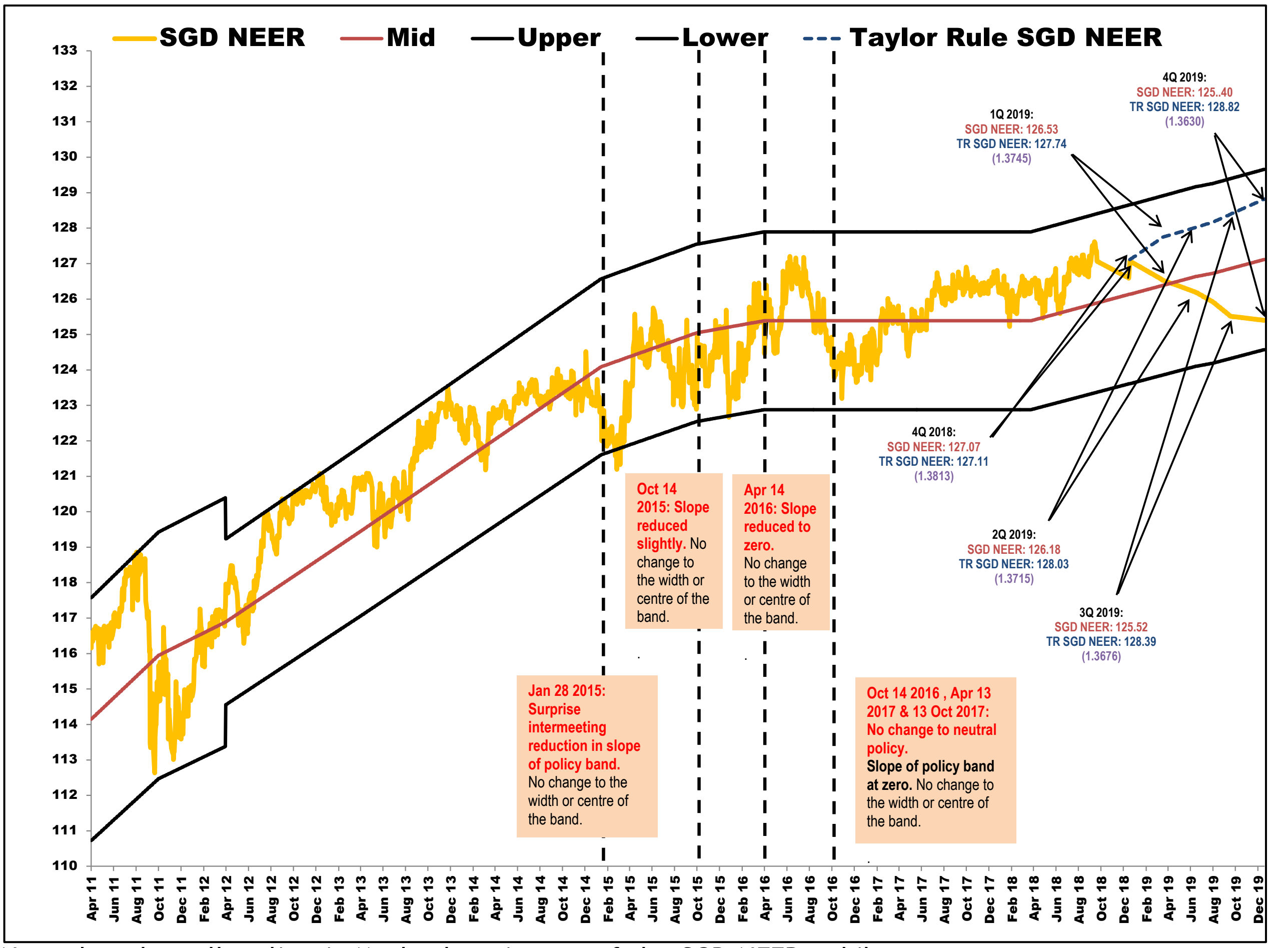
Thus, the appropriate policy response would be for the MAS to maintain its current policy stance of a "modest and gradual appreciation".

Chart 3: MAS Taylor Rule - Output Gap, GDP, CPI and S$NEER (Implied USDSGD) estimates



Source: Bloomberg, CEIC, Maybank FX Research

Chart 4: Our Taylor Rule-SGD NEER Estimates* Point To Stronger SGD NEER

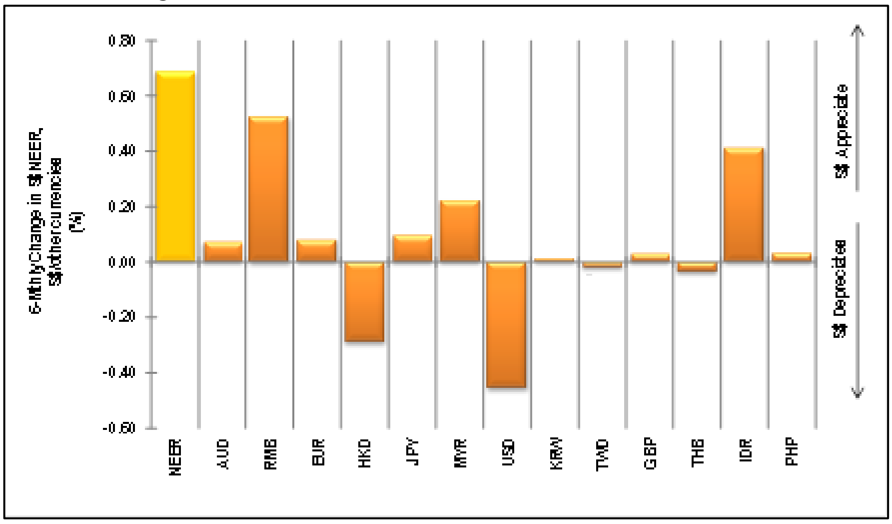


Note that the yellow line is Maybank estimates of the SGD NEER, while the blue dotted line is our Taylor Rule-SGD NEER estimates.

***Estimated using GMM Model using an augmented Taylor Rule Framework**

Source: Bloomberg, Maybank FX Research

Chart 5: Relative Weakness In HKD, USD, TWD and THB Supported The SGD NEER Higher

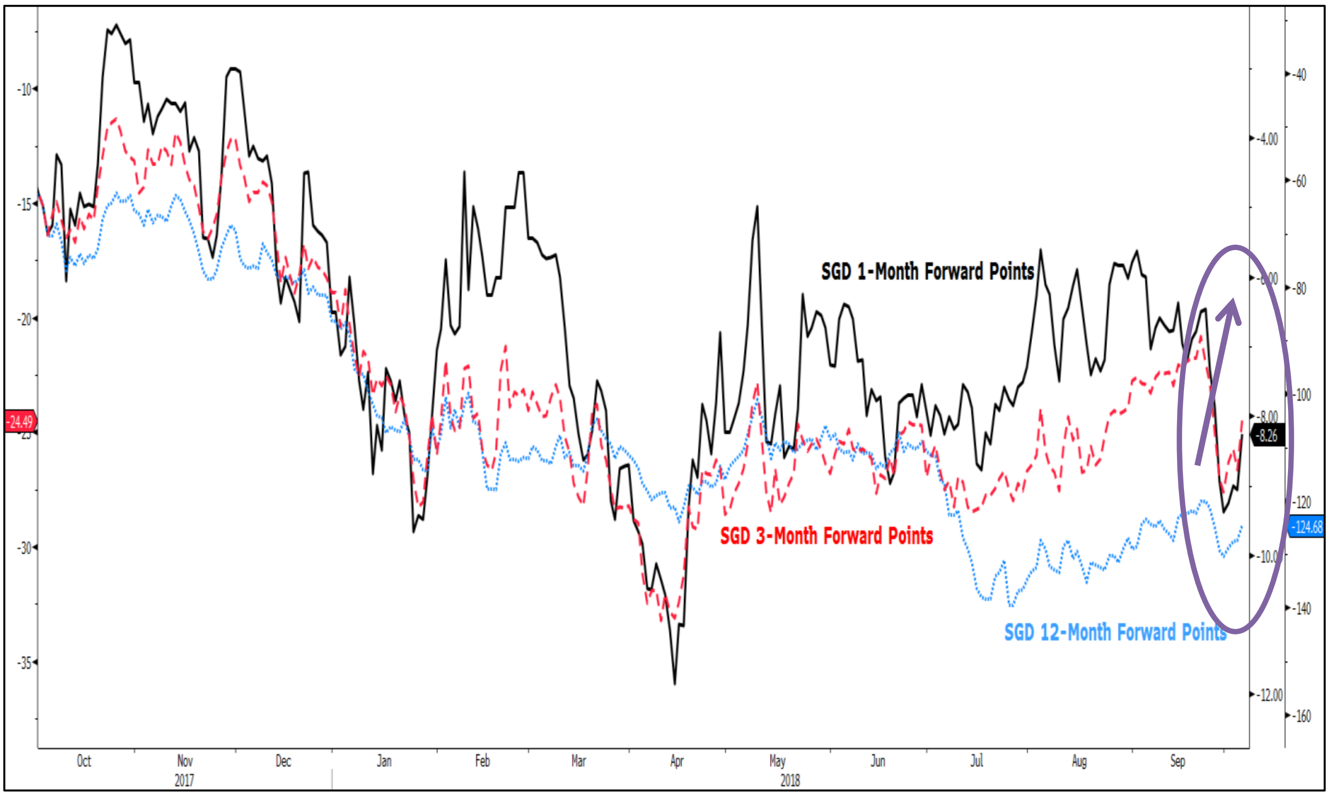


Source: Bloomberg, CEIC, Maybank FX Research

Market Consideration

In the past six months, the SGD has appreciated mildly against the HKD, USD, TWD and THB even as it depreciated against the other currencies in its basket (Chart 5). This suggests that there is some room for the SGD to appreciate in the next six-months. Further, with the SGD NEER currently at around 1.1% above the mid-point of the band (SGD strength), there is still some room for the SGD to appreciate within the current policy parameters in the next 6 months or so.

Chart 6: SGD Forward Points Suggest Further SGD Weakness Losing Momentum Ahead



Source: Bloomberg, Maybank FX Research

Looking ahead, we are likely to see the same pattern emerge in the next six months. Based on our house projections, the SGD is expected to weaken against most of its major trading partners. We should see the SGD depreciate against the JPY, EUR, GBP, NZD, CNY, MYR and IDR but appreciate against the AUD, INR, PHP and THB. Thus from a markets perspective, a further move to tighten policy now would be unnecessary as, on balance, this could lead to an undershoot resulting in a sub-optimal outcome in the economy.

Markets do not appear to share our belief that the USDSGD is poised to move lower in the months ahead. Based on the forward points for the SGD, the market is still positioned for SGD weakness ahead as seen in Chart 6. However, the pace of SGD weakness that market is expecting has lessened. The 1-month, 3-month and 12-month forward points are now pointing upwards even as they remain in negative territory.

Maintain our USDSGD Forecast For Now

We remain positive on the SGD underpinned by a more reduction in USD strength in the next 12 months. In addition, support from the EUR and CNY – on expectations of monetary policy convergence between EU and US and the re-introduction of the counter-cyclical adjustment factor by China – should also keep the SGD on an upward trajectory. While we cannot rule out possible further bouts of weakness in the SGD due to resurgence in the USD, we expect these downside pressures on the SGD to be short-lived. We maintain our forecast for the USDSGD end-2018 around 1.3650 and then to hover around that level by end-1Q 2019. Thereafter, we expect the USDSGD to be on a slow grind lower towards the 1.36-levels by end-3Q 2019.

The difference between our implied USDSGD estimates and our USDSGD forecast suggests that a larger moderation in USD strength is in part embodied in our USDSGD forecast.

Forecast	4Q 2018	1Q 2019	2Q 2019	3Q 2019
USDSGD	1.3650 (--)	1.3650 (--)	1.3600 (--)	1.3600 (--)

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