FX Insight

SGD - Room for SGD NEER to Soften

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MAS Likely to Ease Policy; Higher Chance of Mild Easing

We expect the Monetary Authority of Singapore (MAS) to ease its monetary policy stance on 14 Oct. The call is premised on a stagnating economy and low core inflation. House view is for MAS to reduce the slope of the SGD NEER "slightly" from the current +1% appreciation path to +0.5%, but keep the width and centre of the policy band unchanged. A lower 20% probability is assigned to a more aggressive easing move, i.e., adoption of neutral slope, especially if a technical recession occurs in 3Q. [See report from our Economist team, *MAS Preview: "Slight" Easing, Ducking Recession*].

This is corroborated in part by our Taylor Rule estimates. Our model highlights that an appropriate SGD NEER slope consistent with current growth and inflation projections could be in the 0% to +0.5% range.

Mild Easing Partly Priced In

Markets have partly priced in the possibility of a -0.5% reduction in the policy slope at the upcoming meeting. We observe that: (i) SGD NEER is estimated to have come off from a recent high of +1.8% above mid-point as at end-June to about +1% above mid-point now, (ii) USDSGD 6M Forward Swap points have narrowed from -32.75 as at 28 June to -24.25 now, and (iii) a Reuters poll of analyst opinions on Asian FX shows that there is likely a larger long position of USD vs. SGD now, vs. early July.

Despite this, based on various approaches (i.e., Taylor Rule, aggregating internal FX forecasts, past SGD NEER behavior during easing cycles), we think that there is still some room for SGD NEER to fall by year-end.

Potential SGD NEER Outcomes Under Various Policy Moves

MAS Policy on 14 Oct	Likelihood	Position of SGD NEER relative to implied mid-point after MAS policy**
Mild Easing (0.5% reduction in slope)*	Base Case	+0.5% to +1.0%
Move to Neutral Slope	20%	Below +0.5%
Unchanged Policy	Unlikely	+1.0% to 1.5%

* From estimated 1.0% appreciation currently.
** SGD NEER is currently estimated at +1.0% above mid.

MAS Likely to Ease Policy

We expect the MAS to ease its monetary policy stance on 14 Oct. The call is premised on a stagnating economy and low core inflation. Our Economist team assesses that the economy likely dodged a technical recession, with 3Q GDP growth coming in at a sluggish +0.2% on a year-on-year basis. Meanwhile, core inflation has been sliding, falling to a 3-year low of 0.8% in Aug. In the next few quarters, imported inflation is likely to be benign, and upward price pressure from recent oil supply disruptions (recent Saudi oil drone attack) seems to be fading as a large portion of damaged supply has been credibly restored. Domestically, slower growth outturns should also cap demand-pull price pressures.

House view is for MAS to reduce the slope of the SGD NEER "slightly" from the current +1% appreciation path to +0.5%, but keep the width and centre of the policy band unchanged. A lower 20% probability is assigned to a more aggressive easing move, i.e., adoption of neutral slope, especially if a technical recession occurs in 3Q. [See report from our Economist team, *MAS Preview: "Slight" Easing, Ducking Recession*].

This is corroborated in part by our Taylor Rule estimates. Plugging in the following macro assumptions (GDP growth: 0.6% in 2019, 1.2% in 2020; Core inflation: 1.2% in 2019, 1.2% in 2020), our model highlights that an appropriate SGD NEER slope consistent with these growth and inflation projections could be in the 0% to +0.5% range.

Mild Easing Partly Priced In

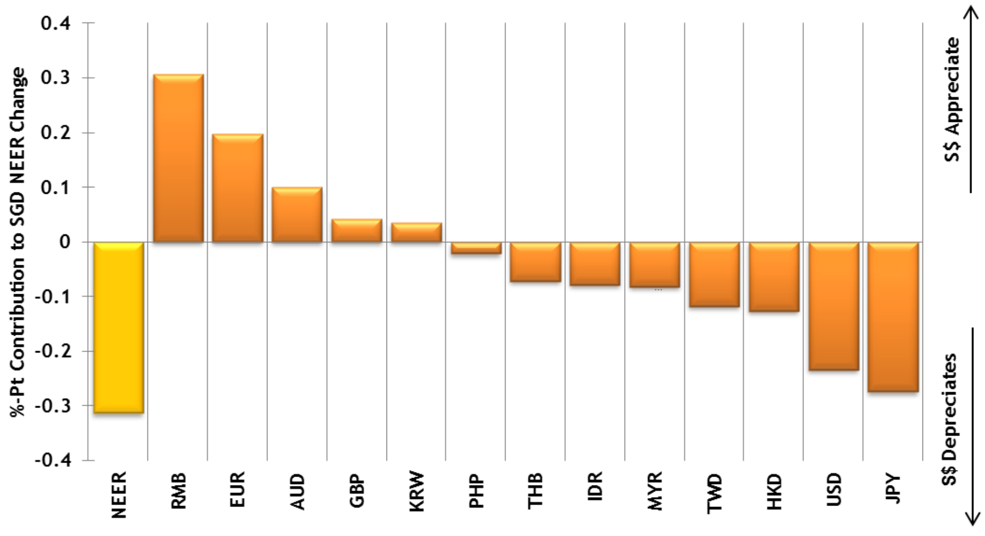
We think that markets have partly priced in the possibility of a -0.5% reduction in the policy slope at the upcoming meeting (i.e., from 1.0% appreciation against basket now to +0.5% appreciation). We base this on three observations.

(i) Despite some volatility in 3Q, the SGD NEER is estimated to have come off from a recent high of +1.8% above mid-point as at end-June to about +1% above mid-point now. [*Refer to Chart 1 below for the extent of SGD movement relative to other currencies over the period.*]

(ii) The USDSGD 6M Forward Swap points have narrowed from -32.75 as at 28 June to -24.25 now, indicating that market participants expect a slower pace of SGD appreciation against USD going forward.

(iii) A Reuters poll of analyst opinions on Asian FX shows that there is likely a larger long position of USD vs. SGD now, vs. early July (score of 0.15 on 4 Jul vs. score of 0.51 on 26 Sep; scores are between +3/-3, with positive scores indicating markets likely being long USD), which could imply that there have been increased bets on MAS easing.

Chart 1: Relative Strength in JPY, USD, HKD Contributed to SGD NEER Weakness Since end-June

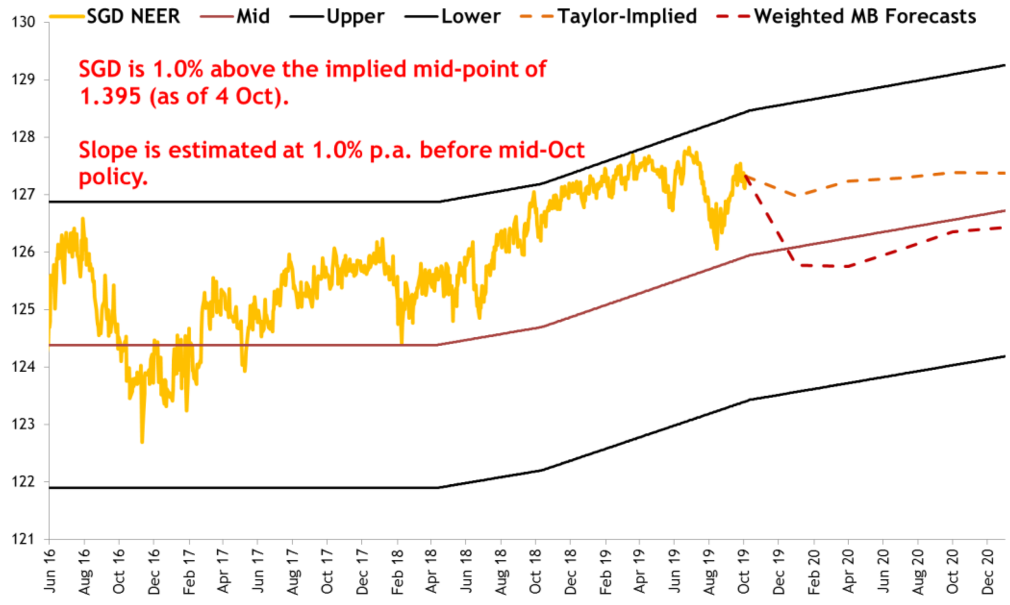


Source: Maybank FX Research & Strategy Estimates

Still Room for SGD NEER to Soften Further

Despite a mild easing move being partly priced in, we think that there is still some room for SGD NEER to fall by year-end.

Chart 2: SGD NEER Trading at Around +1.0% Above Implied Mid-Point



Source: Maybank FX Research & Strategy Estimates

While the extent differs, both our Taylor Rule and "Weighted MB Forecast" estimates suggest that **there is room for SGD NEER to fall (towards or even below implied mid-point of policy band) by year end**, before stabilizing somewhat into 2020, alongside some positivity in AxJ currencies if sentiment on US-China trade deal improves. "Weighted MB Forecast" refers to figures derived via weighting our forecasts of individual currencies in the SGD NEER basket, by their estimated weights in the basket.

Table 1: SGD NEER Level (Relative to Policy Mid-Point) Pre/Post-Easing

		Positions of SGD NEER Rel. to Mid-Point (+ve = above; At Mkt Close)				
	Estimated Reduction in Slope	1 Month Before	1 Day before	Policy Announce-ment Day	1 Month Later	Cumulative Change (1M prior to 1M post)
10-Oct-08	**-2.5%**	-0.4	-1.5	-1.5	-1.1	-0.7
14-Oct-11	**-1.0%**	+0.9	-1.1	-0.4	-1.6	-2.5
28-Jan-15	**-1.0%**	+0.1	-0.3	-1.1	-1.5	-1.6
14-Oct-15	**-0.5%**	-0.7	-1.5	-0.1	-1.2	-0.5
14-Apr-16	**-0.5%**	-0.1	+0.3	-0.5	-0.3	-0.2

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

Looking at past easing instances, there are several key observations.

(i) Comparing the immediate period (1M) before and after an easing announcement, **SGD NEER has always moved lower relative to the implied mid-point**, usually to a level in the lower half of the policy band.

(ii) A large part of the softening in SGD NEER actually occurs in the lead-up to the actual policy announcement.

(iii) Movement on the day of announcement itself would depend on market expectations at the time. On Jan 2015, the off-cycle policy caught markets off-guard, and the intra-day movement was almost equivalent to the extent of the easing.

If the MAS policy in Oct is indeed a 0.5% reduction in slope (base case), this would be somewhat expected by markets, and movement in the SGD NEER could be more modest. Nonetheless, it could still see slight softening by year-end, and end the year in the +0.5% to +1.0% above mid-point range.

If MAS eases to neutral slope, this would be more aggressive than markets expect. Correspondingly, there should be greater room for SGD NEER to fall, perhaps towards a level below +0.5% (relative to policy mid-point), by year-end.

The much larger surprise would be if MAS maintains current policy slope. The lack of a dovish slant under weak growth and tame inflation expectations may lead SGD NEER to appreciate instead, further into the upper half of the current policy band, and end the year perhaps in the +1.0% to +1.5% above mid-point range.

There are two risk factors to the base case view. First, there is a chance that increased portfolio or investment flows from the region (e.g., Hong Kong) into Singapore could impart some resilience to the SGD, due to Singapore's semi-safe haven status. Second, a stronger than expected CNY-fixing (below 7.10) in Oct would indicate a strong preference for yuan stability by the PBOC, which could in turn impart some strength to currencies such as the SGD, given their high positive correlation.

Nonetheless, on net, **risk-reward considerations would still favour shorting the SGD NEER at current levels**.

Forecast	4Q 2019	1Q 2020	2Q 2020	3Q 2020
USDSGD	1.3950 (--)	1.3900 (--)	1.3800 (--)	1.3700 (--)

As at writing, USDSGD is around 1.3820, and trades around 1.0% above the implied mid-point of 1.3950, with the top estimated at 1.3670 and the floor at 1.4230.

Our forecast trajectory for USDSGD remains unchanged from our Monthly report in end-Sep. We see an upward bias in USDSGD as more likely in the interim, with latest soft data points (PMI of 49.5 in Sep vs. 49.9 prior, Electronics Sector Index at 49.1 vs. 49.4 prior) corroborating high likelihood of a MAS easing on 14^{th} Oct. Heading into 2020 however, hopes of some positivity from US-China trade deal outcomes could impart some optimism into AxJ currencies.

USD strength is also likely to fade from current elevated levels, on factors such as a more dovish Fed (weakening US growth), widening twin US deficits and over-stretched USD long positions (at 30-month high currently). Over the medium-term, diversification of FX reserves into other major currencies by global central banks could also see lower demand for USD in this aspect.

Impact on SGD Rates

Technically, a lower rate of SGD NEER appreciation would lead to upside risks for money market rates, ceteris paribus. I.e., a higher rate of SOR or SIBOR return is required to compensate for lower expected gains from holding SGD.

Nonetheless, current domestic rates environment is complicated by expectations of further cuts in the Fed policy rate. House view is for another 50bps worth of cuts into 1H 2020, while current option pricing also indicates that markets are expecting 2-3 more 25 bps cuts by June 2020. This would exert downward pressure on SIBOR and SOR rates, even as an **easing bias by MAS would likely mitigate some of this downward pressure**.

On net, we look for 3M SIBOR to fall to 1.6%-1.7% by end-4Q 2019, from 1.88% currently, and to decline further to around 1.5% by mid-2020. Similarly, 3M SOR could fall to around 1.5% by end-4Q 2019, from 1.67% currently, and potentially decline further to around 1.4% by mid-2020.

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