

FX Insight

SGD - Still Weighed Down By Global Risks

Stronger Economic Growth But No Change In MAS Policy Expected

Our economic team has recently lifted its Singapore growth estimates to 2.5% from 1.5% previously for 2017 underpinned by expectations of a 'synchronised' recovery in ASEAN from stronger US growth. This improvement in the domestic environment would reinforce the MAS' neutral policy that is expected to be maintained for an "extended period". The expected improvement in the domestic economic environment should not trigger a tighter monetary policy by the MAS that could choke-off any nascent recovery unless inflation outpaces. We believe that the neutral policy stance would continue for the rest of 2017 with the SGD NEER possibly hovering at the lower half of the policy band ahead.

Downside Risks Abound But Could Be Partially Mitigated

Singapore being a small-open economy faces stresses from the ongoing economic restructuring, possible impact from US fiscal and monetary policies and geopolitical stresses that could weigh on the SGD. SGD could find some support from its strong domestic fiscal position and from quasi-safe haven flows arising from possible financial crises in some Asian economies from rising USD-denominated debt and rising interest rate. There is also some upside risk from a synchronised recovery in exports and growth, with some tendency of ASEAN regional currencies to strengthen but this could be muted in this initial cycle, limiting the impact on the SGD. This is because of potential dynamic idiosyncratic risks surrounding the regional economies. Taking potential scenarios into consideration, there is some risk of swings but we should expect the impact of the trade and financial channel to negate each other with the big question mark likely to remain on the extent of global trade protectionism in 2017 emanating out of the US and how markets will price that in will affect how the USD and regional currencies perform in 2017, including the SGD. For now, we think it will likely hover around the current levels for most of 2017 until developments change. If the protectionism stance by a Trump administration ends up muted, we could potentially revise the SGD higher in due course.

Maintain Our USDSGD Forecast For Now

Mindful of these risks, we maintain our USDSGD outlook for now. We expect the USDSGD to edge higher in the first six months of the year from current levels underpinned by a firmer dollar. The USDSGD should end 2Q 2017 around 1.4450. Thereafter, the more moderate tone of the US dollar should allow the USDSGD to bounce lower towards the 1.4350 levels by end-2017.

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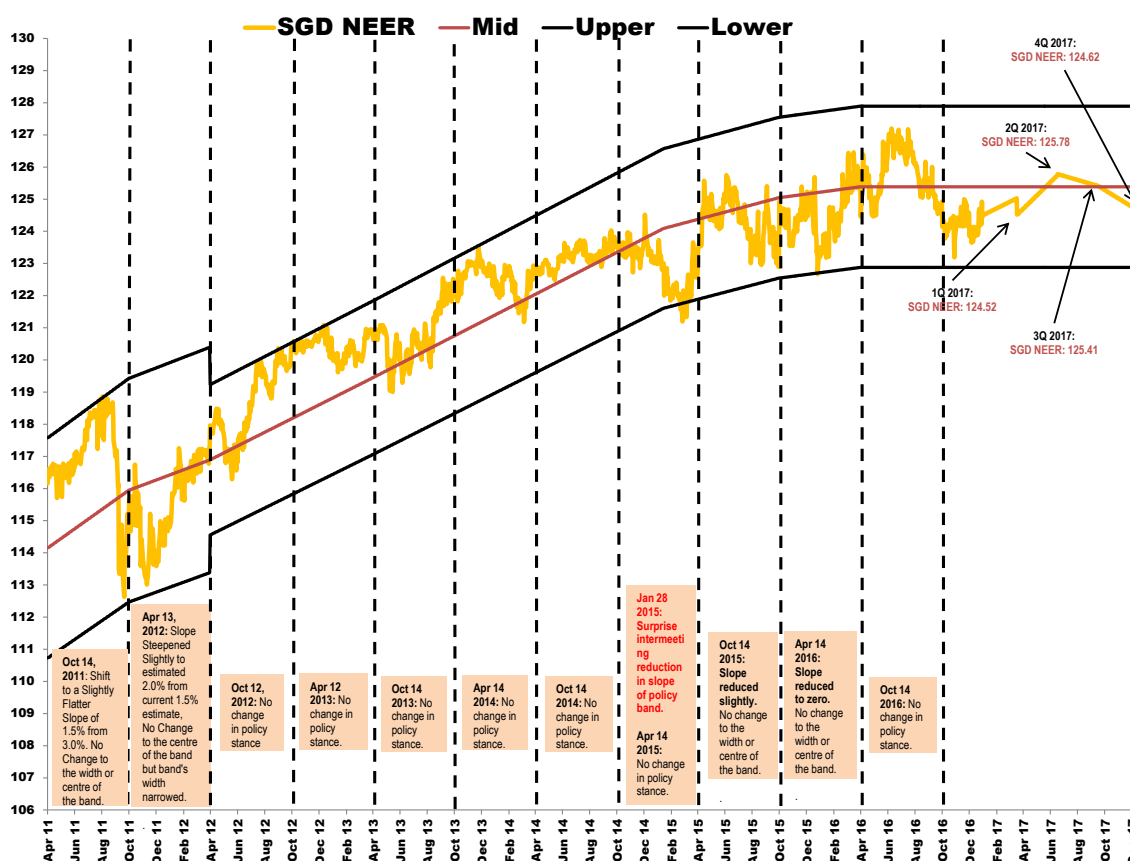
SGD Still Weighed Down By Global Risks

Our economic team has recently lifted its Singapore growth estimates to 2.5% from 1.5% previously for 2017. This upgrade in Singapore growth outlook is underpinned by the expectations of a ‘synchronised’ recovery in ASEAN from stronger US growth. The strong US growth should translate into stronger demand for ASEAN exports and manufacturing as a result. Singapore itself is unlikely to benefit from this upswing in US growth as domestic manufacturing and exports are no longer as sensitive to US and global growth as they used to be.

The improved outlook for the Singapore economy gives us comfort that the MAS is unlikely to ease policy further this year. Recall that in its monetary policy statement in Oct 2016, MAS provided a forward guidance that the neutral policy would be maintained for an “extended period” given that the domestic macroeconomic environment is still not in dire straits. The MAS believes that maintaining such a policy stance would facilitate the closing of the output gap and ensure medium term price stability. Thus, an improvement in the domestic environment would reinforce the MAS current policy stance.

The hurdle for further easing by the MAS remains high and any policy adjustments will be data-dependent. Even an improvement in the domestic economic environment as our economic team expects should not trigger a tighter monetary policy by the MAS. MAS is unlikely to over-react by choking off any nascent recovery with a tighter policy unless inflation outpaces. We believe that the neutral policy stance would continue for the rest of 2017 with the SGD NEER possibly hovering at the lower half of the policy band ahead.

Chart 1: MAS’ Neutral Policy Stance To Stay For ‘Extended Period’ - SGD NEER Likely To Hover Below The Mid-Point By End-2017



Source: Bloomberg, Maybank FX Research

January 17, 2017

The chart above tracks the policy adjustments of the MAS since 2011. MAS has maintained a neutral policy stance, that is the slope of the SGD NEER is at zero percent, since Apr 2016. The width of the policy band and the level at which the SGD NEER is centered has also been unchanged. Our estimates suggest that the SGD NEER is expected to mildly strengthen in 2Q 2017 before sliding back below the mid-point. SGD NEER is expected climb to 125.78 in 2Q from 124.52 in 1Q and thereafter slip lower to 125.41 (3Q 2017) and 124.62 (4Q 2017).

As rightly pointed out by our economic team, there are downside risks facing the Singapore economy that could in turn impact the SGD. Aside from the stresses from the ongoing economic restructuring, the domestic economy could also come under duress from the protectionist measures of the incoming Trump administration should such measures be implemented. Singapore being a small-open economy would be vulnerable to any trade wars that could put downside pressure on the SGD. In addition, an even tighter Fed policy on faster-than-expected inflation in the US from the planned expansionary fiscal program together with geopolitical stresses from the EU (on Brexit concerns) and East Asia (from North Korea's belligerent policies) could weigh on the SGD as well.

Nonetheless, SGD could find some support from its strong domestic fiscal position which should allow the economy to ride out some of these challenges. In addition, quasi-safe haven plays arising from possible financial crises in some Asian economies from rising USD-denominated debt and rising interest rate triggered by potential high risk political events in the EU and global tensions arising out of Trump-inspired policies, could be also be supportive of the SGD as the risk of tighter capital flows management may lead to some inflows into SGD assets in such a scenario.

There is some upside risk also from a synchronised recovery in exports and growth, with some tendency of ASEAN regional currencies to strengthen. But for now we assume it could be muted in this initial cycle given an environment which is drastically different from the past recovery cycles, limiting the impact on the SGD. This is because of potential dynamic idiosyncratic risks surrounding the regional economies. In the region, political risks in Indonesia (contentious Jakarta gubernatorial elections on 15 Feb), Thailand (possible delay in the expected year-end general elections to return to civilian rule) and possibly even in Malaysia (snap elections to cement PM Najib's power base) could weigh on their currencies. In the Philippines, the government's extra-judicial killings, policy flip-flops and the president's unpredictable temperament could put downside pressure on the PHP.

In summary, any upside from the trade channel for Singapore from a more resilient US recovery and support for Asian regional production networks, though positive remains at risk from some form of trade protectionism in 2017. This upside, no matter how positive, will be mitigated by the financial channel, as the impact of higher US rates from Fed normalisation filter through into the regional exposures to dollar denominated debt and loans. This mitigation factor though is probably neutralised to some extent by strong regulatory and prudential measures built up by central banks in the region over the past decade or so.

Taking potential scenarios into consideration, there is some risk of swings but we should expect the impact of the trade and financial channel to negate each other with the big question mark likely to remain on the extent of global trade protectionism in 2017 emanating out of the US and how markets will price that in will affect how the USD and regional currencies perform in 2017, including the SGD. For

now, we think it will likely hover around the current levels for most of 2017 until developments change. If the protectionism stance by a Trump administration ends up muted, we could potentially revise the SGD higher in due course.

Maintain USDSGD Forecast

Forecast	1Q 2017	2Q 2017	3Q 2017	4Q 2017
USDSGD	1.4400	1.4450	1.4350	1.4350

Mindful of these risks, we maintain our USDSGD outlook for now. We expect the USDSGD to edge higher in the first six months of the year from current levels underpinned by a firmer dollar. The USDSGD should end 2Q 2017 around 1.4450. Thereafter, the more moderate tone of the US dollar should allow the USDSGD to bounce lower towards the 1.4350 levels by end-2017.

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