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Wednesday, 01 April 2009

Monetary Policy Preview: SGD NEER Weakening Fairly Certain

- We think that there is a high chance MAS will ease monetary policy-although it may not be the usual one-off mid-point shift- in light of the cloudy economic outlook. One key factor is the fast deteriorating domestic environment. In Oct 2008, when the central bank shifted to a neutral stance, GDP growth was forecasted at around 3% for 2009. Since then, forecasts have been significantly revised downwards, even to as low as a 7-8% contraction.
- The MAS tightened policy in two earlier meetings – in Oct 2007, and Apr 2008, which resulted in a stronger SGD, and the environment has changed since then. This year, there were persistent calls for a policy move in Jan 2009, which did not materialize. Thus, a move at this coming meeting looks fairly certain.
- A weaker SGD would set Singapore on par with other regional central banks which have been pursuing a looser monetary policy by cutting interest rates aggressively.
- The only complication is that SGD NEER is hovering around the mid-point of the policy band – which makes the usual one-off adjustment a little difficult to implement. Still, the challenging economic situation warrants some sort of policy change – possibly through one-off band adjustment, or outright USD/SGD buying to engineer a weaker SGD NEER (a la SNB's moves in early Mar 2009). It could also widen the policy band to allow the SGD to trade with greater volatility.

SGD NEER: More Scope to Weaken

Singapore is confronting its worst recession yet, and with global trade winding down and NODX contracting dramatically, attention has now shifted to the MAS for help on the monetary policy front. On the fiscal side, the government has already committed S\$20.5bn to combat unemployment, preserving jobs, and improve cost competitiveness. We think that there is a high chance MAS will ease monetary policy, in light of the cloudy economic outlook. A weaker SGD would set Singapore on par with other regional central banks which have been pursuing a looser monetary policy by cutting interest rates aggressively.

Fast Deteriorating Domestic Economy

In Oct 2008, when the SGD policy shifted to a neutral stance, MAS was projecting GDP growth of around 3% for 2009. Since then, some private sector economists' forecasts have been revised down drastically, to even as low as a 7-8% contraction, as external demand showed no signs of improvement. Also, the MAS had tightened policies in two earlier meetings – Oct 2007 and Apr 2008, which resulted in a stronger SGD, and the environment has since changed. Indeed, there have been persistent calls for a policy move in Jan 2009, which did not materialize. Thus, a move at the coming meeting looks fairly certain.

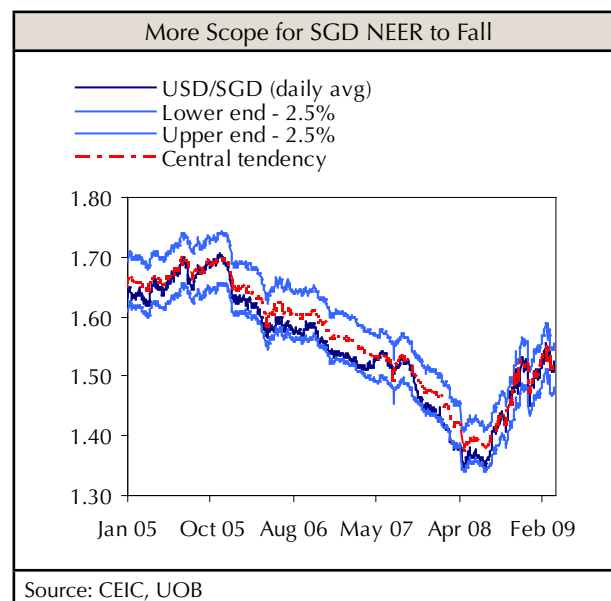
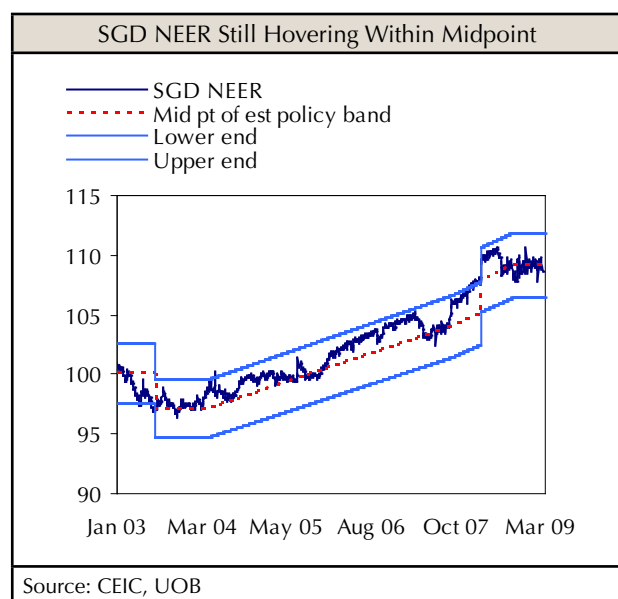
To recap, in the Oct 08 policy meeting, advance estimates released by the MTI showed that Singapore's GDP declined by 6.3% on a quarter-on-quarter seasonally adjusted annualised basis in Q3 2008. Singapore's GDP growth forecast for 2008 was revised from 4-5% to around 3%, and external and domestic inflationary pressures were slated to ease. MAS shifted its policy stance to a zero percent appreciation of the S\$NEER policy band, with no re-centring of the band or change to its width.

In Apr 08, advance estimates showed that GDP grew 7.2% on a year-on-year basis in Q1 2008, bringing average growth to 6.3% in the six months from Oct 2007 to Mar 2008. However, there were signs of significant deterioration in the growth prospects of the developed economies, particularly the US, amidst heightened risk aversion and tighter credit conditions. MAS put Singapore's GDP growth for 2008 at 4-6% this year. At the same time, CPI inflation had also increased and was expected to remain elevated in the first half of this year. Global inflationary pressures remained high even as the downside risks to economic growth had increased. MAS thus shifted the policy band upwards and re-centred the exchange rate policy band at the prevailing level of the S\$NEER, with no change to the slope or width of the policy band, to moderate inflation.

During the Oct 07 meeting, MAS said the Singapore economy was likely to come in within its potential of 4-6% in 2008, following a rapid growth in 2007. Meanwhile, inflationary pressures stemming from external sources were also prevalent. MAS therefore continued with the policy of a modest and gradual appreciation of the S\$NEER policy band, by increasing slightly the slope, with no re-centring of the policy band, or any change in its width.

Implementation of Re-centering Difficult

Despite the difficult state of the economy, our SGD Nominal Effective Exchange Rate (NEER) model shows that the trade-weighted index has not depreciated as much as it should. Especially after the quantitative easing program carried out by the US Fed, the SGD NEER has strengthened in response to a broadly weaker USD, and has been hovering at the midpoint of the policy band.



Traditionally, for the MAS to carry out a one-off re-centering of the band downwards, the SGD NEER has to trade firmly in the weaker part of the band. In April last year, a one-off policy re-centering at the then prevailing level was implemented when the SGD was hovering at the stronger end of the policy band.

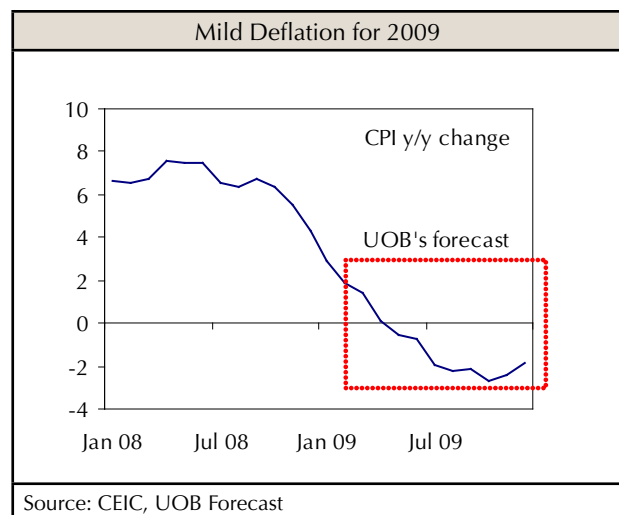
Since the SGD remains at relatively strong levels, there are several options that MAS can pursue to achieve a looser monetary policy. It can sell SGD outright to push the currency down and then shift the mid-point of the policy band downwards. It could also widen the policy band to allow the SGD to trade with greater volatility.

USD/SGD – Stronger in 1H09, and Then Weaker in 2H09

Faced with an unprecedented contraction in its economy this year, and expectation that MAS will ease monetary policy, we are looking at a downward bias on the SGD in the coming months, in anticipation of more bad news on the economic data front, before stabilizing in the second half of the year. We project a softening of the SGD against the USD in the 2Q09 at 1.57/USD, and this decline will ease in the 3Q, to 1.55, before improving slightly in 4Q to 1.53, when the economy starts its slow recovery.

Fast Easing Price Pressure

We are forecasting a period of mild deflation in the coming months, which will set the stage for MAS to ease monetary policy. MTI is forecasting inflation at -1% to 0% in 2009, from a previous estimate of +1 to +2%, on a correction of commodity prices and the deceleration of economic activity. The latest CPI eased in Feb on lower costs of food, housing, and recreation. On a yearly basis, CPI rose 1.9% as housing, food, health care and recreation were still higher compared to a year ago. We expect CPI to continue moderating this year to -0.7%, largely due to basis effect and falling oil price.



Growth Outlook

We are maintaining our call for -4% GDP in 2009, and expecting the Singapore economy to sustain q/q contractions for at least 3 quarters this year. According to our estimates, 1Q09 GDP would shrink 8.2% y/y, with 2Q continuing to contract to around 7.9% y/y. 3Q might see an ease up in the declines, with -4.1% y/y, and then 4Q could finally register a growth of 4.2% y/y.

GDP Preview: Manufacturing and Services to Show Marked Deterioration

Along with the MAS policy statement, Singapore's advance estimates for 1Q09 GDP will also be released. With weak global demand for Singapore's electronics and non-electronic persisting, this will likely drag the manufacturing sector down. Industrial production has already contracted nearly 26% y/y in Jan and Feb. We are forecasting the

manufacturing sector to shrink 19.5% in the first quarter. We expect construction to remain supported, with a growth of 22%, helped by government infrastructure projects as well as projects in the pipeline, which were awarded in the previous quarters. The services sector is likely to again disappoint, with a decline of 4.9%, from a 1.3% contraction in the previous quarter, as financial services, wholesale and retail trade probably registered continuing sluggishness. 1Q09 GDP will likely come in at -8.2%/y/y and -5.9%/q/q saar.

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Announced MAS Monetary Policy Statements/Actions Since 2001

Date	Scheduled Meeting?	Decision		Factors / Outlook Affecting Decision						
		Bias	Pivot Point	Width	External Econ	Global Electronics	Domestic Econ	Imported Inflation	Domestic Inflation	Labour Mkt
22 Feb 01	yes		gradual & modest app		slowdown in US		strong, but to moderate	oil prices ease	upward pressure	ULC to rise moderately
12 Jul 01	yes	neutral stance, 0% app			deteriorated sharply	more protracted downturn	technical recession	benign	muted	easing
2 Jan 02	yes	neutral stance, 0% app	current level	narrowed	downside risks, recovery modest	prolonged adjustment phase	uncertain	falling	falling, govt cost-cutting measures	
11 Jul 02	yes	neutral stance, 0% app	at Jan 02 level		continued recovery but modest	tumaround, modest growth	continued recovery over H2 strength	low, excess capacity	subdued	slack
2 Jan 03	yes	neutral stance, 0% app	at Jan 02 level		deteriorated, Iraq	to strengthen	sluggish, H2 recovery	benign	muted	slack
10 Jul 03	yes	neutral stance, 0% app	at Jul 03 level		signs of pickup, but downside risks	tentative improvement	modest H2 recovery	muted	muted	significant slack
10 Oct 03	yes	neutral stance, 0% app	at Jul 03 level		clearer signs of upturn	continued improvement	outlook improved, modest recovery	benign	subdued into next year	slack
12 Apr 04	yes	modest & gradual app	from Jul 03 level		synchronised upturn,	pickup in global IT demand,	outlook improved, likely to exceed official forecast	risk of rising inflation pressure	subdued, but could intensify	strengthen (output gap turn positive by yr-end)
11 Oct 04	yes	modest & gradual app	from Jul 03 level		greater uncertainty	greater uncertainty	growth momentum easing	risk of rising inflation pressure	subdued, but could intensify	continued improvement
12 Apr 05	yes	modest & gradual app	from Jul 03 level		growing at healthy pace	modest recovery in H2	slowing to potential growth rate	risk of rising inflation pressure	subdued, but could intensify	continued improvement
11 Oct 05	yes	modest & gradual app	from Jul 03 level		growing at steady pace	modest expansion	potential growth in 2005 & 2006	risk of rising inflation pressure	subdued, but expected to pick up in 2006	continued improvement
11 Apr 06	yes	modest & gradual app	from Jul 03 level		holding up, downside risk in 2H	steady pace of expansion	positive outlook	risk of second round inflationary pressure	some upward pressure but well-contained	remains strong
10 Oct 06	yes	modest & gradual app	from Jul 03 level		healthy 1H, moderation in 2H	peaked, 2H demand moderation	strong 1H, moderation in 2H	Benign	subdued	record job gains, some wage pressures
10 Apr 07	yes	modest & gradual app	from Jul 03 level		holding up but US-realised risks emerging	easing in 1H, recovering by 2H	slower growth but outlook still positive	Benign	higher by 0.5% point on GST	tight market, wage pressures in some sectors
10 Oct 07	yes	modest & gradual app, slightly steeper slope of S&NEER policy band	from Jul 03 level		downside risk has increased with fallout in US subprime housing	remained weak	strong 2007	Upside risk	higher, GST rate hiked by 2ppt in July, higher asset prices	tight market, wage pressures in some sectors
10 Apr 08	yes	modest & gradual app	recentre at current level		downside risk	remained weak	stronger-than-expected 1Q08, moderation ahead	Upside risk	remains high	tight market but wage growth easing
10 Oct 08	yes	neutral stance 0% app	from Apr 08 level		deteriorated sharply	expected to weaken	technical recession in 3Q08, growth to remain below potential over the next few quarters	oil prices ease	peaked but remains high	expected to ease