Country Analyst

Chow Penn Nee Chow.PennNee@uobgroup.com
Ho Woei Chen Ho.WoeiChen@uobgroup.com
Jimmy Koh Jimmy.KohCT@uobgroup.com

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Company Reg No. 193500026Z

Singapore: Another Easing in Monetary Policy Before the April Meeting?

The possibility that MAS might be looking to loosen monetary policy again by re-centring the trading band, has been raised in some quarters recently. This is in line with significantly weaker growth outlook and reduced inflationary pressure for next year. Also, in the face of co-ordinated rate cuts by Asian central banks, such as China, Korea, Japan and Taiwan, some believe MAS would take an aggressive stance in easing monetary policy.

In October, the MAS shifted its policy stance to a zero percent appreciation of the S$NEER policy band from 'modest and gradual appreciation' which it had maintained since April 2004. There was no re-centring of the band or a change to its band width in October.

Re-centring SGD NEER Policy Band Mid-point

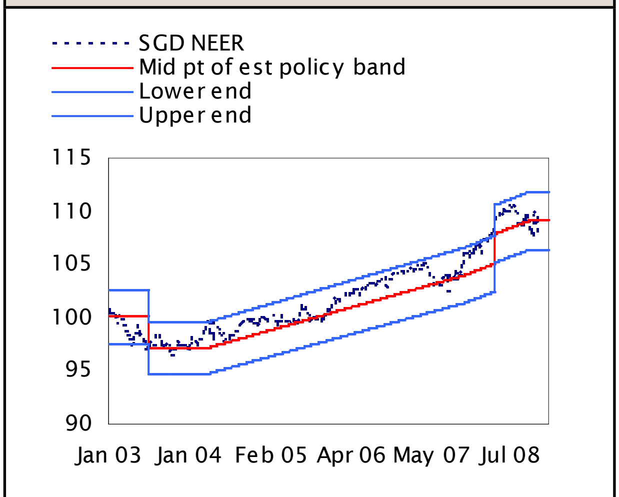
The basis for current expectation appears to stem from the comparison of the current crisis to the Asian Financial Crisis in 1997/98, where slowing growth caused downward pressure on the SGD. The SGD NEER has been around 7% higher - based on the MAS' published NEER values- compared to the beginning of 1998, appearing to imply more room for SGD downside from here.

A re-centring downward is akin to a one-off depreciation of the SGD against the currencies of its trading partners. However, the implementation of such a policy is a little difficult now given that SGD NEER continues to hover around the mid-point of the policy band. Note that a one-off SGD NEER re-centring was implemented in April this year when SGD NEER was hugging the stronger end of the policy band.

Widen Instead of Re-centre

Another option MAS may look at widening the SGD NEER policy band in order to accommodate the increased volatility in the currency market. In early November, we saw SGD NEER trading a wide range of +/-1.0% from the mid-point in the span of two days. These unusual fluctuations are an anomaly for a trade-weighted index, but reflect the risks and uncertainty of the global economy.

UOB's Estimation of SGD NEER



Source: CEIC, UOB

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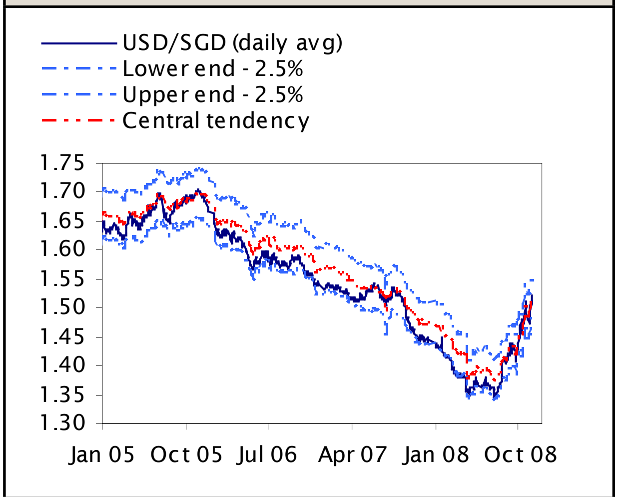

Source: CEIC, UOB

The last time MAS widened the policy band was in Oct 2001, in order to cope with the volatility in the aftermath of Sep 11 terrorist attack. Incidentally, the domestic economy was undergoing a tough period then, similar to current growth slowdown. Again, we see this as an unlikely move by the MAS. According to our SGD NEER charts (see inserted charts), the SGD NEER has not yet breached the 2.5% upper and lower limits of the band, which therefore does not warrant MAS widening the band. Also, too wide a policy band does not look to be meaningful in easing monetary policy.

Assessing the Risks Before Acting

Perhaps, more importantly, is that the effect of the global slowdown has yet to be felt through Singapore's domestic economy, especially employment creation. Also, MAS has just undertaken the neutral policy stance in Oct-2008. Thus, policymakers would prefer to adopt a wait-and-see approach, before undertaking more measures. We suspect the MAS would likely wait to see how Singapore's growth prospects pan out in the 4Q, and full year, before it moves to ease monetary policy.

We believe MAS would look at these two options, but probably later, in Jan 2009, after it has assessed Singapore's growth as well as its trading partners' strengths, before deciding on what it should do.

Trading USD/SGD

The trajectory for USD/SGD remains biased higher in the near-term, as global risk aversion is expected to dominate given the prospects of a prolonged and widespread global recession. Domestically, economic growth prospect is likely to worsen in 1H09 before we start to see some signs of an upturn in the later part of 2009. Anticipation of another monetary loosening in April next year could push SGD NEER towards the lower half of the policy band. We are now forecasting USD/SGD at 1.52 by end-4Q08 and 1.55 end-1Q09 before rebounding to 1.52 by end-2009.

URL: www.uobgroup.com/research
Email: EcoTreasury.Research@UOBgroup.com