

MAS Policy Meeting Preview: No Change Again In April

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Summary

- Although GDP expansion likely to slow to 4.1%/y in 1Q07, Singapore's prospects in 2007 remain optimistic with GDP growth to pick up in 2H, expanding by 5.2% this year.
- Despite the higher inflation in 2007 due to the July GST hike, MAS' current 'modest and gradual appreciation of the SGD stance' is likely to stay in 10 April's monetary policy meeting.
- Tighter labour market in 2007 may have repercussions on ULC, another reason to keep the current MAS policy.
- Although the SGD appreciated another 1.4% against the USD at 1.5128 recently, the SGD NEER was only up 0.4% thanks to the MYR and RMB in the TWI.
- Our view remains that SGD gains will be gradual, likely towards 1.5 end-2Q 07 and then 1.48 by end-2007 in line with the current policy stance.

The Buzz of Optimism in Singapore's Economy

The MTI and MAS will be releasing the 1Q07 GDP advance estimate and the bi-annual Monetary Policy Statement respectively on 10 April (Tuesday, 8 am). We expect GDP to expand by a smaller 4.1%/y in 1Q following the 6.6% expansion recorded in late 2006 while the central bank is likely to keep policy stance unchanged in this meeting. The moderation in growth largely reflected the easing of manufacturing output, especially electronics which we feel is still in the easing cycle and is expected to rebound only later in end-2Q 07. Nonetheless, financial services, transport engineering and bio-medical engineering would remain supportive of the Singapore economy despite expectations of moderating global growth this year.

In addition, the domestic economy appears to be buzzing with optimism in the domestic economy, as reflected in the surge in Singapore assets prices. High-end properties have hit record high levels, as foreigners bet on the new found optimism surrounding the two Integrated Resorts (IRs), the city-state as a global wealth management centre, tourism, education and medical hubs. Tourist arrivals hit record high of 9.7mn - estimated to have contributed \$12.4bn in GDP - and are likely to remain high this year as well. Employment has also showed sterling performance, with 176k jobs created in 2006, up 55% from 113,300 jobs in 2005 and 71,400 in 2004. Thus while GDP growth is expected at slower 5.2% this year from 7.9% in 2006 amidst a more moderate environment, growth engines are likely to be more broad-base in 2007.

Although CPI inflation is likely to pick up in 2007, especially in 2H when the GST hike kicks in, we believe the overall price increases still remains manageable and the MAS will most likely maintain their current "gradual and modest appreciation of SGD NEER" policy stance.

CPI Likely to Hit 2% on GST Impact but MAS Unlikely to Alter Current Policy

So far, inflation has remained benign in Singapore, with headline CPI at meager 1% in 2006. Going into 2007, the recent CPI data for Jan-Feb period showed that inflation was at a low 0.4%/y. In addition to factoring in some price increases from oil-related items as well as upward trending housing cost, reflecting the continued strong buying interest of private property in 2007 and some labour cost pressures to 2007 prices, the implementation of the GST hike from 5% to 7% in July

2007 would imply a one-time increase in inflation in 2H07 and 1H08. Assuming that the GST hike affects around 70-75% of the CPI basket (a rough estimate using the methodology by MAS in an earlier report), we expect a one-off GST hike to increase inflation by 0.6%age point in 2007 and result in inflation coming in at a still manageable 2% for the full year. We anticipate the MAS to revise their CPI forecast range higher, to 1.5-2.5% from the current 0.5-1.5% with the upside risk factors in 2007 still residing with sharp oil price movements and the related geo-political developments.

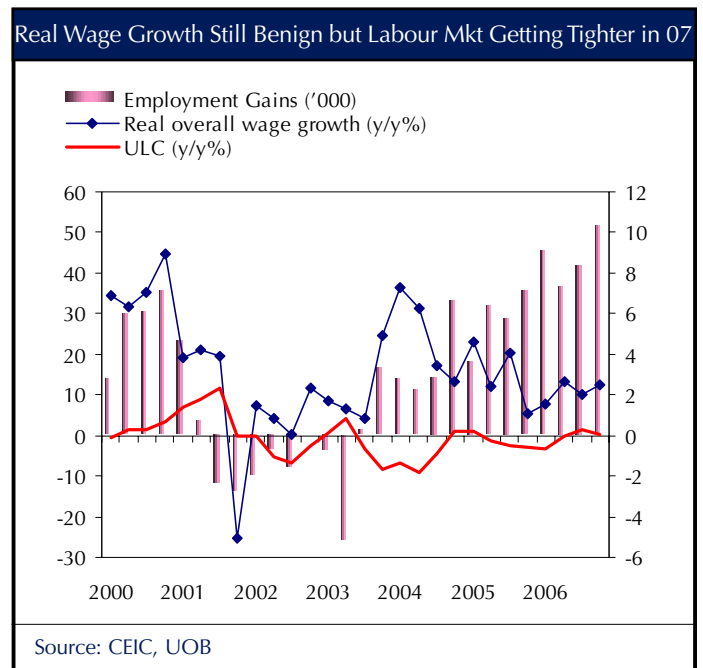
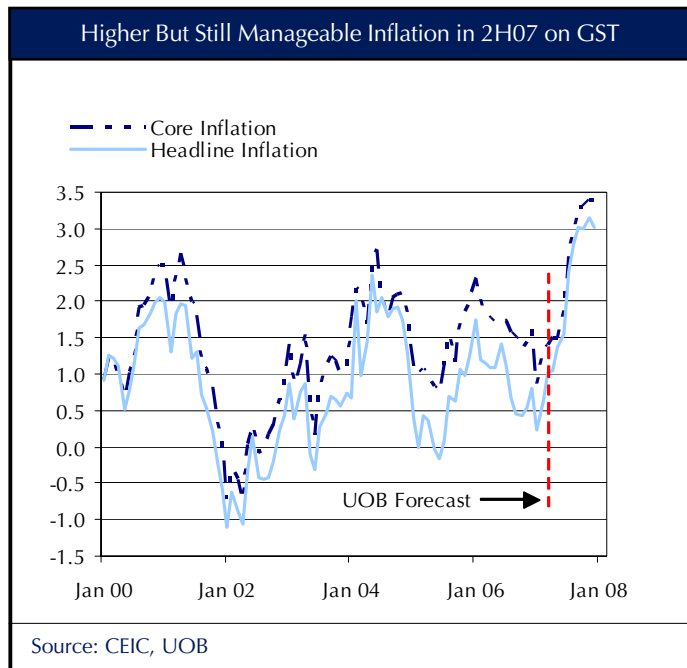
As the GST impact is one-off price hike, there is really little reason for the MAS to change its current policy stance at the 10 Apr 2007 monetary policy statement announcement. Indeed, unless there is spike up in global price pressure, global monetary tightening peaking implies that it is unlikely that the MAS would shift its current stance over the next 12 months.

Tighter Labour Market Another Reason to Keep Current Policy

Although 2006 retrenchment (12,359) was slightly above that during the previous two years (which was mostly from manufacturing), the employment gains last year more than offset the difference, to an all-time record high of 176,000 greatly exceeding 113,300 jobs created in 2005.

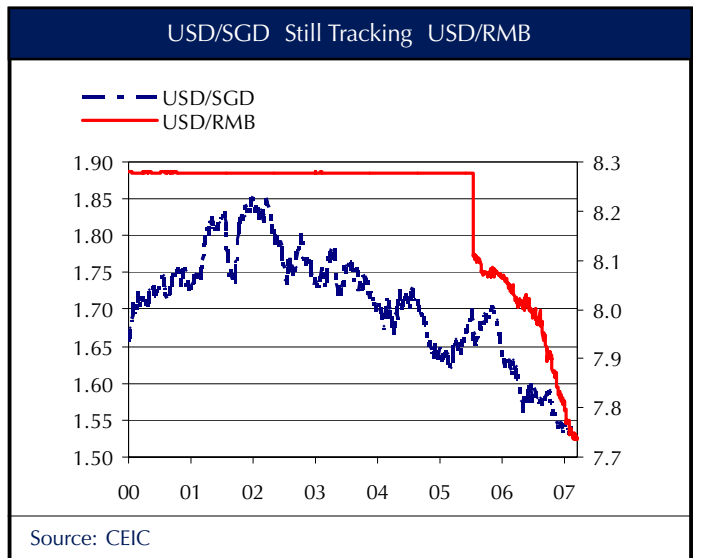
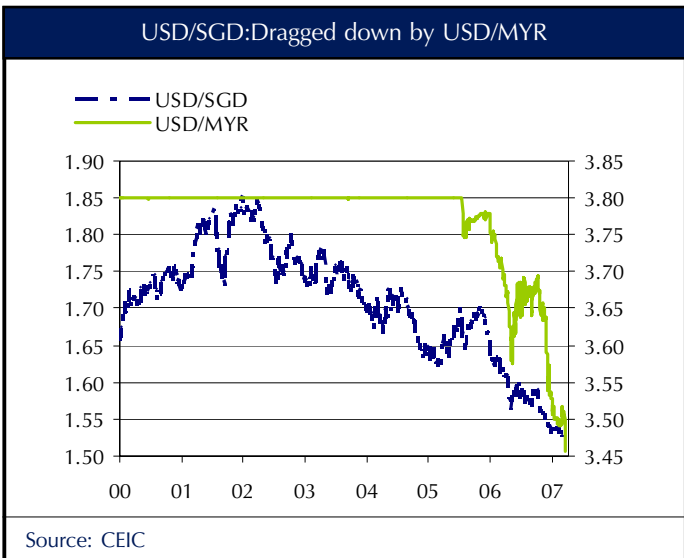
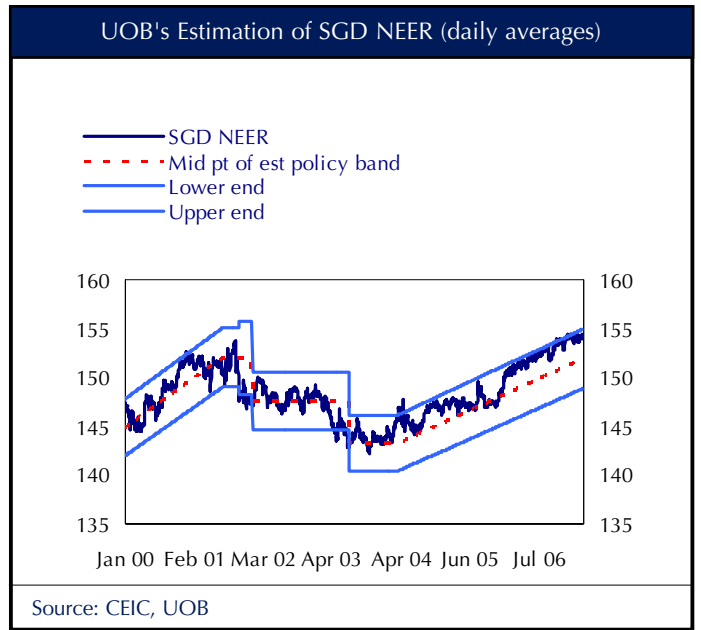
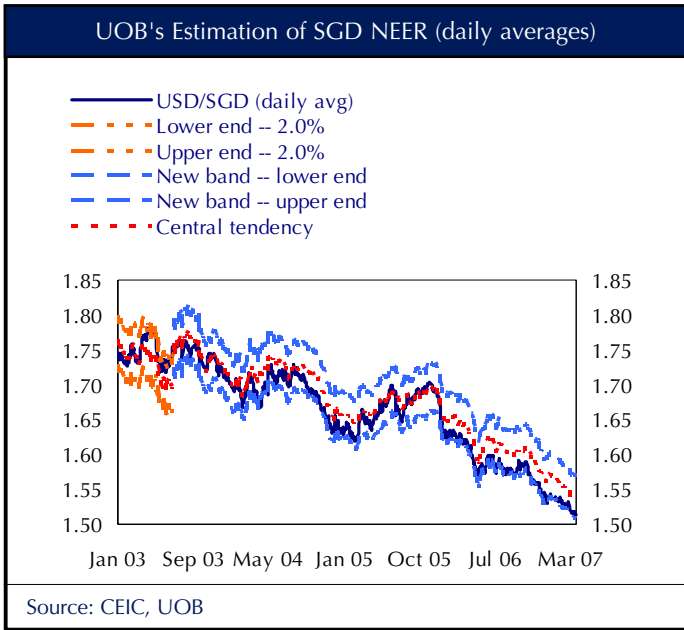
Local employment expanded by a record 90,900 last year from 63,500 in 2005 (while the rest of jobs created were filled by foreign employees, especially within construction sector). This high number of local placements greatly exceeded the average inflow of 33,000 into the local labour supply each year and could possibly indicate that some domestic wage pressures building up in the next few quarters. With GDP growth expected to moderate in 1H07, productivity will likely to slow with a further upside in unit labour cost later into 2007. Indeed, after contracting for 5 straight quarters, ULC turned around in 3Q06, expanding 1.5%/y and a smaller 0.1% in 4Q06.

Nonetheless, overall wage increase for 2007 likely to remain well within expectations on the back of healthy job gains (80-100k this year), and will not lead to excessive wage cost pressures while SGD is expected to remain on the appreciation path for 2007 (USD/SGD to hit low of 1.48 by end-4Q 07) thereby partially offsetting the increases in ULC in real terms.



USD/SGD Outlook and SGD NEER

USD/SGD has continued to edge lower as Asian currencies continue to undertake the second leg of broad USD correction. In particular, MYR appreciation has been rather extensive. After gains of 4.3% in 4Q-2006, the MYR appreciated about 2.1% in 1Q-2007. In fact, our call of 3.45 on USD/MYR by year-end was met in 1Q-2007. Accounting for close to 1/5 of our in-house SGD NEER model, this has permitted SGD appreciation without challenging the SGD NEER policy model. Indeed, after gains of 3.1% in 4Q-2006, SGD was up another 1.4% since Jan 2007, hitting a recent high of 1.5127 although the SGD NEER was only up by about 0.4%. The extended flows were very much reflected in the build up in FX reserves, as the authorities try to limit excessive SGD gains.



However, our view is that further SGD gains will be gradual, probably towards 1.50 end-2Q07 and then 1.48 end-2007. To begin with, RMB appreciation is in line with expectation, up about 1% per quarter. In 1Q-2007, the Chinese yuan rose 1.06%. Second, despite the extended MYR adjustment, our view is that BNM would prefer a more gradual sort of MYR adjustment, especially with global growth likely to moderate in 2H-2007. In addition, the positive correlation between USD/SGD and USD/JPY appears to be breaking down, as a result of flush global liquidity and JPY related carry-trades. This should limit USD/SGD downside, as SGD NEER threatens the threshold of SGD NEER policy band.

