

Highlights From the 1Q07 GDP Release and the MAS Monetary Policy Statement

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Highlights of the Latest MAS Policy Statement

- As widely anticipated, The MAS maintained its current “policy of a modest and gradual appreciation of the S\$NEER policy band” with “no re-centering of the policy band, or any change to its slope or width” in its April 2007 MPS.
- Official GDP growth forecast remained at 4.5-6.5% in 2007 on a benign external environment although risk factors relating to US growth momentum weakening and US housing market woes have emerged.
- While “the S\$NEER has fluctuated near the upper end of the policy band during the past six months” which has fueled market talk of a re-centering of the MAS S\$NEER policy mid-point so as to allow for more S\$ appreciation, this has been dismissed by the CB which continued to focus on economic fundamentals against US\$ weakness and excess liquidity in the region. Our expectations are for the US\$/S\$ pair to trend towards 1.5 by end-2Q, and lower towards 1.48 by year-end.
- Since peaking at 1.08 in Oct 97, the loans-to-deposit ratio has fallen to a record low of 0.68 in Feb 07 even as domestic loans grew at 7.9% in that month, its strongest pace in 10 years. Holding policy steady would mean domestic interest rates likely to remain depressed in the short term amid “expectations over the appreciation of the S\$ and the liquidity conditions in the market” with the 3-month SIBOR at 2.875% currently from 3.4% in September 2006.
- According to the MAS, “the 2% point GST hike (effective in July 2007) is estimated to raise CPI inflation by about 0.5% point each in 2007 and 2008”. So it came as a surprise to us that the MAS kept its headline inflation forecast range unchanged at 0.5-1.5%/y and underlying inflation to remain within 1-2% in 2007 as well. We believe that it is likely for headline inflation to exceed 1.5% (UOB: 2.0% in 2007) on GST hike and higher housing costs this year, with some further upside risk stemming from higher oil prices.
- So while we concur with MAS policy decision today, we believe that if prices start adjusting higher in the next 6 months we may see the MAS changing tone for the Oct MPS although we think that the CB is able to accommodate CPI inflation up to 2% within its current policy stance.

Singapore: 1Q07 GDP Growth Stronger than Expected

- Although the pace of GDP expansion continued to moderate in 1Q07, as the advance estimate for the first quarter growth came in at 6.0%/y (lower than the 6.6% pace in 4Q06) the 3Q GDP estimates were nonetheless better than expected (UOB: 4.1%, Mkt: 4.9%).
- On a q/q seasonally-adjusted annualised basis, real output expanded by 7.2% in 1Q, slightly off the 7.9% pace set in Dec last year. More importantly, this represented an incredible 15 consecutive quarters of expansion.
- And while manufacturing sector growth continued to ease in 1Q to 6.1% (from 7.7% in 4Q06) on the back of weaker electronics demand, the sector remained well supported by transport engineering and bio-medical output. Based on the 6.1% manufacturing expansion, it would imply manufacturing output would grow at 3%/y in March.

- Construction activity continued to expand at a healthy pace, coming in at 7.0%/y this quarter on the back of rising property prices and a strong buzz of optimism within the economy. We continue to anticipate a strong outlook for construction in 2007 with the slew of en-bloc sales in 2006 starting to translate into new development projects, the continued construction of various large scale commercial and industrial projects all over Singapore. While the disruption in Indonesian sand and granite supply would lead to higher building costs (estimated 1-2% increase), it would not dent construction prospects in 2007.
- Services sector has remained resilient in the recent quarter, with growth coming in at 6.0%/y slightly lower from 6.6% in 4Q06. We expect brighter labour market outlook and healthy tourist arrivals to keep services buoyant while financial services sector keeps on its expansionary path.
- Overall, our full-year GDP growth forecast of 5.2% is maintained for now with a view for upgrading the GDP growth forecast pending the recovery of non-oil domestic exports expected in late 2Q07.

	<u>Weight 2006</u>	<u>1Q06</u>	<u>2Q06</u>	<u>3Q06</u>	<u>4Q06</u>	<u>2006</u>	<u>1Q07</u>
		<u>y/y % change</u>					
Real GDP	100	10.1	8.0	7.0	6.6	7.9	6.0
Goods-producing Industries							
Manufacturing	26.9	18.6	11.9	9.5	7.7	11.5	6.1
Construction	3.2	-0.7	0.9	5.8	4.7	2.7	7.0
Services-producing industries	62.1	8.2	6.9	6.3	6.6	7.0	6.1
* Advance estimate							
Source: MTI							