

Singapore: Buzz of Optimism & SGD Implication

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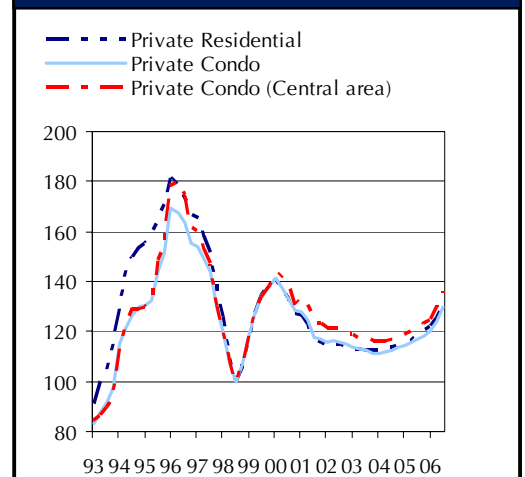
While the global economy is expected to somewhat moderate this year, there is certainly a buzz of optimism sweeping across the domestic economy, as reflected in the surge in Singapore assets prices. High-end properties have hit record high levels, as foreigners bet on the new found optimism surrounding the two Integrated Resorts (IRs), the city-state as a global wealth management centre, tourism, education and medical hubs. Recent newspaper reported that foreigners' share of private homes purchases was 23% in 2006, from 22% in 2005. Although this is below 24% recorded in 1995, it is important to note that high-end prime areas foreigners' purchases amounted to 30-40% (with some as high as 50-60%) last year. Tourist arrivals hit record high of 9.7mn, estimated to have contributed \$12.4bn in GDP. Hotel occupancy, as a result, was at 85%, and average room rate of \$164. 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. In all, while a more moderate environment, with

Singapore: Asset Price Inflation Spreading to Equity Markets



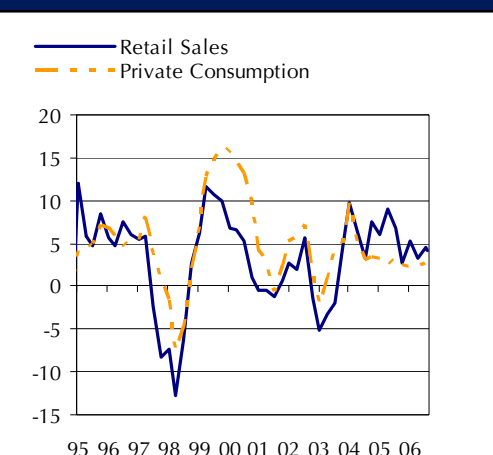
Source: CEIC

Singapore: Foreign Led Interests in the Real Estate Markets



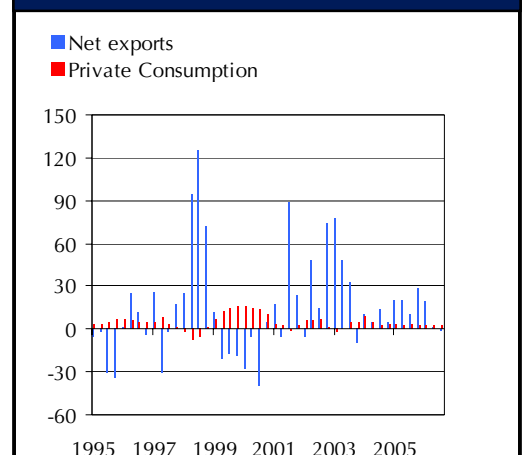
Source: CEIC

Singapore: Renewed Confidence Should Work Through Domestic Consumption



Source: CEIC

Singapore: Domestic Consumption Should Kick in more Significantly Going Forward



Source: CEIC

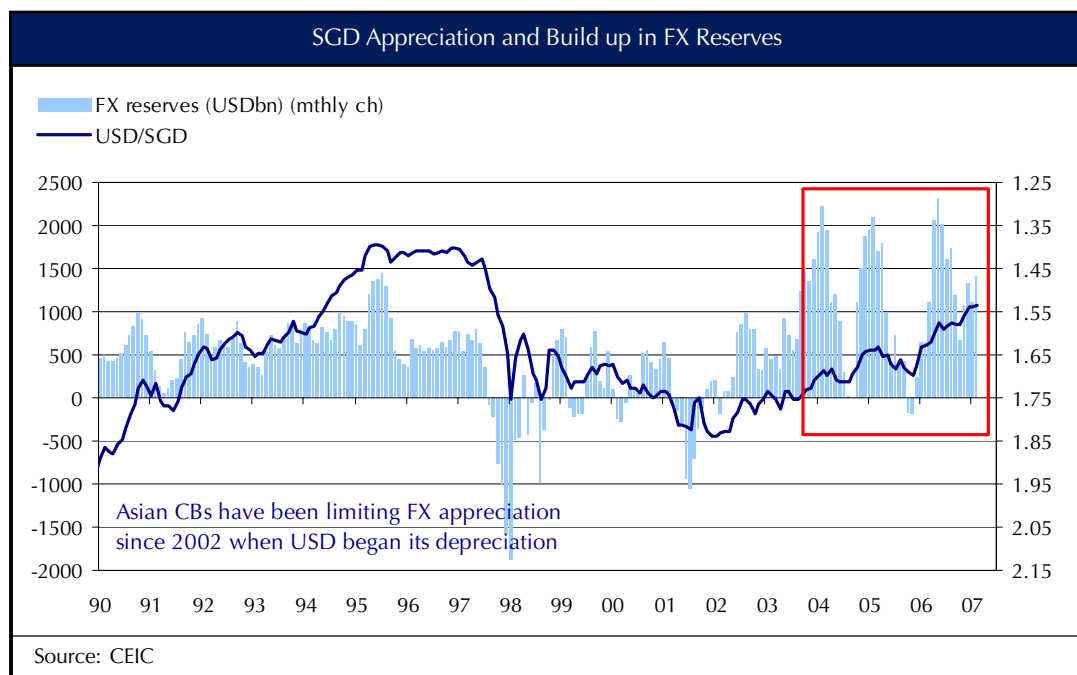
GDP growth expected at 5.2% this year from 7.9% in 2006, growth engines are likely to be more broad-based in 2007.

Benign Inflationary Environment & SGD Policy Implication

So far, inflation has remained benign in Singapore, with headline CPI at meager 1% in 2006. While price pressure could intensify this year, due to basis effect (especially 2H07) and the effect of the 2% points in GST, our view is that inflation is still at a manageable 2% this year. As such, there is really little reason for the MAS to change its current policy stance - i.e. gradual and modest appreciation of SGD NEER -- at the coming Apr 2007 policy meeting. Indeed, unless there is spike up in global price pressure, global monetary tightening peaking implies that it is fairly unlikely that the MAS would shift its current stance over the next 12 months. 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% points in 2007.

USD/SGD Outlook

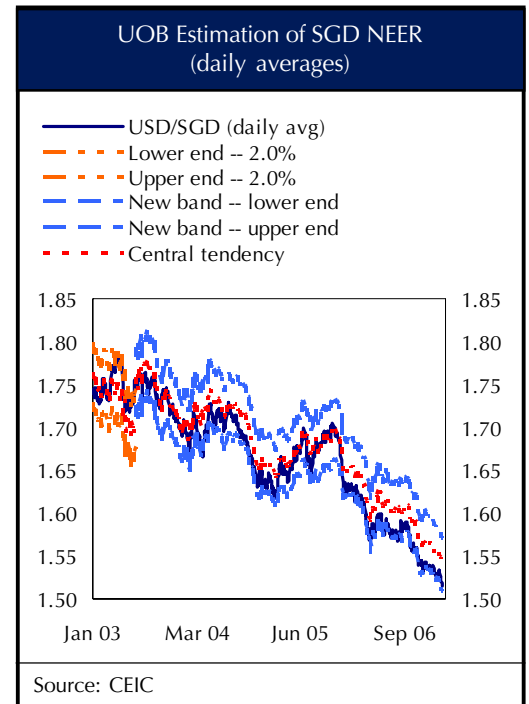
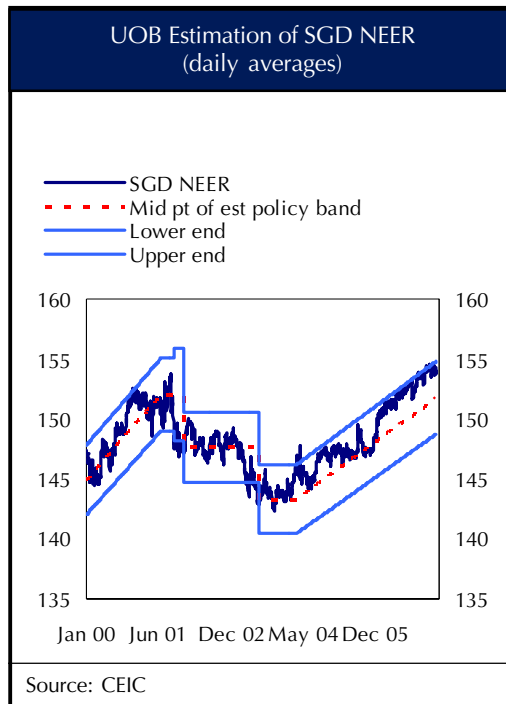
USD/SGD has continued to edge lower as Asian currencies continue to undertake the second leg of broad USD correction. In particular, ringgit appreciation has been rather extensive. After gains of 4.3% in 4Q-2006, the ringgit appreciated about 2.1% in 1Q07. In fact, our call of 3.45 on USD/MYR by year-end was met in 1Q07. Accounting for close to 17.6% 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 4Q06, SGD was up another 1% since Jan 2007, hitting a high of 1.5152. 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 local unit rose 1.06%. Second, despite the extended ringgit 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. Also, the positive correlation between USD/SGD and USD/JPY appear 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.

USD/MYR - Finally, Catching up with the Other Regional

Renewed interests in Malaysian assets have led to outperformance of KLCI and MYR over the last 6 months. After hovering around 850-950 between Dec 2004 and Oct 2006, KCI burst above the 1,000-level in Oct 2006, and then surging to 1,272 on 23 Feb 2007, prior to the sharp global correction. Similarly, the ringgit has appreciated 3.8% in 2H06, and then 2.1% over the last 3 months. This is well above 3.6% appreciation between Jul 2005 and Jun 2006. Indeed, this is probably one of the



FX Outlook

Country	As at 28 Mar	End Q207	End Q307	End Q407	End Q108	End Q208
USD/JPY	117.43	117.50	116.00	114.00	114.00	113.00
EUR/USD	1.3346	1.3400	1.3500	1.3600	1.3600	1.3600
USD/SGD	1.5156	1.5200	1.5000	1.4800	1.4600	1.4600
USD/MYR	3.4500	3.4500	3.4300	3.4000	3.3800	3.3800
USD/CNY	7.7300	7.6400	7.5500	7.4700	7.3950	7.3200

Source: Reuters, UOB

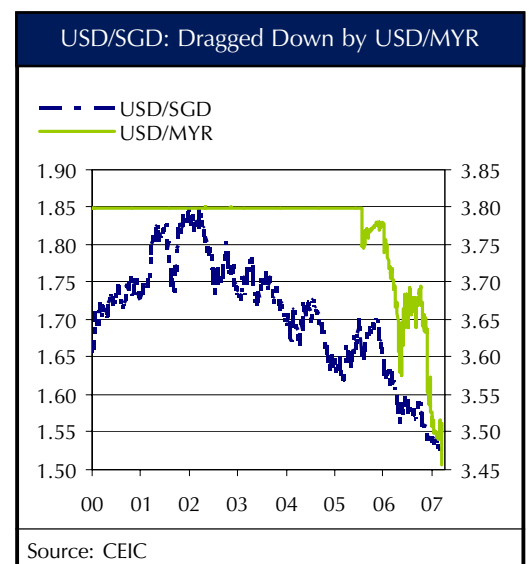
key factors behind the more extended SGD appreciation. While most calculations indicate more ringgit upside, in particular as the local unit is finally catching up with the other regional, our take is that bulk of the ringgit appreciation for the year may have been delivered - especially with a more benign global outlook in 2H07. In all, upside from her should be limited at around 3.43 in end-2Q07 and then 3.40 end-2007, which should help moderate the extent of SGD appreciation.

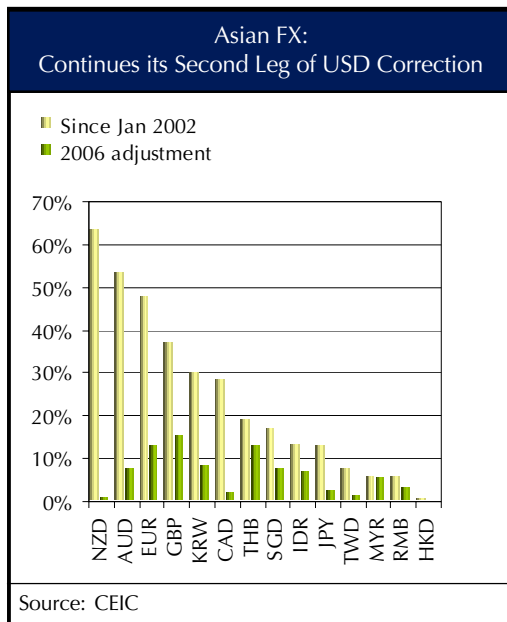
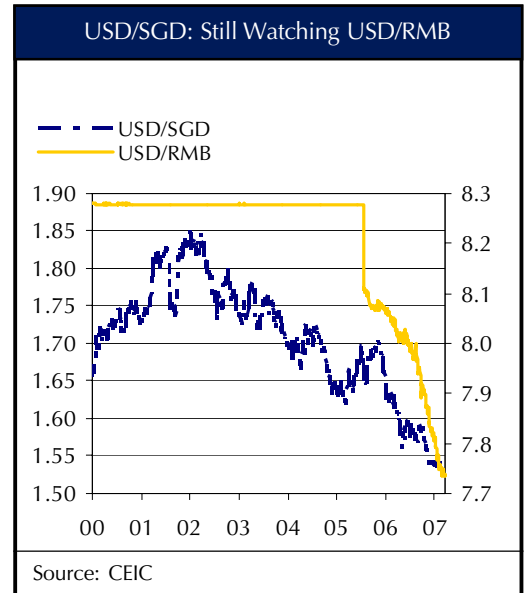
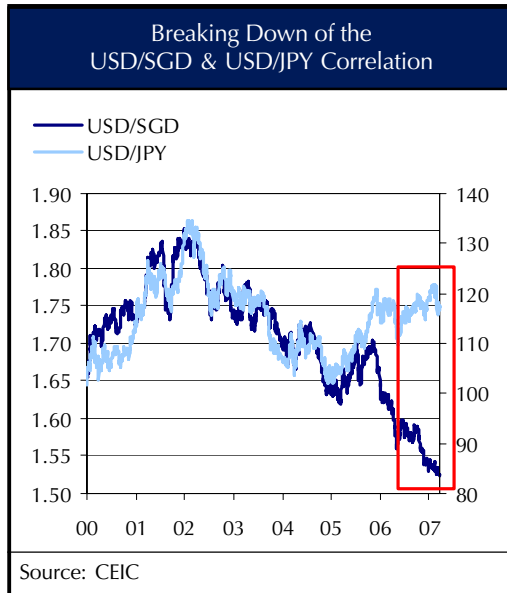
USD/JPY & USD/SGD Positive Correlation Breaking Down

Flush global liquidity, JPY carry trade a dominant theme in the financial markets, and increasing risk appetite on Asian assets, have led to breaking down of the usual positive correlation between USD/SGD and USD/JPY. Accounting for 9.7% of the SGD NEER trade-weights (based on our in-house model), further upside on SGD appears limited, as the local unit is already hugging the SGD NEER band.

USD/RMB - Still a Steady 3-5% Appreciation

On 17 Mar 2007, Chinese central bank announced a 27bps hikes to its benchmark 1Y lending and deposit rates, to 6.39% and 2.79%, respectively, effective 18 Mar. This marked the third interest rate





hike since 28 Apr 2006, when the current tightening cycle began. Looking ahead, China's tightening policy appears to have some way to go given that the central government had targeted GDP growth of 8% in 2007 (as it did in 2006, which turned out to be 10.7%). With momentum for data to stay relatively elevated over 1H07, we see risk of another 27bps rate hike to the benchmark interest rate before end-2Q07. However, the probability weighs heavily on banks' required reserve ratio (RRR), which at this point, is likely to be more effective in freezing some credit growth. The PBoC has raised RRR 5 times over the past 8 months, and we see at least 2 additional 50bps hikes to the banks' RRR before end-2Q07 from 10% currently.

Another avenue is via the RMB adjustment, which to a certain extent is the cause of the flush liquidity conditions. However, we maintain the Chinese economic restructuring process will be gradual, and RMB appreciation will remain around 3-5% per annum. In 1Q-2007, RMB appreciation was around 1.06%, which is in line with our expectation of 4.5% gains to 7.47 by end-2007.

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