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Flash Notes

Singapore: August Industrial Output Continued Double-Digit Contraction

August IP came in below expectation at -12.2%y/y (UOB: -9.0% ; Mkt: -9.3%y/y), but eased from the 21.5% contraction in July. With the exception of the transport engineering cluster which posted flat growth in Aug, all other clusters saw output declining in the month. The biomedical output decline was mainly due to a different mix of active pharmaceutical ingredients being produced while maintenance shutdowns of the petroleum and petrochemicals plants and the continued relocation of mobile device production led to growth contractions in the chemicals and electronics clusters respectively. On a s/adj m/m basis, IP fell 1.9% over July following similar pace of contraction in the preceding month.

With that, manufacturing output had fallen 17.2%y/y in July-August, suggesting that the sector is likely to have contracted for the second consecutive quarter in 3Q. Unless the pharmaceutical production sees a strong rebound in the next few months, the manufacturing sector contraction could extend into 4Q as well. The last time we have a full-year manufacturing sector contraction was in 2001 (-10.8%) due to the tech bubble burst. The difference this time is that the contribution will be mainly from biomedical manufacturing. YTD, industrial production has fallen 2.0%y/y as a result of the 13.8% slump in biomedical manufacturing while electronics production has actually grown by 2.6%.

Given the weak set of IP numbers, we now expect the Singapore economy to have slipped into a ‘technical recession’ in 2Q/3Q, defined as two consecutive qoq contraction. On a y/y basis, we expect to see flat growth in 3Q08 with risk that it could slip into the negative territory as well. The last time we have a y/y contraction was in 2Q03 when the economy fell 1.8%y/y as a result of the SARS outbreak. We have revised down our full-year GDP growth forecast to 3.0% from 4.2% previously.

Implication on the Monetary Policy

The growth downturn has increased the likelihood that the MAS will reverse some of its monetary tightening in the last two meetings. This was despite the fact that the weakness was mainly due to the biomedical manufacturing which was in fact less price-sensitive compared with industries such as electronics. In Asia, Taiwan and China have already taken the lead to cut their interest rates this month.

Aug Industrial Production (y/y %)						
	VA Share (%)					
	2007	2007	YTD	Jun-08	Jul-08	Aug-08
Industrial Output	100	5.8	-2	3	-21.5	-12.2
Electronics	29.7	4	2.6	2.8	7.5	-7.1
Chemicals	11.8	3.3	0.5	1.4	3.1	-6
Precision Engineering	13	0	-3.5	-2.4	-6.7	-8.9
Transport Engineering	11.9	23.5	6.1	8.2	6	0.1
General Manufacturing	9.2	6.3	2	2.1	3.9	-0.9
Biomedical Manufacturing	24.4	-0.6	-13.8	5.3	-67.3	-33.8
Pharmaceuticals	21.8	-2.5	-14.9	6.7	-69.6	-35.7
Source: EDB						

We think the most probable way is to reduce the slope of the S$NEER appreciation path than do a one-off re-centering of the pivot point downward as the MAS will likely favour a gradual approach. Over the past month, S$NEER has established a trading range of +/-0.5% around the mid-point as market priced in chances of a monetary easing. Based on current levels, this corresponds to USD/SGD in a range of 1.4170-1.4320.

3-mth SGD SIBOR Spiked Up

The 3-mth SGD SIBOR spiked up to 2.225% today from 1.758% on Thur. The domestic interest rates have been climbing since Lehman's bankruptcy, reflecting the global and not just domestic liquidity squeeze. Asian central banks have been pumping money into the interbank market over the past two weeks to ease the liquidity crunch. With the exception of the Asian Financial Crisis during 1997-1998, the 3-mth SGD SIBOR has always been trading at a discount to the Fed funds target rate which is currently at 2.00%. As a result we expect the current phenomenon to be temporary. While 3-mth SGD SIBOR could trade above our year-end target of 1.3% in the near-term due to the financial market turmoil, we expect the rate to ease below 2.00% with the announcement of more details on the US' US$700 bn bailout plan. Furthermore, market is now pricing in some probably of a Fed rate cut on 28-29 October which could drive the 3-mth SGD SIBOR lower going forward.