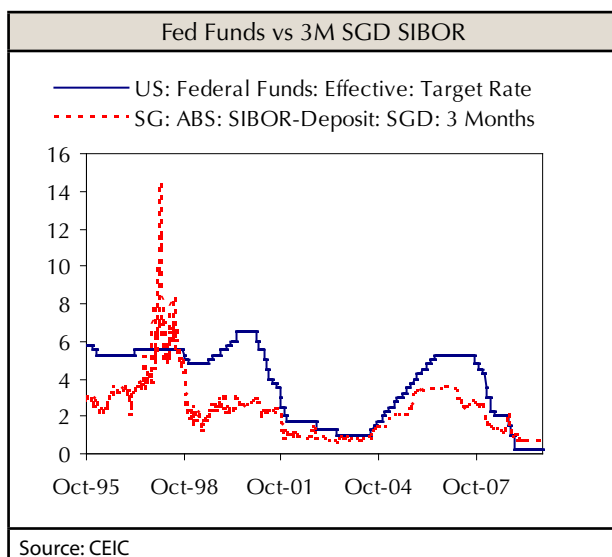


Singapore

SGD 3-Month SIBOR in 2010 to Rise Moderately, But will be Chippy

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- In Singapore, against earlier fears of 8-10% contraction, we now expect the economy to suffer a 2% contraction in 2009. After growth of 0.6%/y in 3Q09, we project the domestic economy to post growth of 4.9%/y in 4Q09. And, we forecast expansion of 4.5% in 2010, alongside official estimates of 3-5%.
- As such, expectation is that the MAS will unwind some of its easy monetary stance at its next monetary policy meeting in April 2010. However, because the main policy tool is FX, instead of the conventional interest rate, the impact on SGD cost of funds may be a little difficult to read.

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Key Factors that will Determine SGD Cost of Borrowing:

1. A strong SGD NEER may not result in higher SGD cost of borrowing. On the contrary, it could well be the opposite, as capital flows into the republic.

2. A clearer determinant is USD cost of borrowing. However, USD short-term rates are only expected to head higher in 2H10.
3. Watch USD/SGD direction, which through the swap market could impact domestic cost of funds. Two forces at play here: Watch Asian currency movement, in particular the RMB. If the Chinese currency were to inch higher, the outcome is lower SGD cost of borrowing, through weaker USD/SGD. The other front is broad USD direction. Clearly, the outcome is far from certain. Survey results show that the market is expecting USD/SGD between 1.35-1.45 at end-2010. There is the broad consensus of more Asian FX appreciation, but there is also the perception that once the Fed starts to normalize, the initial moves could be quite aggressive. This means USD/SGD direction and SGD cost of funds could be quite volatile next year.
4. The two integrated resorts and the impact on overall domestic liquidity, as tourists swarm into the country. Our guesstimate is another 2-3mn tourist arrivals, on top of the yearly 8-9mn tourists arrivals, given the novelty factor. This should be especially prevalent in 2H10. How much additional inflows and the impact on the overall domestic liquidity this will have, is something to contemplate. As such, while we expect SGD 3-mth SIBOR to edge higher at end-2010, the process could be quite chippy.

Re-visiting SGD-USD Interest Rate Relationship

Given that the choice of FX is the monetary policy tool, SGD interest rates are more closely related to the USD – probably due to the fact that SGD is quoted against the greenback. Based on our estimates, the correlation between movements in the Fed funds rate and the 3M SGD is around 0.8 between, the years 2003 till present. Historically, every 1% rise in the Fed funds rate is accompanied by a 0.5%

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shift in the 3M SGD SIBOR, and the 3M SGD SIBOR has typically been lower than the US rates, given the high level of savings in Singapore (both private and public). The only other time SIBOR shot up above the Fed Funds rate was during a period of stress in the system—the Asian financial crisis in 1997/1998, where the SIBOR touched a high of 14.5% in Jan 1998, and the Fed Funds rate was lower, at 5.5%. However, it must be noted that it was the FX crisis in the region, which forced costs of borrowing up.

In the current environment, the 3M SGD SIBOR is above the Fed Funds rate. This could be related to Singapore still being subjected to global volatility, be it on the financial or economic fronts. Another more likely reason is that Fed

Funds is at unprecedented 0-0.25%, which is an anomaly. Our reading is that, once the trigger is hit, i.e., interest rates start to rise, markets will be volatile. The SIBOR may even begin to move before the Fed Funds shift, based on market expectations of rate hikes by the Fed. With cost of borrowing at such low levels, and the neutral Fed Funds rates perceived at between 4-5%, the markets will have to grapple with how fast and how much the initial moves will be. We have projected the Fed to only hike rates in the 4Q10, hiking rates by 50bps to 0.75%. By then, we might start to see 3M SGD SIBOR moving up more than the usual magnitude, having stayed at low levels for an extended period of time, probably heading towards 1.1% by end 2010.