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Global Credit Crisis Biting Into Singapore: MAS Monetary Policy Preview

- Growth prospects deteriorating fast, inflation risks as well. 'Technical recession' prospect has risen, with GDP growth likely at 3% this year.
- The failure of Lehman Brothers and bail-out of AIG, have resulted in renewed squeeze in global liquidity. USD LIBOR rates have shot up, pushing up SGD interest rates as a result. 3-mth SGD SIBOR rose to 2.25% from about 1.25% some two months back. While the rate has eased to 1.7-1.8%, it looks like liquidity will remain tight for a while, with 3-mth SGD SIBOR to stay at around 1.8% year-end - even if the Fed were to keep its key interest rate at 2.0% for the time being. Market should ease a little when there is more clarity of the US $700bn bail-out package.
- We expect the MAS to loosen its monetary policy at its coming policy meeting on 10 Oct 2008, probably maintaining its 'modest and gradual appreciation path' of the S$NEER policy band but reducing slightly the slope which was steepened in October 2007.
- Against a low of 1.35, USD/SGD surged to 1.45 in Sep 2008, as investors unwound their longs across asset classes (including FX). Also, the RMB appreciation path appears to be more moderate, along with policymakers' statements out of Beijing that global developments will affect growth prospects in China.
- Our view is that USD/SGD would probably end the year around 1.43. For the time being, extreme volatilities around the world would keep USD/SGD in a fairly broad range of 1.42-1.46.
- Into next year, as growth prospect further deteriorates, and as the Wall Street effects feed through Main Street, it appears that Asian FX are unlikely to appreciate significantly. USD/SGD will probably trade around 1.40-1.46 at least in the 1H08, and then falling marginally towards 1.40 by end-2009.

In our last quarterly, much was spoken about inflation risk in the region, including Singapore, as commodities and crude oil prices sky-rocketed. However, in the less than three months, the focus in back at growth concerns, including high risk of a 'technical recession' in Singapore. Meanwhile, the failure of Lehman Brothers and bail-out of AIG, have resulted in renewed squeeze in global liquidity. USD LIBOR rates have shot up, pushing up SGD interest rates as a result. 3-mth SGD SIBOR rose to a high of 2.25% from about 1.25% some two months back. As such, we expect the MAS to loosen its monetary policy at its coming policy meeting on 10 Oct 2008. Some sort of flattening of the appreciation path is expected. A few are expecting the MAS to ease more aggressively by changing the stance to 'neutral' from current 'modest and gradual appreciation' of the S$NEER policy band. While inflation trajectory is easing, we think it is not sharp enough to warrant such an aggressive move – we are still looking at inflation of about 2.5% for 2009, which is not low compared against the high base this year.

'Technical Recession' Risk – Fast Rising

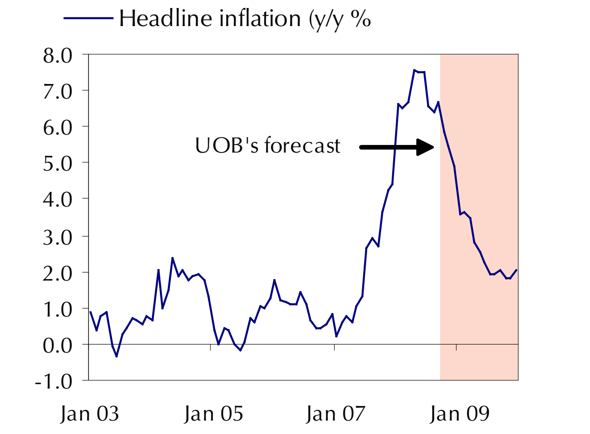
Following the 12.2%y/y (mkt est: -9.3%y/y) drop in Aug, Singapore manufacturing output had fallen 17.2%y/y in July-August, suggesting that the sector is likely to have contracted for the second consecutive quarter in 3Q. Unless the pharmaceutical production sees a strong rebound in the next few months, 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 q/q 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.

Inflation Risk – Declining, but not Fast Enough

August CPI rose a stronger-than-expected 6.4%y/y (UOB: 6.1% ; Mkt: 6.2%) but has continued to ease from 6.5% in July after peaking at 7.5% in June. Inflation in August was driven primarily by higher accommodation costs and food prices despite falling oil and commodity prices in the month. On a m/m s/adj basis, prices rose 0.1% in August, slowing from 0.4% in July. Near term, inflationary pressure will remain high with the 0.7% net fare hike for public transport and average 21% increase in the electricity tariff effective 1 October. We are expecting full-year inflation to average 6.5% but this should fall to around 2.5% in 2009 against a high base this year.

Inflation Rate Easing
Due to High Base but Pressure Remains



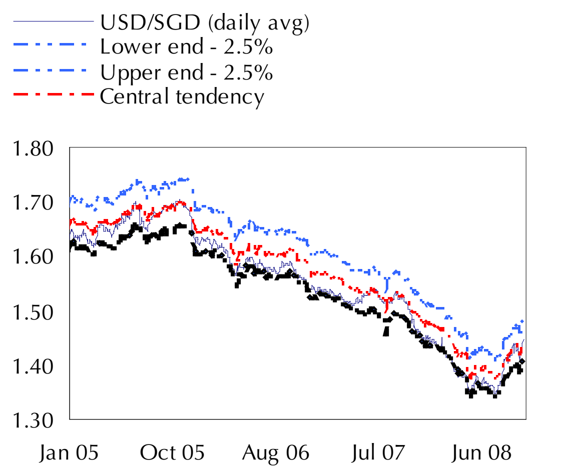
Source: CEIC

Monetary Policy Implication – Reducing Slightly the Slope of S$NEER Appreciation Path

The easing inflation is likely to reinforce view that the MAS will loosen policy on 10 October. Furthermore, policy makers are definitely less optimistic about the road ahead -- Trade and Industry Minister Lim Hng Kiang said recently that Singapore's full-year economic growth may dip below its earlier forecast of between 4-5%. Finally, the MAS has been rather aggressive in its policy stance over the past year – steepening the S$NEER slope in October 2007, and then re-centered the S$NEER policy band in April 2008 at then prevailing level, which we estimate is equivalent to a one-off 2.5% appreciation of the S$NEER given our assumption of a +/-2.5% band width and that the S$NEER was trading at the top of the band at that time.

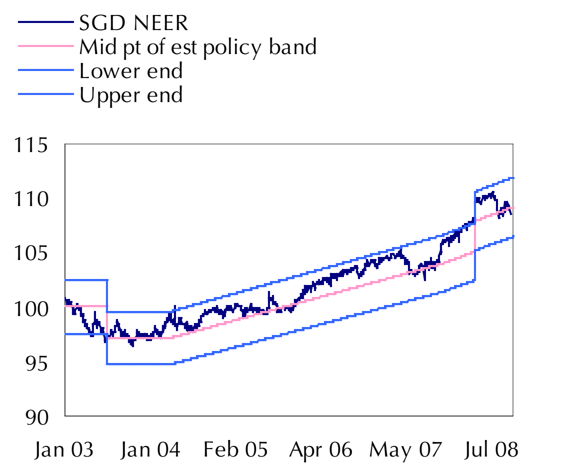
Thus, it is likely that MAS would maintain its 'modest and gradual appreciation path' of the S$NEER policy band but reduce slightly the slope of appreciation which we estimate is around 2.5% per annum now. While some said the current situation warrants a more aggressive easing by probably shifting to a 'neutral' stance (equivalent to flat S$NEER over at least the next six months instead of current 2.5% appreciation in the pivot point over a 12-mth period), our take

UOB's Estimation of SGD NEER



Source: CEIC, UOB

UOB's Estimation of SGD NEER



Source: CEIC, UOB

is that the S$NEER band policy has given the CB some sort of flexibility – such as S$NEER hugging the weaker half of the policy band. Thus with doubt the MAS would be that aggressive. The current inflationary pressure will also prevent the MAS from unwinding its monetary tightening too aggressively although more could be expected next year should economic growth deteriorates more sharply and inflation eases more.

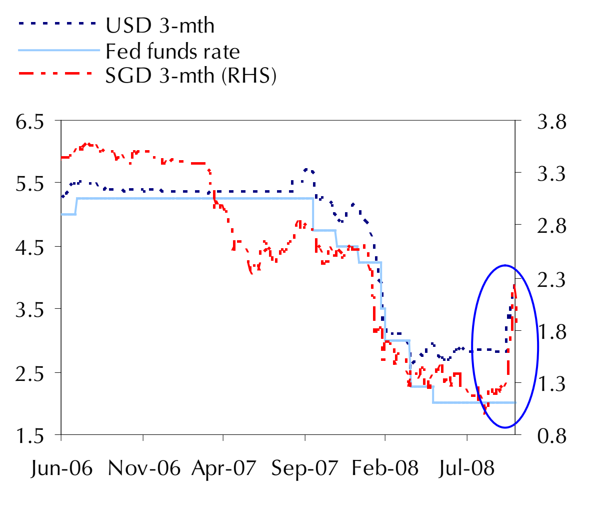
USD/SGD Outlook – Fairly Wide Range, but would be Volatile

Against a low of 1.35, USD/SGD surged to 1.45 in Sep 2008, as investors continue to unwind their longs across asset classes. The move was even more extended in high-yielder such as AUD and NZD. Also, the RMB appreciation path appears to be more moderate, along with policymakers' statements out of Beijing that global developments will affect growth prospects in China. As such, our view is that USD/SGD would probably end the year at around 1.43. For the time being, extreme volatilities around the world would keep USD/SGD in a fairly broad range of 1.40-1.44. Into next year, as growth prospects bleaken, and the Wall Street effects feed through Main Street, it appears that Asian FX are unlikely to appreciate significantly. USD/SGD will probably trade around 1.42-1.46 at least in the 1H08, and then falling marginally towards 1.40 by end-2009.

SGD Interest Rate Outlook – Suffering from Global Liquidity Squeeze

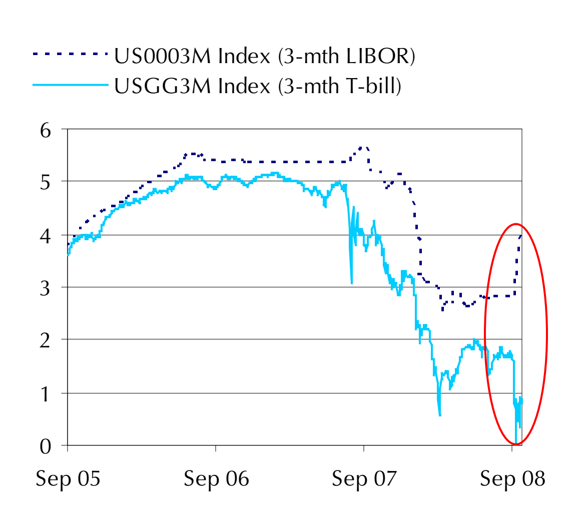
Liquidity risk is back again, as reflected in the widening spread between 3-mth US LIBOR and T-bill spread. This has resulted in a sharp pull back in interbank lending activities, pushing 3-mth SGD SIBOR up to 2.25% in late Sep 2008 from 1.25% some 4 weeks back. While uncertainty surrounding the $700bn bail-out package has contributed to the sharp move, our view is that global cost of borrowing is likely to remain alleviated in the months ahead, as financial markets continue to grapple with 'which bank will be next'? As such, it looks like the 3-mth SGD SIBOR is likely to trade closer to 2.0%. A spike to above 4-5% like the episode during the Asian crisis is unlikely to take place for now. Note that there is very little pressure on SGD and other regional currencies, and Singapore's system (in particular) remains ample.

Credit Risk Concerns Resulting in Spike-up in Interbank Rates (both USD and SGD)



Source: CEIC

Interbank Liquidity Drying up: Money Shifting Into Treasury Papers



Source: CEIC

Country	As at 03 Oct 2008	End 4Q08	End 1Q09	End 2Q09	End 3Q09	End 4Q09
USD/SGD	1.4475	1.43	1.44	1.43	1.42	1.40
SGD (3-Mth SIBOR)	1.8125	1.80	1.90	1.80	1.60	1.50
Source: Reuters, UOB						

Announced MAS Monetary Policy Statements/Actions Since 2001

Date	Scheduled Meeting ?	Decision			Factors / Outlook Affecting Decision					
		Bias	Pivot Point	Width	External Econ	Global Electronics	Domestic Econ	Imported Inflation	Domestic Inflation	Labour Mkt
22 Feb 01	yes		gradual & modest app		slowdown in US		strong, but to moderate	oil prices ease	upward pressure	ULC to rise moderately
12 Jul 01	yes	neutral stance, 0% app			deteriorated sharply	more protracted downturn	technical recession	benign	muted	easing
2 Jan 02	yes	neutral stance, 0% app	current level	narrowed	downside risks, recovery modest	prolonged adjustment phase	uncertain	falling	falling, govt cost-cutting measures	
11 Jul 02	yes	neutral stance, 0% app	at Jan 02 level		continued recovery but modest	turnaround, modest growth	continued recovery uncertainty over H2 strength	low, excess capacity	subdued	slack
2 Jan 03	yes	neutral stance, 0% app	at Jan 02 level		deteriorated, Iraq	to strengthen	sluggish, H2 recovery	benign	muted	slack
10 Jul 03	yes	neutral stance, 0% app	at Jul 03 level		signs of pickup, but downside risks	tentative improvement	modest H2 recovery	muted	muted	significant slack
10 Oct 03	yes	neutral stance, 0% app	at Jul 03 level		clearer signs of upturn	continued improvement	outlook improved, modest recovery	benign	subdued into next year	slack
12 Apr 04	yes	modest & gradual app	from Jul 03 level		synchronised upturn,	pickup in global IT demand,	outlook improved, likely to exceed official forecast	risk of rising inflation pressure	subdued, but could intensify	strengthen (output gap turn positive by yr-end)
11 Oct 04	yes	modest & gradual app	from Jul 03 level		greater uncertainty	greater uncertainty	growth momentum easing	risk of rising inflation pressure	subdued, but could intensify	continued improvement
12 Apr 05	yes	modest & gradual app	from Jul 03 level		growing at healthy pace	modest recovery in H2	slowing to potential growth rate	risk of rising inflation pressure	subdued, but could intensify	continued improvement
11 Oct 05	yes	modest & gradual app	from Jul 03 level		growing at steady pace	modest expansion	potential growth in 2005 & 2006	risk of rising inflation pressure	subdued, but expected to pick up in 2006	continued improvement
11 Apr 06	yes	modest & gradual app	from Jul 03 level		holding up, downside risk in 2H	steady pace of expansion	positive outlook	risk of second round inflationary pressure	some upward pressure but well-contained	remains strong
10 Oct 06	yes	modest & gradual app	from Jul 03 level		healthy 1H, moderation in 2H	peaked, 2H demand moderation	strong 1H, moderation in 2H	Benign	subdued	record job gains, some wage pressures
10 Apr 07	yes	modest & gradual app	from Jul 03 level		holding up but US-realted risks emerging	easing in 1H, recovering by 2H	slower growth but outlook still positive	Benign	higher by 0.5% point on GST	tight market, wage pressures in some sectors
10 Oct 07	yes	modest & gradual app, slightly steeper slope of S$NEER policy band	from Jul 03 level		downside risk has increased with fallout in US subprime housing	remained weak	strong 2007	Upside risk	higher. GST rate hiked by 2ppt in July, higher asset prices	tight market, wage pressures in some sectors
10 Apr 08	yes	modest & gradual app	recentre at current level		downside risk	remained weak	stronger-than-expected 1Q08, moderation ahead	Upside risk	remains high	tight market but wage growth easing
10 Oct 08	yes	modest & gradual app, reduce slope of S$NEER policy band	from Apr 08 level		risk has increased	remained weak	moderation ahead	moderating	remains high	expected to ease

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