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USD/SGD: Continuing to Push Higher Near-Term

USD/SGD climbed above 1.43 on Tue (2 Sep) and is likely to edge higher in the near-term on the back of the continued rebound in the greenback with SGD giving up all its gains since the beginning of the year. Domestically, SGD could face headwind from economic growth downgrades after the sharper-than-expected decline in July industrial production which increases the risk of a technical recession in 2Q/3Q this year. The peaking of the inflation rate at 7.5%y/y in June has also sparked talks of monetary policy loosening at the October meeting which could see SGD weaker in the weeks ahead. Position adjustment as investors reverse short USD/SGD positions could continue as the slowdown in the developed economies are beginning to have more apparent impact on the Asian exports. In the near-term, the political crisis in Thailand which declared a state of emergency in Bangkok on Tuesday morning (2 Sep) could also hurt investors' sentiment in Asia.

For now, we have raised our USD/SGD forecast to 1.42 by year-end from 1.38 previously. However, in the near-term, we could see further upside to USD/SGD given the USD momentum. Furthermore, if the Aug industrial production due on 26 Sep shows another large contraction, we could see the S$NEER trading to 1.0%-1.5% below the mid-point from -0.5%-0.5% around the mid-point currently. This translates to USD/SGD in the range of 1.4480-1.4560 based on current currency levels.

Beyond that, we are retaining our forecast for lower USD/SGD towards 1.37 by end-2009. This would be driven largely by an appreciating RMB (we are expecting around 5% RMB appreciation vs USD in 2009 and 9% this year) and a resilient Singapore economy which should see some lift from the opening of the Marina integrated resort late next year. For the USD, there could be some pullback as a result of higher growth risks which could probably lead to some monetary loosening in the US in 2H09.

	4Q08	1Q09	2Q09	3Q09	4Q09
USD/SGD Forecast	1.42	1.43	1.42	1.40	1.37
Source: UOB					

Inflation Has Probably Peaked

Singapore's July CPI rose 6.5% y/y, moderating from the 7.1% y/y CPI in 1H08. Inflation is likely to have peaked in June already, and will moderate to an average of around 5.0% y/y in 2H08, due to the basis effect from 2H07's 2ppt hike in Goods and Services Tax. Furthermore, Malaysia's move to cut its gasoline and diesel prices in August will help to ease inflationary pressure. This would take some price pressure off food imports, two-thirds of which come from Malaysia. We also note that inflation in the food and transport segments are showing signs of stabilizing from their 1H08 peaks, and with global oil prices correcting, we expect this to help bring 2H08 inflation lower. As a result, full-year inflation should come in at around 6.0%.

The Jury is Not Out Yet But Risk of Technical Recession Has Risen

The risk of a technical recession has risen after the July industrial production fell a sharp 21.9%y/y as biomedical output slumped. This was the sharpest decline since the recession in 2001. Despite the weakness, we are expecting some rebound in biomedical production after it fell sharply in three out of the preceding four months.

With Singapore's GDP growth contracting SAAR 6.0%q/q in 2Q08, the economy will be in a technical recession if we get another q/q contraction in 3Q08. And the risk of manufacturing-led technical recession in 2Q/3Q would be very real should we get another large decline in biomedical output in August. The data is due on 26 Sep which would then allow us to assess the recession risk and review our full-year growth forecast of 4.2%.

Our Take on the Monetary Policy

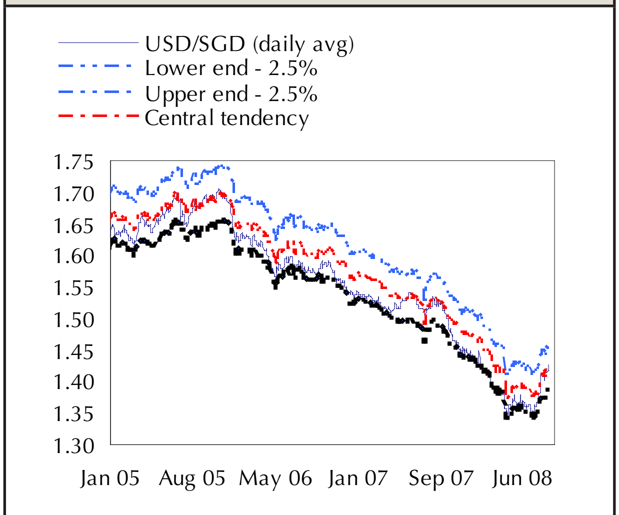
The S$NEER has been hovering around the policy mid-point for around a month, after trading close to the top of the policy band (+2.5%) in our model since the MAS tightened its monetary policy further in April. In April, the MAS re-centred the exchange rate policy band at the then prevailing level of the S$NEER which was at the stronger side of the pivot point, effectively a 2.5% appreciation of the S$NEER given our assumption of 2.5% band width on each side of the pivot point. Since then, S$NEER has given up all of its gains.

With risk of technical recession in 2Q/3Q 2008 and inflation rate coming off, the market is now looking at a greater risk of MAS reversing its tight monetary policy stance at the coming October meeting. The MAS has been very proactive in its monetary policy actions as it tightened the SGD policy at the two preceding meetings in anticipation of the surge in inflation. In October 2007, the tightening was through a 'slight increase in the slope of the band'. Similarly, the MAS could be as quick to reverse the tight monetary policy stance as inflation comes off and risk of economic slowdown foreshadows that of inflation concerns.

The incoming economic data will play a pivotal role in the monetary policy decision in October. The risk of a reversal in the tight monetary policy stance will definitely increase if the August IP disappoints again and puts the economy at a risk of a technical recession in 2Q/3Q. Although inflationary pressure remains high, we should see prices easing given the correction in global oil prices and the global growth slowdown will limit the secondary inflation.

Until the August industrial output data, SGD should remain on a weak footing vs USD in the face of broad USD strength against the majors. Furthermore, if the Aug industrial production shows another large contraction, we could see the S$NEER trading to 1.0%-1.5% below the mid-point from -0.5%-0.5% around the mid-point currently. This translates to USD/SGD in the range of 1.4480-1.4560 based on current currency levels. For now, we are expecting USD/SGD at 1.42 by year-end which should edge lower to 1.37 by end-2009, barring a sharper-than-expected downturn in the domestic economy.

UOB's Estimation of SGD NEER



Source: CEIC, UOB

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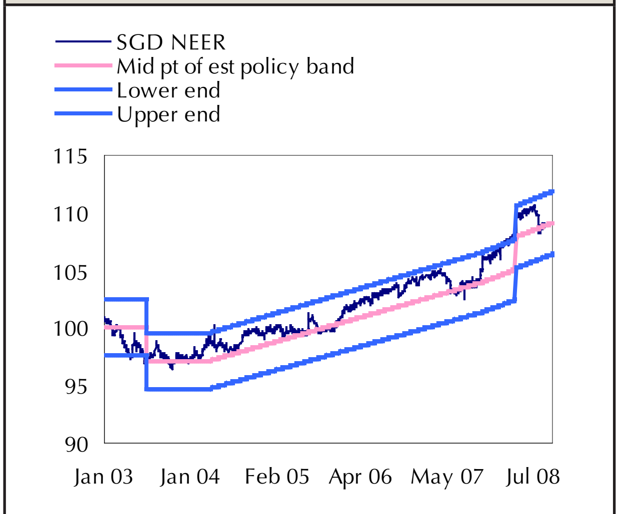

Source: CEIC, UOB

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