Country Analyst

UOB Economic-Treasury Research
Company Reg No. 193500026Z

Jimmy Koh Jimmy.KohCT@uobgroup.com
Ho Woei Chen Ho.WoeiChen@uobgroup.com

Friday, 10 October 2008

Singapore: MAS Shifts to Neutral Policy Stance; Singapore Sank into a 'technical recession' in 3Q08

In its latest policy statement, the MAS shifts its policy stance to a zero percent appreciation of the S$NEER policy band from 'modest and gradual appreciation' which it had maintained since April 2004. The MAS maintains the current level of the policy band, and there will be no re-centring of the band or change to its width.

This is more aggressive than most in the market, including ourselves, thought as we were expecting a more gradual pace of S$NEER appreciation than a neutral stance since inflation is still a concern. The last time MAS shifted from the 'gradual & modest appreciation' to neutral stance was in July 2001 when the external economy fell sharply. Nonetheless, the sharp deterioration in the financial markets and global growth prospects over the past two weeks would have justified the MAS' move today. Earlier this week, six major central banks (BoC, BoE, ECB, Fed, Riksbank and SNB) have announced joint cuts in their policy interest rates by 50bps. In Asia, South Korea, Taiwan and China have also cut their benchmark interest rates this week. The MAS says that it is ready to intervene to dampen excessive volatility in the S$NEER should this become necessary.

We have previously estimated an annual 2.5-3.0% appreciation of the S$NEER and this policy change means that we will see the S$NEER flat for the next six months at least (until the next meeting in April 2009), which will keep SGD stable against the currencies of its major trading partners. As the change is in the slope, there should not be immediate major moves in S$NEER due to the policy change especially since the market has already priced in this possibility and S$NEER was trading well-below the mid-point. In fact, for today, there is little change to the policy mid-point and ranges for USD/SGD compared with the previous 'modest and gradual appreciation' stance.

S$NEER has recovered to trade at 1.1% below the mid-point this morning from around -1.4% prior to the policy announcement as market had actually priced in some possibility of a one-off re-centring of the band downwards following the extended market panic due to the credit crisis. The -0.5% to -1.5% band on our S$NEER model corresponds to USD/SGD in the range of 1.4670-1.4820 based on current currency levels.

Price Pressure Coming Off…

The key reason for the shift to neutral policy stance is the moderating inflation. The MAS expects inflation to ease although the pass-through of earlier domestic cost increases will continue for a while. Overall, inflation is expected to fall to 2.5-3.5% in 2009 from 6-7% this year.

'Externally, the recent sharp decline in commodity prices has helped to dampen global inflation. Domestically, the effects of past monetary policy tightening measures and the slowing economy have alleviated price pressures and eased resource constraints. Cost pressures have begun to recede, as evidenced by the recent fall in commercial rentals and more subdued wage increases.

CPI inflation is projected to come within the 6-7% forecast range in 2008, while the MAS underlying inflation measure, which excludes accommodation and private road transport costs, is expected to be 5-6%. Over the coming months and into early 2009, the headline inflation rate will continue to be impacted by the pass-through of some earlier domestic cost increases. Nevertheless, CPI inflation is expected to trend down in 2009 as the global and domestic economies slow and for the year as a whole it is forecast to moderate to 2.5-3.5%, with the MAS underlying inflation coming down to around 2%.'

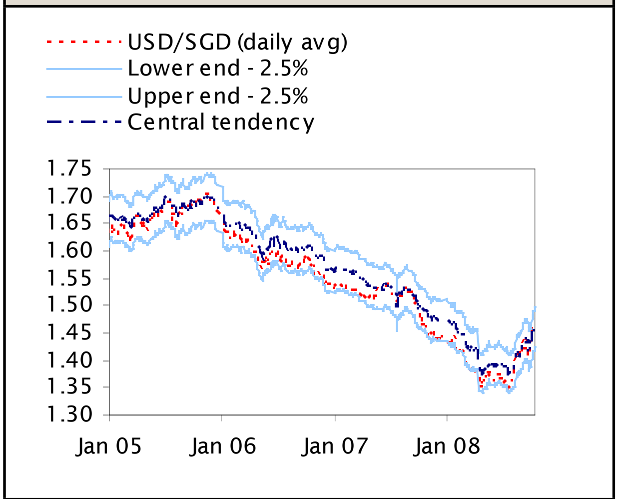
Growth Risks Have Risen…

The MAS has highlighted the significant growth risks into 2009 as a result of the sharp deterioration in the global economic outlook. It is premature to even predict any recovery in 2H09 given the highly fluid developments in the financial markets. The uncertainties support the case of looser monetary policy.

'Looking ahead, the outlook for the global economy has deteriorated amidst heightened risk aversion and deleveraging in the financial sector. After a brief rebound in Q2 2008, economic conditions in the US have worsened as the effects of the fiscal stimulus package dissipated. The Japanese and Eurozone economies contracted in Q2 2008 and near-term conditions remain difficult. Economies in Asia, including China and India, are also expected to slow.

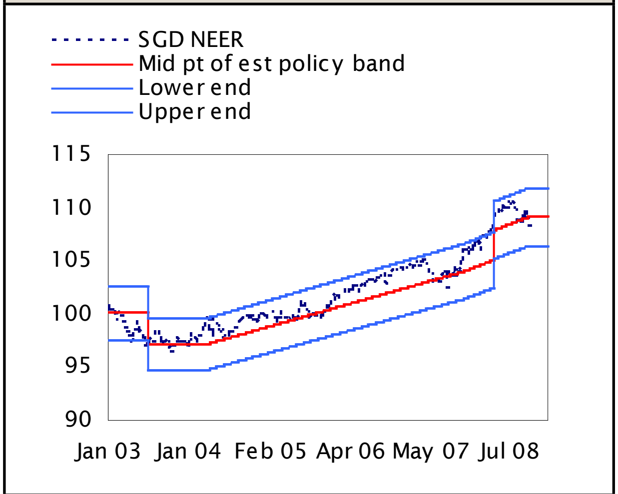
These developments have presented new uncertainties for the Singapore economy. The risks to external demand conditions continue to be on the downside, and a more severe global downturn cannot be discounted…..Economic growth will likely remain below its potential rate over the next few quarters. Prospects of a recovery in the latter half of 2009 will depend significantly on how conditions evolve in the G3 and regional economies.'

UOB's Estimation of SGD NEER



Source: CEIC, UOB

UOB's Estimation of SGD NEER



Source: CEIC, UOB

Advance 3Q GDP: Singapore Slipped into 'technical recession' in 2Q/3Q08

The MTI reported a worse-than-expected 3Q08 GDP growth of -0.5%y/y (UOB: +0.3%y/y; Mkt:+1.3%) in its advance estimates this morning. The last time we had a y/y contraction was in 2Q03 when the economy fell 1.8%y/y as a result of the SARS outbreak. With s/adj q/q annualized GDP growth contracting 6.3% following 5.7% decline in 2Q08, Singapore has slipped into a 'technical recession' for the first time since 3Q/4Q 2002.

The weaker-than-expected growth in 3Q08 against our forecast was due mainly to the sharp slowdown in the construction sector as we have already factored in weaker manufacturing and services sectors. The construction sector growth slipped to 7.8%y/y in 3Q after posting double-digit growth pace for six consecutive quarters. This would have meant a sharp q/q contraction in 3Q. The MTI attributed weaker outlook for the construction sector to resource bottle-necks which have led to projects delay despite strong line-up of projects.

Overall, the main drag to growth in 3Q was still the manufacturing sector, leading to the so-called pharmaceutical-led 'technical recession'. The manufacturing sector contracted for the second straight quarter at -11.5%y/y in 3Q. Based on the industrial output data, biomedical production has slumped 55.0% in July-August while electronics was flat in the period. Given that manufacturing output had fallen 17.2%y/y in July-August, the advance estimates suggest that we could see a modest 1.2%y/y increase in industrial output in September. Should we get anything lower than that, the 3Q GDP growth could come in lower than the estimated -0.5%y/y, assuming no change to the growth in the other sectors.

Unless the pharmaceutical production sees a strong rebound soon, the manufacturing sector contraction could extend into 1Q09. The last time we have a full-year manufacturing sector contraction was in 2001 (-10.8%) due to the tech bubble burst. The sector has already fallen 1.8% in the first three quarters of the year.

Services sector growth slowed to 6.1%y/y in 3Q. This was the slowest pace of growth since 5.4% in 1Q05. Transport & storage, information & communications and bank intermediation were the key supports for the services sector in the quarter. Going forward, we expect the services sector growth to continue to moderate. The MAS said that services industries such as transport-hub and tourism will likely be hit by the global downturn.

The MTI has slashed its full-year growth forecast to 'around 3%' from previous 4.0-5.0%. With the weaker-than-expected GDP growth in 3Q08 and the downturn in the major economies, the risk is that full-year growth will come in below 3.0%, probably between 2.5-3.0%. We are maintaining our 2008 GDP growth forecast at 3.0% and downgrading our 2009 growth forecast to 3.0% for now.

Singapore GDP: 1Q and 2Q Growth Revised up Slightly, 3Q Contracted (y/y % change)

	3Q07	4Q07	2007	1Q08	2Q08	3Q08 (p)
Real GDP	9.5	5.4	7.7	7.0	2.3	-0.5
Goods-producing Industries						
Manufacturing	11.0	0.2	5.8	13.1	-4.9	-11.5
Construction	20.1	24.3	20.3	16.9	19.8	7.8
Services-producing Industries	8.5	7.7	8.1	7.7	7.0	6.1

Source: MTI

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	neutral stance 0% app	from Apr 08 level		deteriorated sharply	expected to weaken	technical recession in 3Q08, growth to to remain below potential over the next few quarters	oil prices ease	peaked but remains high	expected to ease