

*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 1.6-1.7%, it looks like liquidity will remain tight for a while, with 3-mth SGD SIBOR to stay at around 1.5% year-end - even if the Fed were to cut by another 50bps before then. Market should ease a little when there is more clarity of the USD700bn 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 1.45. For the time being, extreme volatilities around the world would keep USD/SGD in a fairly broad range of 1.42-1.48.*

*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 1.42-1.48 at least in the 1H09, and then falling marginally towards 1.42 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 less than three months, the focus is 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 given 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%.

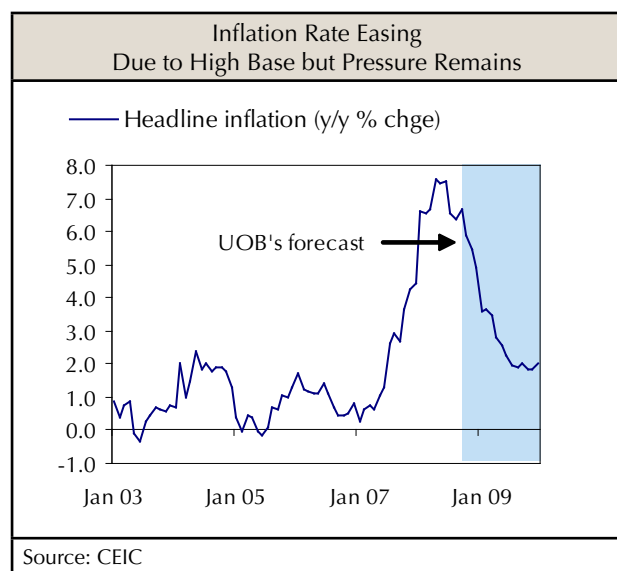
Given the weak set of IP numbers, we now expect the Singapore economy to have slipped into a 'technical recession' in 2Q/3Q, defined as two consecutive q/q contraction. On a y/y basis, we expect to see flat growth in 3Q08 with risk that it could slip into the negative territory as well. The last time 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

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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.

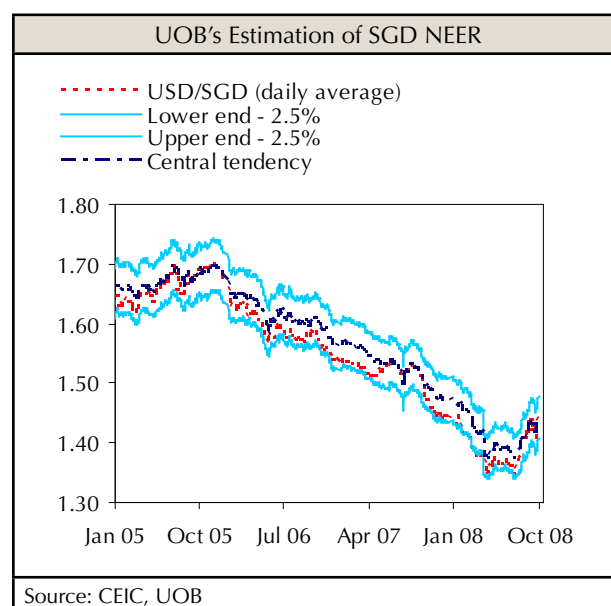
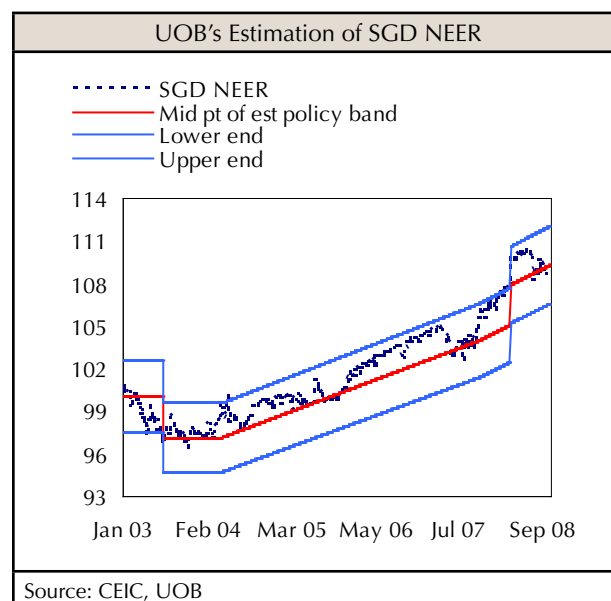


### Monetary Policy Implication: Reducing Slightly the Slope of S\$NEER Appreciation Path

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 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.

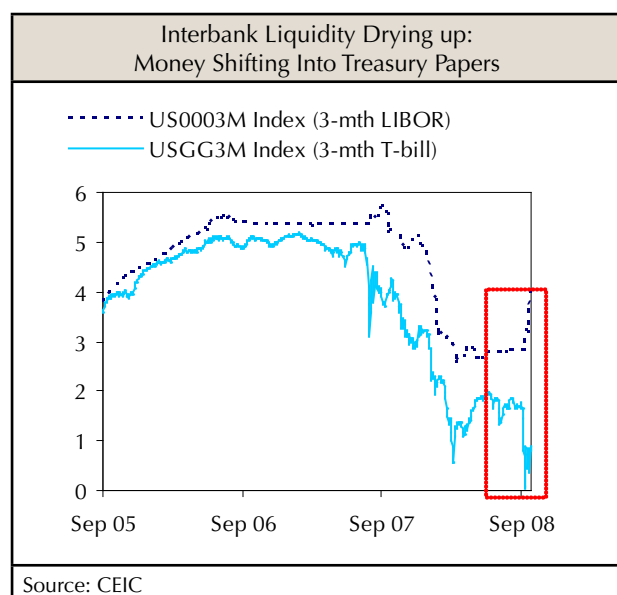


### USD/SGD Outlook: Fairly Wide Range, but would be Volatile

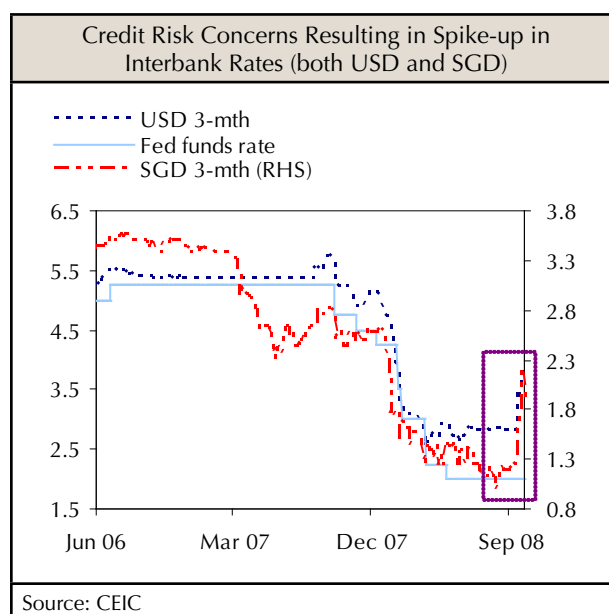
Against a low of 1.35, USD/SGD surged to 1.45 in Sep 2008, as investors continue to unwind their longs across asset classes. The move was even more extended in high-yielders such as AUD and NZD. Also, the RMB appreciation path appears to be more moderate, along with

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polymakers' 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 1.45. For the time being, extreme volatilities around the world would keep USD/SGD in a fairly broad range of 1.42-1.48. 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 1.42-1.48 at least in the 1H08, and then falling marginally towards 1.42 by end-2009.



UOB Economics Projections	2006	2007	2008F	2009F
GDP	8.2	7.7	3.0	4.0
CPI (average, y/y)	1.0	2.1	6.5	2.5
Unemployment Rate (End-4Q)	2.6	1.7	2.4	2.6
Current Acct (% of GDP, SGD)	21.8	24.3	17.0	15.9
DBU Loan Growth (% y/y)	6.3	19.9	16.0	6.0



### 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 1.5% even if the Fed were to cut by another 50bps before year-end. 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.