

Singapore: MAS Monetary Policy Preview: Tightening In Apr Via A Recentring

Inflation A Going Concern

Inflationary pressures look likely to continue. Despite a slowdown in Feb, with the Consumer Price Index rising 5.0% y/y and contracting 0.1% m/m, compared to 5.5% y/y and 1.6% m/m in Jan. Even though the m/m dip in Feb came from lower transport costs, other major components of the index, such as food and accommodation still continued to rise on a y/y and m/m basis. We think food prices and housing costs should continue to increase, even as transport costs rise at a slower pace, and these could be sustained well into the year, despite a lower headline inflation in Feb. Not forgetting the buoyant labour market, with unemployment rate at a low 2.2%, and 33,900 jobs added at end Dec 2010, which will continue to give rise to demand pressures. Core inflation which the MAS tracks, and excludes accommodation and private road transport, continued to rise on a m/m basis, at 0.3% m/m in Feb, and could continue to show further increases throughout the year. On a y/y basis, core inflation rose at a slower pace of 1.8% y/y in Feb, from 2.0% y/y in Jan, but we expect it to stay above 2% for the first half of this year. The increase in CPI will also likely continue for the first half of this year, at an average rate of around 4.9%, and then head down to a more moderate 3.5% in the 2H. For the full year, we expect CPI will likely average about 4.2%, higher than MAS' revised forecast of 3.0-4.0%.

Looking ahead, inflationary pressures should still dominate, and we are maintaining our call for a monetary tightening in April. Increased car, food and recreation prices, as well as wage pressures should push inflation higher. The continuing problems at Japan's nuclear power plant may drive up oil price, as Japan seeks other methods of power generation. The unrest in the Middle East has also seen oil price climbing upwards. Also with the latest increase of in the electricity tariffs, we think inflationary pressures still abound.

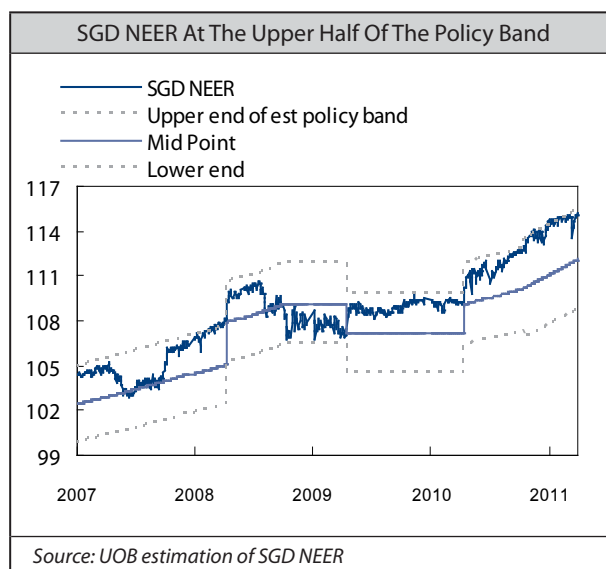
Monetary Tightening Via A One-Off Shift Of The Policy Band

Given the prospects of continued inflationary pressure, we are expecting the MAS to tighten monetary policy via a one-off shift of the policy band, with the slope unchanged from Oct's monetary policy decision, kept at gradual and modest appreciation. The decision for a tightening is not clear cut, seeing as to how MAS has said that inflation is likely to moderate in the second half of this year. Also, growth could be impacted with the disruption to Japan's production, and hampering Singapore's manufacturing output. Imports of Japanese electronic parts such as flash memory and DRAM, and particularly semiconductors, will be affected by the disruption to production. According to some reports, the Japanese earthquake has resulted in the suspension of 1/4 of the global production of silicon wafers used to make semiconductors. According to IHS iSuppli, a research firm, Japan accounts for less than 21% of total semiconductor production, but a larger share of about 35% of flash memory used in smartphones and tablet computers. So this could put a slight dampener on Singapore's electronics production and result in slightly slower GDP growth. Although our forecast is for 1Q GDP turning in a pretty robust rate of 6.5% y/y, +14.3% q/q saar, 2Q growth is likely to moderate to about 1.5% y/y, due to the high basis effect in 2Q of 2010, and the slowdown expected in manufacturing. We are still maintaining our GDP growth forecast of 5.0% for the full year 2011.

Upwards Recentring Vs Slope-Steepening

We think a one-off recentring would be appropriate given that growth might be moderating. Steepening of the slope would imply a more gradual appreciation of the SGD in the immediate term, but over the longer term, the signal is one of a faster appreciation. With a one-off shift, at first, this might seem to be a more aggressive tightening measure, but over time, the SGD does not necessarily have to appreciate, especially if the economic recovery does not warrant a SGD appreciation stance in the future, owing to the uncertainty of the economic growth.

Our SGD NEER model shows the trade-weighted index is currently around 2.6% above the midpoint, at the top half of the policy band. We have estimated the band to be about 3.0% on each side, with the upper band corresponding to USD/SGD at 1.2566, and the slope to be inclined at around 3.5%. As for the width of the band, given the existing volatility in the markets with the ongoing crisis in Japan, problems in the Eurozone and Middle East, the band might not be narrowed.



USD/SGD Impact

If monetary policy is indeed tightened, SGD could see some further marginal upside. The market is largely pricing in a tightening, which has resulted in SGD strength. But if monetary policy is left unchanged, the market could pare back long SGD positions, which could result in USD/SGD rising immediately after the policy announcement. With our view that the MAS will tighten monetary policy in Apr, and coupled with the appreciation of the RMB, we think the SGD should continue to strengthen this year, and we expect to see the USD/SGD pair trend down to around 1.23 at end 2011.

Announced MAS Monetary Policy Statements / Actions Since 2005

Date	Scheduled Meeting?	Decision		Width	Factors / Outlook Affecting Decision					Labour Mkt
		Bias	Pivot Point		External Econ	Global Electronics	Domestic Econ	Imported Inflation	Domestic Inflation	
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-related 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 SSNEER 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 remain below potential over the next few quarters	oil prices ease	peaked but remains high	expected to ease
14-Apr-09	yes	neutral stance, 0% app	recentre at current level	-	sustained weakness	could weaken further	growth downgraded sharply	muted	full-year deflation expected	job losses
12-Oct-09	yes	neutral stance, 0% app	from Apr 09 level	-	signs of recovery, but downside risks remain	continued improvement	out of technical recession, outlook improved, growth in 2010	upside risk	eased, but picking up	jobs remained fairly resilient
14-Apr-10	yes	modest & gradual app	recentre at current level	-	recovery in place, some downside risks remain	continued improvement	outlook for 2010 good, expected 7.5% growth rate	risk of rising inflation pressure	MAS revised forecast to 2.5-3.5% from 2.0-3.0%	tight labour market: rising wage growth
1-Oct-10	yes	modest & gradual app, slightly steeper slope of SSNEER policy band, & bandwidth widenend slightly	from Apr 10 level	-	slow recovery in the G7 economies	continued improvement	domestic economy projected to continue expanding, at growth potential	upside risk from food commodity price increases	increasing due to rising accommodation & domestic-oriented services	tight labour market
14-Apr-11 (expected)	yes	slope unchanged from Oct 10 MP: modest & gradual app, slightly steeper slope of SSNEER policy band, & bandwidth widenend slightly	recentre at current level	-	slow recovery in the G7 economies	expected to weaken on disruptions to global supply chain	domestic economic growth to moderate, but at a sustainable rate	upside risk from food commodity price increases	high inflation could be sustained into the year	tight labour market: rising wage growth

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