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SINGAPORE's 1Q16 GDP GROWTH STALLED

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1Q16 GDP growth stalled at 0% qoq saar as services momentum decelerated. The S'pore economy ran out of steam in 1Q16, chalking up no sequential growth from 4Q15 (+6.2% qoq saar) and the weakest qoq growth since 2Q15. Manufacturing saw broad-based weakness across transport engineering, precision engineering and electronics clusters, with only a temporary ramp-up in pharmaceutical production in January. We expect the manufacturing slump to extend throughout this year.

Rapid services deceleration is a cause for concern and could clearly tip the balance for a technical recession ahead.
The key downside risk was in the rapid deceleration in the services momentum which went from 2.8% yoy (+7.7% qoq sa) in 4Q15 to 1.9% yoy (-3.8% qoq saar) in 1Q16, marking the first sequential contraction in 1Q15 and the slowest yoy pace since 3Q09 (-0.2% yoy). In particular, the growth support from wholesale & retail trade and finance & insurance sectors was not immune in 1Q16. Financial services activity actually saw a pullback amid the slowdown in bank lending to the region.

The silver lining in the 1Q16 GDP was the shining construction sector.
The construction industry, notwithstanding the foreign manpower restrictions, actually surged 6.2% yoy (+10.2% qoq saar) and marked its strongest quarter since 1Q14 (+9.1% yoy and +10.2% qoq saar) on the back of both public and private sector construction activities. Given the pipeline of public infrastructure projects, we believe the construction sector could ironically become the shining growth pillar in 2016 despite its underperforming labour productivity image.

With the new year comes a new reality as MAS unexpectedly shifted to a neutral policy stance notwithstanding unchanged official GDP growth, headline and core inflation forecasts.
Looking in the rear mirror, MAS noted that the average level of the S$NEER over the last six months as a whole has been unchanged compared to the previous six months. Both headline and inflation are also expected to tread a more subdued trajectory - MAS core inflation is now anticipated to rise over the course of 2016 at a milder pace than earlier expected and the pass through of business costs to consumer prices will be constrained by the sluggish growth environment. MAS now tips medium-term core inflation to average slightly below 2%, but clarified that the move to set the appreciation rate for the S$NEER to zero percent effective today is not a policy to depreciate the currency. The 3-, 5- and 10-year core inflation averaged 1.3%, 1.7% and 2.0% yoy respectively. Nonetheless, there was a kneejerk reaction for USDSGD higher from around the 1.35 handle to the 1.36 handle this morning. Note the last shift to a neutral slope was back in Oct08 during the Lehman crisis and lasted till Apr10, with a recentering lower in Apr09.

We downgrade our full-year growth forecast to 1.8% yoy with 1Q markdown.

Given the 1Q16 GDP growth flash estimate disappointment, we downgrade our full-year growth forecast from 2% yoy previously to 1.8% yoy. Pending the March data, further revision to the 1Q16 flash data could easily swing to a quarterly contraction as well. Since we expect 2Q16 to be weaker, this is likely to tip the scales towards a technical recession materializing by 2Q16 or even 3Q16. The cyclical headwinds to the external-oriented sectors remain strong, notably in the transport engineering, precision engineering, IT and supporting electronics industries, whereas the domestic-oriented sectors like healthcare and education should remain supportive. Nevertheless, the retail and real estate segments are also likely to soften as economic sentiments weaken. While the official growth forecast remained unchanged at 1-3%, MAS and MTI also tipped the level of activity to be “slightly below potential” (which we read as sub-2%).

Returning interest rate risks and even unemployment is likely to tilt higher. Post-MAS’s announcement of a neutral slope which took the interest rate swap curve and SGS bond yield curves higher by 4-10bps and 2-6bps respectively, the removal of the modest and gradual appreciation path of the S$NEER policy band (which was estimated at 0.5% pa) was obviously the trigger. This reinforces our existing view that the current soft patch of SIBOR and SOR rates retracement was overdone since it was largely driven by the unwinding of the USD strength story from 4Q15. It would be interesting to watch the reaction of the 3-month SIBOR and SOR fixings later today, vis-à-vis the previous day’s 1.0% and 0.85% readings. Our house view remains that the FOMC will attempt to hike another two 25bps this year and current market is underpricing this risk, hence the current period of calm since March in the FX-cum-interest rate environment may not sustain into summer. Our year-end 3-month SIBOR and SOR forecasts remain at 1.3% and 1.35% respectively.

In addition, the labour market is also clearly softening, albeit from a very strong position and the resident unemployment rate is likely to rise slightly ahead with the gradual hike in redundancies and falling job vacancies. The unemployment rate stood at a relatively low 1.9% at 4Q15 but is forecast to increase modestly to 2.1% by end-2016, which would be the highest since 4Q11, albeit still well below the 3.3% seen in 3Q09. While consumer sentiments may be modestly more cautious, we do not anticipate a sharp drop-off in consumer spending in the near-term.

Gross Domestic Product at 2010 Prices

	1Q15	2Q15	3Q15	4Q15	2015	**1Q16***
Percentage change over corresponding period of previous year						
Overall GDP	2.7	1.7	1.8	1.8	2.0	**1.8**
Goods Producing Industries						
Manufacturing	-2.9	-5.2	-6.0	-6.7	-5.2	**-2.0**
Construction	-1.6	3.6	3.0	4.9	2.5	**6.2**
Services Producing Industries	4.3	3.2	3.4	2.8	3.4	**1.9**
Quarter-on-quarter annualised growth rate, seasonally-adjusted						
Overall GDP	0.2	-1.6	2.3	6.2	2.0	**0.0**
Goods Producing Industries						
Manufacturing	-3.5	-13.8	-6.0	-4.9	-5.2	**18.2**
Construction	6.7	7.7	0.2	6.0	2.5	**10.2**
Services Producing Industries	-0.4	0.4	3.8	7.7	3.4	**-3.8**

*Advance estimates

Source: MTI

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