OCBC TREASURY RESEARCH

FX Viewpoint

24 September 2019

SGD NEER and October MAS MPS View

- **For the upcoming October MAS Monetary Policy Statement (MPS), our base case scenario is for the MAS to ease its monetary policy stance by reducing the slope the SGD NEER policy band from the currently estimated +1.00% p.a. appreciation path to +0.50% p.a.. We expect no change in the width and centre of the policy band.**

- The recent time path of the SGD NEER has been reflective of market focus. Since August, the SGD NEER has effectively been on an uptrend relative to its parity level. We first saw relative SGD outperformance against Asian counterparts amid RMB-led weakness in the Asian complex as the Sino-US trade tensions escalated in August, keeping the SGD NEER buoyed. Subsequently, the alleviation of tensions from September onwards saw the SGD recover against the USD and JPY, providing further support for the SGD NEER.

- Contrast that to the period between late-June and August, where the SGD NEER was on an easing trend (from an estimated +1.80% above parity to near-parity levels) as the market focused on a softening domestic economy. **Overall, the ongoing retracement higher of the SGD NEER relative to parity is largely driven by external factors, and not a reflection of reduced domestic concerns today, as compared to the pre-August period.**

- Despite the soft domestic and global growth/inflation narrative (set out below), the SGD NEER is still effectively flat year-to-date. **There is room for the SGD NEER to ease lower to provide the stimulus required for the economy.**

- Since the April MPS, the domestic growth/inflation outcomes have softened steadily, underlying the "slightly below potential" prognosis:

    - The downward revision of the 2019 official growth forecast in August to 0.0-1.0% yoy (from 1.5-2.5% yoy in May 2019, and 1.5-3.5% yoy in November 2018) probably best encapsulates the loss of momentum. A wide range of indicators, ranging from PMIs to NODX, also point towards a slowdown.

    - The inflation picture has continued to soften, with the August core and headline prints at +0.80% yoy and +0.50% yoy. The core and headline inflation averaged around +1.25% yoy and +0.59% yoy so far this year, still within the MAS forecast ranges (but below the midpoint). The headline gauge, however, is looking at risk of falling below range (+0.5-1.5% yoy). Into the year-end, while we expect headline inflation to edge higher from base effects, we will be hard-pressed to find signals that point to a quick acceleration of price pressures.

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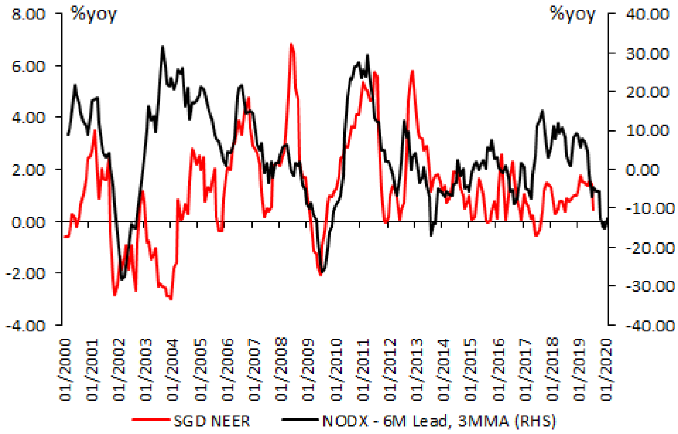
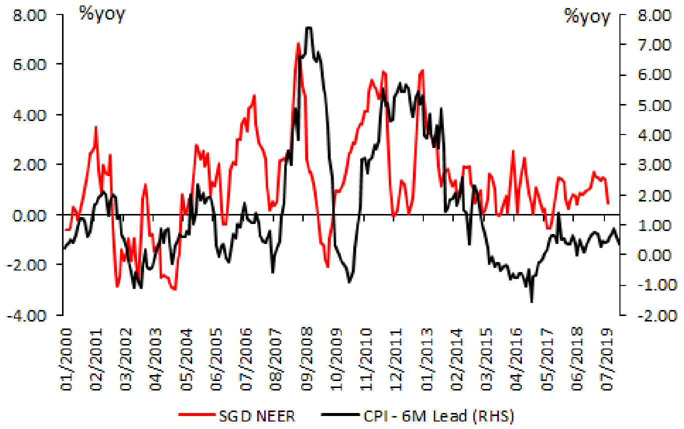




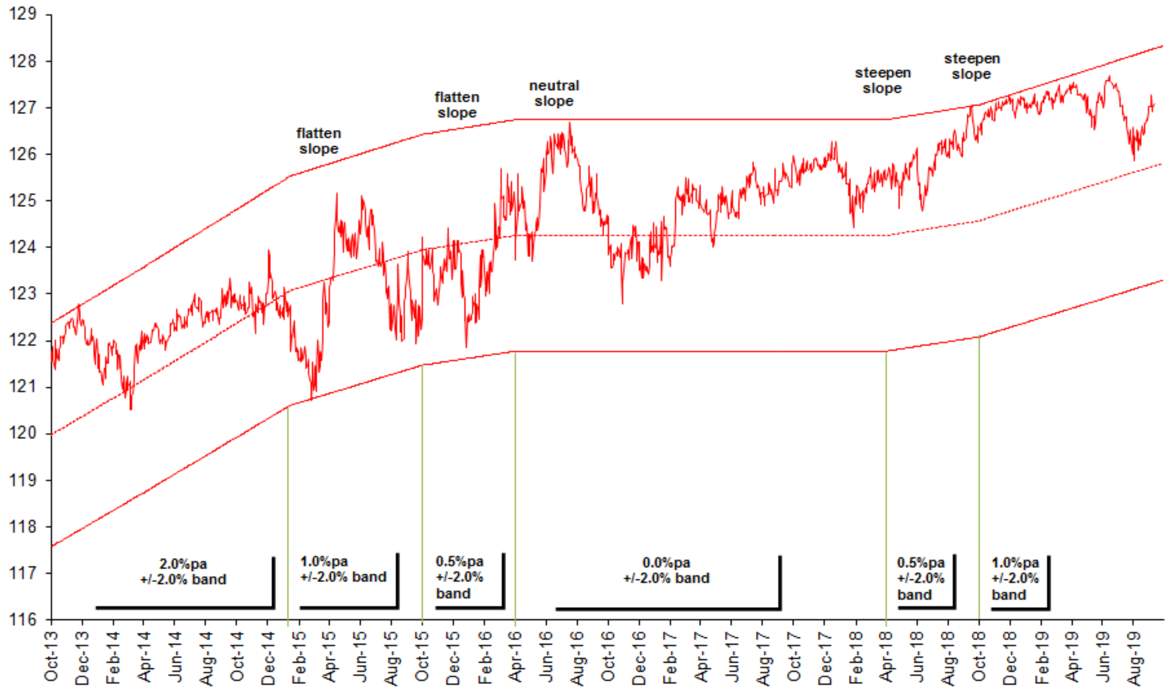
- The global growth/inflation narrative has also been anemic at best. Tellingly, market focus has shifted from whether global central banks will cut rates, to when and how deep the rate cuts will be going forward:

  - Global PMIs have continued to lose traction, while the composite leading indicators show no signs of bottoming (except in the Asia Major Five sub-region). Meanwhile, headline and core inflation prints are essentially flat-lined. Thus, it remains too early to expect a global growth rebound to carry the Singapore economy.

  - Arguably, the ongoing Sino-US rapprochement is a slight bright spot for the global economy. Nevertheless, without a concrete truce (interim or otherwise) to at least nominally lock down progress on this front, the situation may be too fragile to generate sustained optimism.

- Thus, appealing to the policy reaction function should suggest that the MAS should undertake some form of easing action, with the question being the extent of easing.

- **While the risk of a more dovish move to a zero rate of appreciation cannot be fully discounted, we think this drastic step may not be warranted for now.** Taking this step would imply an official economic prognosis that is considerably worse than our expectation, or expected to deteriorate rapidly from here. Granted that the economic indicators have softened, it is insufficient to characterize the situation as a severe dislocation of the economy. Similarly, if there is a threat of a rapid deterioration, the more natural response would be for an off-cycle adjustment (just ruled out in August), rather than trudge the way to October. **On balance, we think a measured easing action to an estimated +0.50% p.a. appreciation path may be the most likely scenario.**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