FX Viewpoint

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SGD NEER and the Oct MAS MPS Preview

- In the previous MAS MPS meeting, the MAS moved to a "zero percent appreciation of the policy band starting at the prevailing level" of the SGD NEER. **We interpreted this as the policy band turning flat, with the centre of the band moving lower by approximately -0.50% to the level where our estimated SGD NEER was at**.

- Heading into the October MPS, given that the macro outlook is still soft, but on the mend, **we find very little impetus for the MAS to further loosen the monetary taps**. Similarly, it is still way too early to contemplate a tightening. **We expect the MAS to leave the policy parameters – the slope, centre and width of the SGD NEER band – unchanged in this round**. A tightening move in 2021 cannot be ruled out, but the prospects will depend on the evolution of the pandemic.

Domestic macro outlook: Still soft, but definitely on the mend

- On the domestic front, the FY2020 growth outlook has worsened compared to the prognosis in April. **Our analysis suggest a substantial widening of the negative output gap, starting from 1Q 2020, and reaching its widest extent in 2Q.** From 3Q onwards, the extent of negative output gap has probably started to contract, although it may persist in negative territory until 2Q 2021. This picture is in-line with the view that the economic trough was in 2Q 2020.

- Translated to domestic price pressures, disinflationary pressures were probably the strongest in 1H 2020. We have started to see month-on-month upticks in segments of the CPI basket starting 3Q, suggesting that disinflationary pressures is easing as economic activity recovers.

- We watch with some concern the labour market situation, where the number of retrenchments in 2Q 2020 is already close to the peak during the SARS period. What is perhaps more worrying is the significant spike in number of employees on shortened work week or temporary layoff. This group may translate to further retrenchments down the road if the pandemic situation outlasts the support from the Jobs Support Scheme.

- Overall, although the domestic outlook is soft, and pockets of weakness still exist, the worst is likely behind us. Thus, **there is limited justification in stepping up monetary policy support at this juncture, especially given that fiscal policy has been identified as the main policy lever, and the government remains ready to do more on that front if required**. This view informs our stance that the MAS will hold policy parameters unchanged in the upcoming policy meeting.

SGD NEER: Current posture likely to be maintained

- In our Post-view of the previous policy meeting (see FX Viewpoint: April 2020 MAS MPS Post-view – Stability is key, 30 March 2020), we called for the SGD NEER time-path going forward to be limited by +/-1.0% above/below the perceived parity. In reality, an even tighter ship was run, with the SGD NEER mostly fluctuating between the parity and +0.50% above parity levels since. We think this is a reflection of the "stable" monetary policy stance expounded in the MPS.

- Going forward, much of the time-path of the SGD NEER will depend on how the pandemic situation evolves. We consider the following options:

    1. **The SGD NEER retains its current posture, a tight range near the parity level**: This is our base case, and should stand as long as the pandemic status quo (domestic situation contained, sporadic second wave outbreaks globally, vaccine in progress) persists.
    2. **The SGD NEER weakens to populate the lower half of the policy band**: This would take a significant worsening of the pandemic and imply an acknowledgement that a weaker SGD is required to supplement fiscal policy in supporting the economy. The barrier to this is high, and we see this as a low probability event.
    3. **The SGD NEER lifting higher towards the strong end of the policy band**: This would require a big step towards normalization globally and perhaps a successful vaccine. We will take this as a sign that a tightening move in April 2021 is potentially in play.

- Under our base case of the SGD NEER retaining its current posture, it will leave the USD-SGD a function of broad USD and RMB movements. We expect the pair to retain a high correlation with the DXY index. However, if the RMB continues to strengthen as we expect (see FX Viewpoint: RMB – Still room to strengthen, 20 Sep 2020), this would open up more room for the USD-SGD to search lower. Overall, we have a year-end forecast for the USD-SGD at 1.3553.

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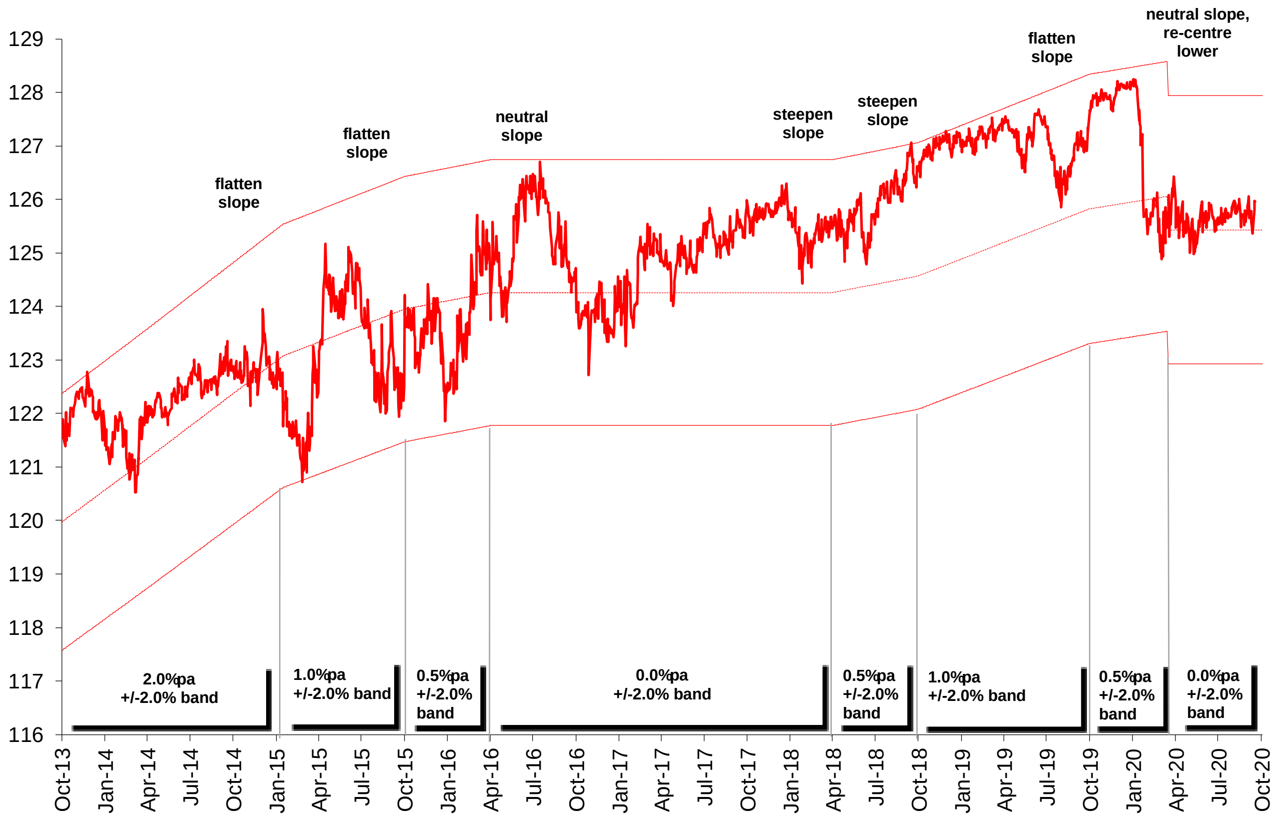

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