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FX Viewpoint

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SGD NEER and March MAS MPS Preview

- In the October 2019 MAS MPS meeting, the MAS reduced the rate of appreciation of the SGD NEER slightly. Following that move, we estimated of the rate of appreciation to be +0.50% per annum. Over the past month or so, the flurry of emergency policy action by global central banks has created an atmosphere of nervousness and urgency. **In this context, the upcoming MAS MPS, although carried forward from the typical April date to 30 March, comes across as composed and in control**.

- This round, **we fully expect the MAS to further reduce the slope of the SGD NEER policy band to neutral (ie. zero appreciation trend). The main policy dilemma is whether to lower the policy band** to provide a further boost to the economy. We expect no change in the width of the policy band.

- Across the world, economies are groaning under the weight of the different measures taken by governments to contain the spread of the COVID-19 virus. The resultant capitulation from the financial markets will also filter into the real economy eventually. **Growth downgrades have already been put in place.** For now, save for selected Chinese indicators, the economic hit has yet to be fully reflected in data in Asia and Singapore. Thus, we are effectively still in the dark over the actual impact. **The path is least resistance is probably for more growth downgrades ahead.**

- Our Singapore economists are expecting a FY2020 GDP growth of -0.50% yoy, with the hit coming in mainly in 1H2020. **Our own analysis suggests that the output gap may open up significantly in 2Q2019, to levels not seen since the 2008/09 Great Financial Crisis (GFC)**. The October MPS position of a “slightly negative” output gap that will “persist into 2020” is probably no longer tenable. To be fair however, no one would have called for the macroeconomic climate to be this challenging in October 2019.

- The SGD NEER may need to persist in the bottom half the policy band to support the domestic economy. **Thus, we expect the MAS to flatten the slope further to a zero appreciation path to reflect the preference for a softer SGD NEER.**

- The policy dilemma is whether there is a need to re-centre the policy band lower to give a further boost to the economy. Relating to this, we note that:

    1. The policy band was lowered in towards the tail-end of the GFC in April 2009.

2. Historically, a change in the centre of the policy band occurs when the SGD NEER is at or very near the extreme end of the policy band. Currently, the SGD NEER is fluctuating between -0.20% and -1.10% below our estimated parity level.

- Lowering the policy band, coupled with a reduction of slope, will send a stronger signal that the SGD NEER ought to drift further south, giving a further boost to the economy. **Whilst such a double move may be required from a macro perspective, the time path of SGD NEER itself does not point to such an action.**

- Based on current levels, the extent to which the policy band can be lowered may not be significant. One can justifiably question whether the additional boost to the economy will be sufficiently meaningful to justify the action. Of course, this argument may shift if the SGD NEER moves lower towards the lower extreme of the policy band in the run up to the March MPS meeting itself.

SGD NEER: Staying away from the negative extreme of the policy band

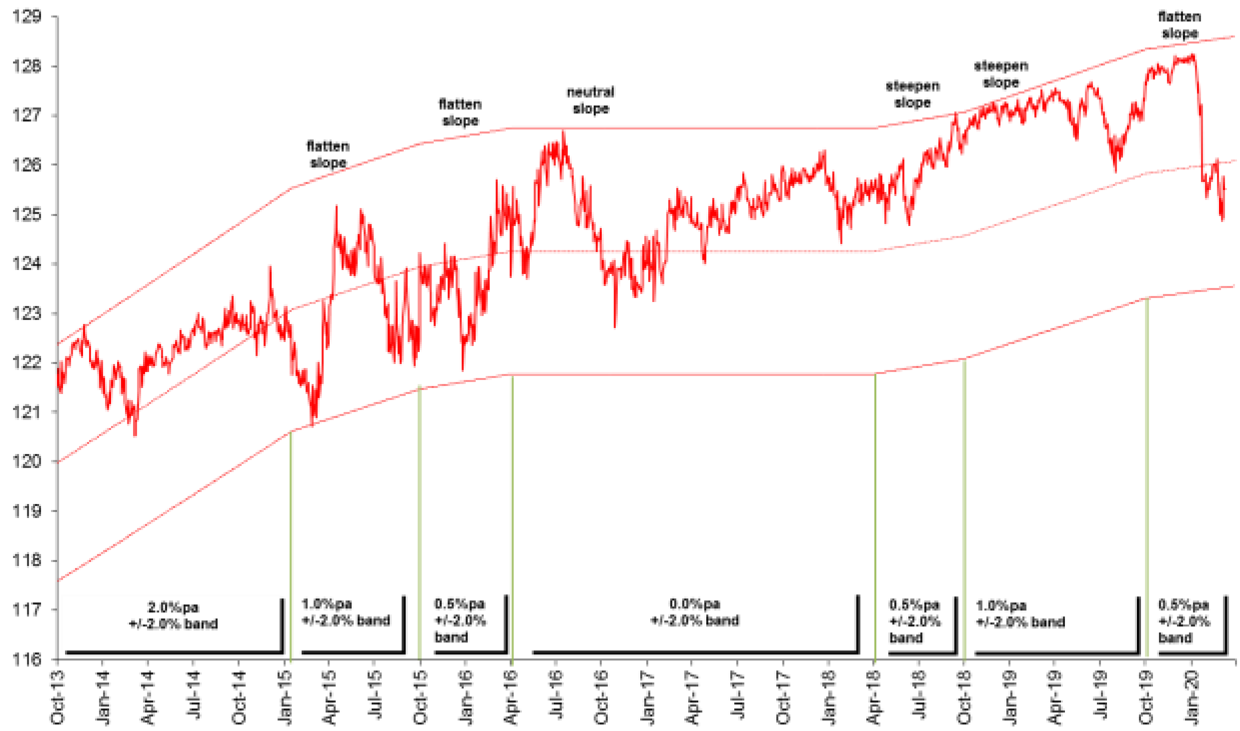
- In our October MAS MPS Post-view, we bucked the consensus to call for the SGD NEER to stay supported despite domestic economic imperatives. Our view held out until late January 2020, when the COVID-19 situation first reared its head in China. As the spread through China, then Asia and into US/Europe, the SGD NEER fell towards parity and beyond, before bouncing off a base at an estimated -0.91% below parity.

- Into the March MAS MPS and in its immediate aftermath, we expect broad USD strength to be the central theme in the FX space. **We do not expect the USD-SGD to be able to resist the USD's pull higher**. Thus, the path of least resistance is for the USD-SGD to float higher alongside the broad USD. This will undoubtedly exert a downside pressure on the SGD NEER. However, we do not expect a deeper decline for now.

- **The SGD should be able to draw support from the RMB complex**. The CFETS RMB Index was supported on the downside when the COVID-19 focus was on China, and tracked higher as soon as the attention shifted towards other parts of the world. This is in spite of the broad USD strength. **Although the firm RMB itself also exerts a negative pressure on the SGD NEER, the RMB complex serves as a shield to prevent Asian currencies (SGD included) from excessive downside against the USD and other G-10 currencies**. In fact, even in the latest upswing in the USD-SGD (starting 9 March), the SGD has outperformed all G-10 currencies other than the USD. In turn, this puts a base on the SGD NEER downside.

Conclusion: Keep an eye on the SGD NEER

- Reducing the slope of the SGD NEER to a zero appreciation path is an easy decision to make. However, lowering the policy band is a closer call and we prefer to watch the SGD NEER for cues. On balance, if the SGD NEER is higher than -1.00% below parity going into the scheduled March MPS, the lowering of the policy band may have little impact on the economy. We find little justification for such a move. On the flipside, if the SGD NEER softens further from now till 30 March, we think likelihood of a lowering of the policy band will be correspondingly increased.



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