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S'pore skirted a technical recession in 3Q19

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Highlights

The Singapore economy narrowed escaped a technical recession (defined as two consecutive quarters of qoq contraction) in 3Q19 as we expected. GDP growth flash estimates came in at 0.1% yoy (+0.6% qoq saar), matching the revised 2Q19 growth reading of 0.1% yoy (-2.7% qoq saar), but missed both market forecast for 0.2% yoy (1.2% qoq saar) and our expectations (0.3% yoy and 1.9% qoq saar).

The main drag was again manufacturing as expected at -3.5% yoy, which is the weakest showing since 4Q15. The output contraction was attributable to electronics, precision engineering and transport engineering clusters amid the ongoing US-China trade tensions and tech war. At this juncture, leading indicators like the manufacturing and electronics PMIs had weakened further into September at 49.5 and 49.1 respectively, suggesting that the sector is still searching for a bottom in 4Q19. More importantly, Phase 1 of the US-China trade deal does not cover Huawei or other Chinese companies in the US entity list, which suggests any near-term market optimism about the tech sector regaining its momentum may be disappointed.

However, the more disconcerting fact is that the services sector has continued to soften in growth momentum to 0.9% yoy (0.7% qoq saar) in 3Q19, the slowest pace since 3Q09. While finance & insurance sector, business and professional services and ICT clusters remained resilient, the wholesale and retail sectors have been dented by spill overs from all the negative headline news. Even the MAS statement recognised that there are nascent signs that the downturn could spill over into domestic demand in some of Singapore's major trading partners in the quarters ahead. To a certain extent, belt-tightening by consumers domestically is inevitable given the ongoing downgrades of global and domestic growth expectations.

The silver lining is the construction sector which expanded 2.7% yoy (-1.1% qoq saar) in 3Q19, similar to the 2.8% yoy seen in 2Q19. The construction sector's recovery was aided by an uptick in both public and private sector construction activities. While we expect that the public construction pipeline should remain healthy with ongoing infrastructure projects, whether in public housing, transport, healthcare and education, the construction sector is unlikely to catalyse Singapore's growth per se. Moreover, the import leakage for the construction sector is relatively high.

The 4Q19 growth prognosis still remains soft. **We anticipate another anaemic 4Q19 GDP growth, with the risk that full-year 2019 GDP growth may come in on the lower end of the official 0-1% yoy forecast.** The latest phase 1 of the US-China trade deal may lift near-term market sentiments, but we must see how phase 2 and 3 negotiations proceed from here. However, without any complete unwinding of existing US-China tariffs, the cloud over the global trade environment may not fully dissipate. It is not inconceivable that if US President Trump is unhappy with the subsequent trade negotiations, he may again threaten to put the planned tariff hikes back again. Accordingly, the electronics and supporting industries should still see persistent weakness over the near term.

Looking out into 2020, we anticipate a modest improvement in Singapore's GDP growth to 1-2% yoy but this is from a low base in 2019 and predicated on no further escalation in US-China trade tensions and geopolitical hotspots. Notably, the output gap has turned slightly negative and is expected to persist into 2020, which should keep inflationary pressures subdued. In fact, MAS noted that the output level will remain "below potential" in 2020 and MAS "is prepared to recalibrate monetary policy should prospects for inflation and growth weaken significantly". This clearly illustrates that the current monetary policy easing to flatten the S$NEER slope is a calibrated move, given that currently there is no technical recession or full-year recession. That said, the window remains open for another measured easing come April 2020 should Singapore's output remain below potential.

Inflation continues to run below the policy radar. MAS telegraphed that core inflation is likely to come in at the lower end of its 1-2% range this year and average 0.5-1.5% in 2020, while headline CPI may average around 0.5% this year and 0.5-1.5% in 2020. While external inflation sources remain benign amid soft global demand conditions, crude oil prices could be volatile due to geopolitical risks. On the domestic inflation front, wage growth is expected to taper off from 2018 and given softening business and consumer confidence, the pass-through to end-consumers should also be limited. Our headline and core inflation forecast for 2020 are 1.1% and 1.2% yoy, compared to 0.6% and 1.1% yoy for 2019.

Labour market softening is to be anticipated and could be the catalyst for a more expansionary fiscal policy stance at the upcoming 2020 Budget. While the headline unemployment rate has edged up slightly, the retrenchments data is not alarming at this juncture by any means. As firms potentially shift from being cautious about fresh hiring to considering right-sizing into the new year, the domestic labour market (typically a lagging indicator) may soften into 2020 as well. The FY2020 Budget may see more targeted measures to assist workers, especially those facing transition difficulties, through reskilling and upskilling.

Domestic short-term interest rates may see a softer bias going ahead as well, given our expectation that the FOMC has at least one more 25bp rate cut remaining for the rest of this year and probably another cut frontloaded into early 2020. The 3-month SOR has dropped to 1.57%, the lowest since August 2019, compared to the 3-month SIBOR which is relatively stable at 1.87% as of 11 October. Swap rates and SGS bonds yields had firmed around 2bps this morning while USDSGD flirted with the 1.37 handle post-MAS. Our forecast for 3-month SIBOR and SOR remains around 1.6% handle for end-2019 and around 1.5% handle for end-2020.

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