FX Viewpoint

OCBC Bank

Friday, October 12, 2018

MAS MPS – Slope steepening again

- This morning, at its MPS (Monetary Policy Statement), the MAS increased "slightly" the slope of the SGD NEER policy band, following on the heels of its initial slope steepening in April 2018 from 0% to an estimated +0.50% pa. We expect that with today's policy move, the new gradient for the SGD NEER is at +1.0% pa.

- The move was motivated by the view that the economy "has largely evolved as envisaged" since the April 2018 MPS. Downside risks were given scant mention, with only one reference to "trade frictions" (as opposed to 3 references in the April MPS).

- Going ahead, growth is expected to "moderate slightly" into 2019 – in line with the street. Crucially, the authority expects growth to be "slightly above potential" in the coming quarters. In fact, the output gap was highlighted a total of four times in the statement, perhaps in an effort to underscore the fact that the economy has returned to its steady state path.

- Meanwhile, the anticipated (core) inflation dynamics we think played a more significant role in motivating the additional policy tightening this morning. Headline inflation is expected to clock around +0.50% in 2018 before firming slightly to 1-2% in 2019 (in line with expectations).

- Crucially, core inflation is expected to "experience modest but continuing pressures" and is expected by the authority to firm "to around 2% in the months ahead", "…before levelling off at just below 2.00% over the medium term". The expected time path here is also not a surprise to market participants, but the core inflation forecast of 1.5-2.5% in 2019 (from an estimated 1.5-2.0% for 2018) we think is a notch warmer than current market expectations.

- Structurally, the MAS expects pass-through effects from generalized price pressures to emanate from firming imported inflation pressures (oil and food prices) as well as strengthening labor costs (especially from services). On our end, apart from the efficacy of expected pass-through effects, we think it also remains to be seen if the above two factors would crystallize significantly (or at a faster than expected pace) to constitute an inflation threat in the coming months.

- Overall, the slope steepening this morning again can be characterized as another neutral-tightening, effectively a continued normalization (if pre-

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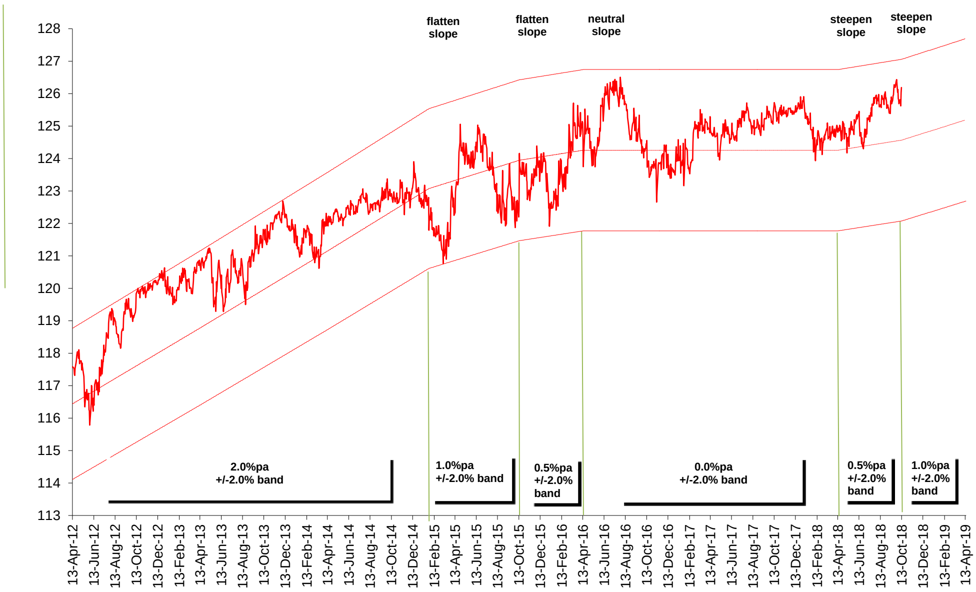
emptively) of the policy posture of a gradual and modest appreciation path of the SGD NEER.

- Going ahead, with the current gradient of the policy band estimated at +1.00% pa, the question then is whether there is further scope for further steepening in the coming quarters. This morning's MPS statement certainly did not convey any finality with respect to its current policy trajectory nor did it implicitly telegraph any urgency for a further slope steepening at the next MPS in April 2019 (with points and the vol surface also largely unperturbed). Nonetheless, the eventual terminal gradient of the policy band remains up in the air at this juncture (and dependent on the modelled reaction function) and a further steepening cannot be ruled out in 2019.

SGD NEER



Source: OCBC Bank

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