FX Viewpoint

Friday, April 13, 2018

MAS MPS - Modest and gradual appreciation again

- This morning, at its semi-annual MPS (Monetary Policy Statement), the MAS "decided to increase slightly the slope" of the NEER policy band from 0%, effectively returning policy to a gradual and modest appreciation path.

- From the statement, the slope steepening was motivated by the view that: 1) imported inflation is likely to rise mildly; 2) domestic sources of inflation are expected to rise gradually; 3) an improving labor market in terms of faster wage growth; 4) the Singapore economy is expected to remain on a steady expansion path in 2018 and come in above the middle of a previously projected 1.5%-3.5% range.

- Overall however, no explicit urgency was detected from the accompanying statement with core inflation seen in the upper half of the unchanged forecast range of 1-2%. Meanwhile, headline inflation is also projected to be in the upper half of the previously projected 0-1% range. These expectations we feel are/were wholly within the market's prior reckoning for price developments for the rest of 2018 and into 2019.

- On a related note, global trade tensions were mentioned thrice but the MAS stated that today's policy change takes into account potential uncertainty from this front.

- **Implications:** Firstly, with little urgency (in terms of significant upside risks to growth and inflation) behind today's policy shift, we think the MAS will likely let the current policy ride towards the October MPS, and barring any overshoot on the growth/inflation front (relative to current projections), maintain the current gradient at the October MPS. Specifically, we'd also continue to watch for an explicit drift higher (nominal Index values) in the SGD NEER in the coming 6 months.

- Secondly, there are no implications for SGD NEER-implied USD-SGD valuations today, given that a gradient change would not impact values on t=0, today. Meanwhile, the NEER is around +0.59% as of the time of writing, essentially within its recent range. While the nominal implied short end may see a near term cap as a result of the slope steepening, the discounts may remain more a function of Libor. Meanwhile, the long end is expected to remain at the mercy of global growth/inflation prospects.

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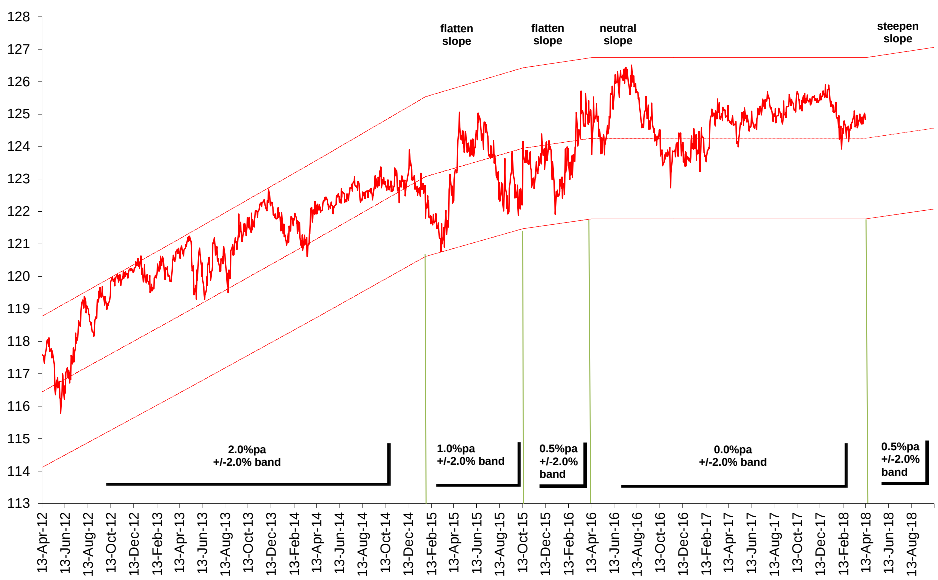
- Thirdly, with little hawkishness being imputed from the policy move, expect little in the way of discretionary renewed downside pressure for the USD-SGD, or strong north-bound pressure for the NEER to rise significantly above its perceived parity in the near term. At this juncture, the front end of the vol surface continues to remain subdued – perhaps a desired outcome.

- Fourthly, generalized market expectations would likely settle upon a +0.50% p.a. slope for the SGD NEER band at this juncture, pending market triangulation in the coming weeks/months.

- Overall, the gradient increase can perhaps be viewed as a pre-emptive move (today's accompanying statement would not have been out of place if policy had remained static), and we had previously attached a non-trivial probability of 30% for a slope steepening today.

SGD NEER



Source: OCBC Bank

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