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Singapore

MAS "calibrated tightening" implies vigilance against core inflation into 2027

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- MAS increased the rate of appreciation of the policy band “very slightly” at today’s quarterly monetary policy review (as opposed to April’s “slightly”), noting that the extent of this increase is smaller than that in April.

- This marked a back-to-back consecutive policy tightening since the 2022 cycle, but the balance of risk is distinctly different from the April MPS. For one, there was no change to the MAS headline and core inflation forecast of 1.5-2.5% YoY for 2026. Second, the growth prognosis remains upbeat, with an anticipated widening of the positive output gap, powered by AI-related investments benefiting the tech sector, but also broad-based sectoral growth.

- This should be viewed as a policy fine-tuning rather than a regime shift. The April policy tightening was likely reactive to the onset of the US-Iran war, whereas today’s move is positioned as honing the tool against the core inflation which has yet to peak and is only expected to peak in coming months and subside only gradually after 1Q27.

Highlights:

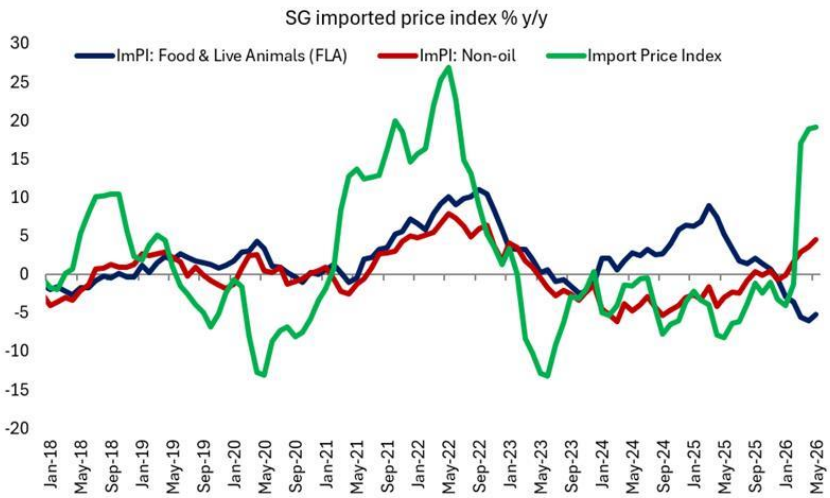
- **MAS policy decision:** MAS increased the rate of appreciation of the policy band "very slightly" at today's quarterly monetary policy review (as opposed to April's "slightly"), noting that the extent of this increase is smaller than that in April. There was no change to the policy band width of the level at which it is centred. This "calibrated adjustment" builds on the earlier April tightening and sustains an appropriate appreciation path for the S$NEER policy band which will cap inflationary pressures, in an environment of continued heightened uncertainty. MAS noted that external price pressures are expected to persist and pass through more broadly to domestic consumer prices in the period ahead, and MAS core inflation is projected to step up from July and remain elevated but should moderate discernibly from around mid-2027. Moreover, MAS said it is well-positioned to respond effectively to any risk to medium-term price stability. MAS noted it will continue to closely monitor economic developments and reiterated it stands ready to curb excessive volatility in the S$NEER.

- **OCBC view:** This marked a back-to-back consecutive policy tightening since the 2022 cycle, but the balance of risk is distinctly different from the April MPS. For one, there was no change to the MAS headline and core inflation forecast of 1.5-2.5% YoY for 2026. Second, the growth prognosis remains upbeat, with an anticipated widening of the positive output gap, powered by AI-related investments benefiting the tech sector, but also broad-based sectoral growth. Third, and most importantly, crude oil prices had pulled back from the year-to-date highs following the US-Iran MOU, albeit it had retraced higher back to above the US$90 handle per barrel amid the return of strikes. The core inflation outlook into 2027 was key as the pass-through and persistence of global energy prices into imported input costs, not just for fuel but also electronic input prices which feed into upstream and intermediate items like construction materials, capital equipment and food commodities etc. Two consecutive monetary policy tightening means that MAS remains very vigilant and will not become complacent to imported price pressures, but the pressure may be less, so still data-dependent going forward. Despite the geopolitical tensions, especially in the Middle East, remains in flux, the global AI-related investment boom is ongoing, hence the growth fundamentals have come in stronger than expected. So, no room for complacency just yet, although with the consecutive policy tightening, the risks for another follow-through move at the next October MPS is likely reduced, ceteris paribus, since policy is now mildly restrictive.

- **Importance of this July move:** This should be viewed as a policy fine-tuning rather than a regime shift. The April policy tightening was likely reactive to the onset of the US-Iran war, whereas today's move is positioned as honing the tool against the core inflation which has yet to peak and is only expected to peak in coming months and subside only gradually after 1Q27. Our 2026 headline and core inflation forecast stands at 2.0% and 1.8% YoY respectively but is anticipated to overshoot to 2.5% and 2.3% in 3Q26 with the adjustments in electricity and gas prices. Our 2027 headline and core inflation forecasts both stand at 1.9% YoY, with the step-down to below the 2% handle only coming from 2Q-3Q27. MAS remains data-dependent and watchful of demand-pull inflation, with policy flexibility intact. The policy determination to do more is only if necessary, i.e. that core inflation continues to surprise on the upside more than anticipated.

- **Broad-based growth prospects:** MAS remains sanguine on the external growth outlook: major trading partner's growth momentum is tipped to continue apace, and firm technology spending is also likely to sustain activity in the global electronics supply chain, albeit energy costs are still elevated compared to a year ago and will fuel global inflationary pressures further. With a stellar 1H26 GDP growth performance in the bag, MAS noted that most other major sectors grew in line with their trend rates, apart from the robust growth in the technology-related segments and selected oil-related sectors being adversely affected by feedstock disruptions. In particular, MAS noted that Singapore's positive output gap is now forecast to widen slightly this year, reflecting the above-trend growth outturns in 1H26 and the expectation that overall GDP will be sustained at high levels in the near-term. The latter will be buoyed not only by the global AI-related capex spending but also the construction sector due to a significant pipeline of public and private projects as well as the financial sector due to strong credit growth.

- **Inflation outlook:** Energy price surge has broader pass-through into other goods inflation including point-to-point transport services, non-cooked food etc. While services inflation had moderated amid subdued unit labour cost growth and greater telecommunication services competition, nevertheless Singapore's imported costs are likely to rise in the quarters ahead. Beyond fuel costs, electronic input costs are lifting prices for upstream and intermediate items such as construction materials, capital equipment and food commodities. Adverse weather conditions like the threat of a super El-Nino could reduce agricultural output and drive food prices higher. In contrast, domestic price pressures should be contained due to moderating nominal wage growth and sustained labour productivity growth which will cap unit labour cost increases.

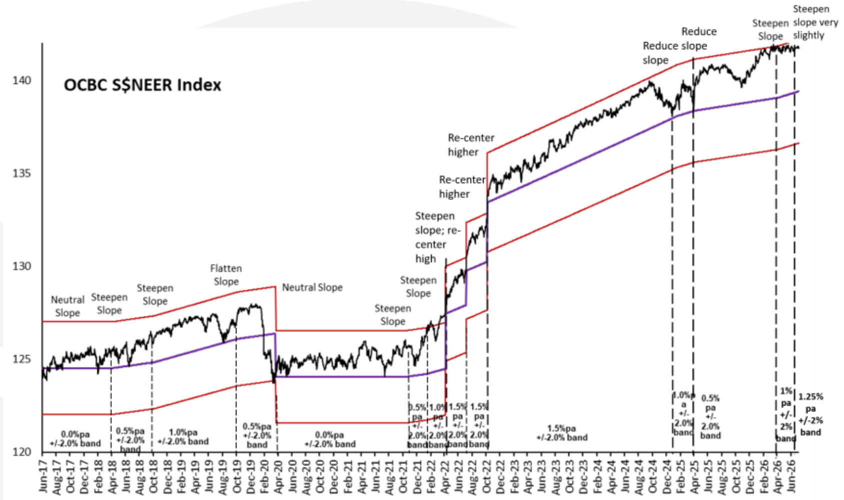


Source: CEIC, OCBC Group Research.

- **Still a two-sided risks to the inflation trajectory**: MAS warned of continued significant macroeconomic outlook uncertainties, with upside inflation risk if energy prices spike anew since fuel reserves have been drawn down significantly and the risk of renewed supply disruptions in the Middle East and/or more persistent inflation if robust investment growth causes greater demand spillovers abroad and in Singapore. On the downside, an unexpected tightening in financial conditions or a pullback in AI-related investment could also prompt a rethink about the sustainability of GDP growth and thus weaken inflation. MAS anticipates that MAS core inflation would step up from July, partly due to the electricity and gas tariff adjustments passing through more broadly to domestic consumer prices and remain elevated but should moderate discernibly from around mid-2027.

- **For the SGD,** the decision should provide some near-term support. However, the incremental effect may be more modest than the headline surprise suggests. The S$NEER had already traded in the upper half of the policy band following April's tightening, and MAS has made clear that the July slope increase is smaller. The broader SGD trajectory will therefore continue to depend on the direction of the US dollar, Federal Reserve expectations, energy prices and global risk sentiment, rather than on the MAS decision alone. S$NEER was last around 1.9% above our model-implied mid.

- **The latest MAS tightening reinforces, rather than changes, our view for USDSGD** to remain under downward pressure over the projection period. The "very slight" increase in the S$NEER slope should provide an additional, albeit modest, policy tailwind for the Singapore dollar, while signalling MAS' preference to lean against renewed inflation risks. We would not overstate the immediate FX impact, given the small calibration and the continued importance of broader USD, US rates and risk-sentiment drivers. Nonetheless, alongside Singapore's resilient macro fundamentals and the maintained appreciation bias in the policy band, the decision adds conviction to our expectation that bouts of USDSGD strength are more likely to fade than develop into a sustained reversal.



Source: OCBC Group Research estimates.