Economics

DBS Flash

No urgency to tighten SGD policy

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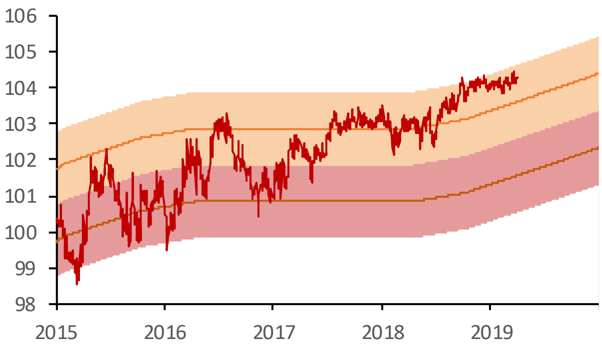
MAS SGD policy on hold

There is no urgency for the Monetary Authority of Singapore (MAS) to tighten monetary policy a third time at its policy review due before mid-April. According to our model, the SGD nominal effective exchange rate (SGD NEER) is in the strongest quartile of its modest and gradual appreciation policy band. On the other hand, economic and inflation have disappointed amidst a cautious global outlook with a dovish policy tilt.

DBS SGD NEER is in the top quartile of its modest and gradual appreciation band

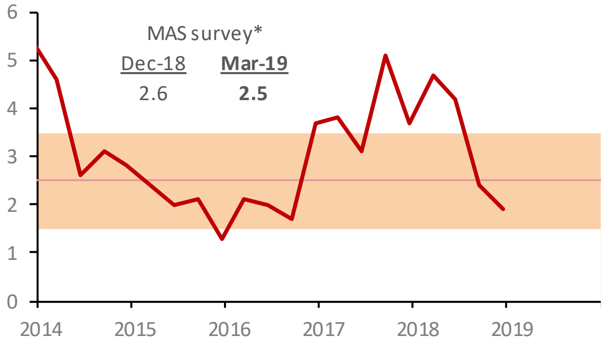
Index (6-10 April 2015 Average = 100)



Singapore's economic outlook has dimmed. Real GDP growth has decelerated to 1.9% YoY in 4Q18. According to the MAS Survey of Professional Forecasters in March, growth is set to slow for a second consecutive year to 2.5% (down marginally from the 2.6% projected in December) in 2019 from 3.3% last year, at the mid-point of this year's official growth forecast of 1.5-3.5%.

Consensus expects 2019 growth to be tamer around the mid-point the 1.5-3.5% official forecast range

Real GDP growth, % YoY



* Professional forecasters' outlook for 2019

The world's largest economies have downgraded this year's growth outlook with a dovish pivot. The US Federal Reserve has, at its FOMC meeting on March 20, downgraded its 2019 growth forecast to 2.1% from 2.3% projected three months earlier, and extended its rate hike for the rest of the year. In China, the National People's Congress announced, on March 6, a lower official growth target of 6-6.5% for 2019. The European Central Bank (ECB) has slashed this year's growth forecast to 1.1% from its previous 1.7% projection and announced new TLTROs to improve bank lending conditions. The ECB believes that markets have underestimated the risk of a disorderly Brexit.

According to the MAS Survey of Professional Forecasters in March, **the top three potential risks – trade protectionism, China slowdown and higher interest rates – to the Singapore economy are all external.** It was not reassuring that the upside risks were identified as an easing of the same downside risks.

Top 3 potential risks to the Singapore economy % of respondents

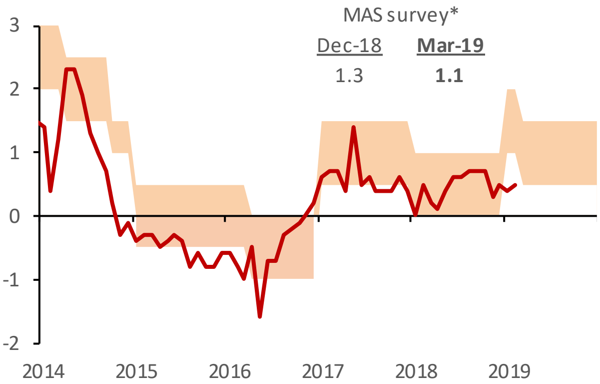
UPSIDE RISK	Dec-18 survey	Mar-19 survey	DOWNSIDE RISK	Dec-18 survey	Mar-19 survey
Trade tensions easing	47	74	Trade protectionism	100	84
Growth in China	24	37	China Slowdown	41	53
Pause in monetary policy tightening	29	37	Higher interest rates	41	32

Sources: MAS survey of professional forecasters, March 2019

Trade protectionism has been consistently flagged as the top downside risk, which if eased, could also improve prospects. Manufacturing/export activities were not spared by the US-China tariff war and shrank to two-year lows (when the SGD NEER stance was neutral). US-China trade talks have gone into overtime after the 90-day truce ended in March without tariff increases. A US-China trade deal, if any, is now expected in 2Q19 but come as late as the Osaka G20 Summit on June 28-29.

2019 forecast range for CPI has been downgraded

SG CPI All-Items, % YoY

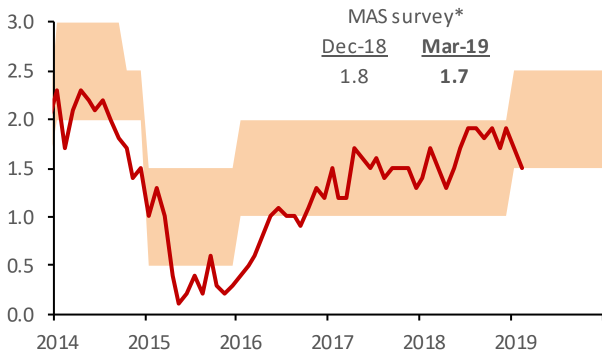


* Professional forecasters' outlook for 2019

There are no inflation pressures. The MAS has, on February 24, downgraded its 2019 forecast for CPI-All Items to 0.5-1.5% the from 1-2% projected last October. Inflation last fell to 0.4% YoY in January. Brent crude oil prices have recovered to only USD68/barrel in 1Q19 after the plunge from USD86 to USD50 in 4Q18. The Singapore Power Group has projected electricity tariffs to fall by an average 4.7% in the April-June quarter. The **MAS core inflation**, which strips out the costs of accommodation and private road transport, **has been well-behaved in the lower half of its official 1.5-2.5% range** for 2019.

SG core inflation has been stable in the lower half of its official 1-2% forecast range

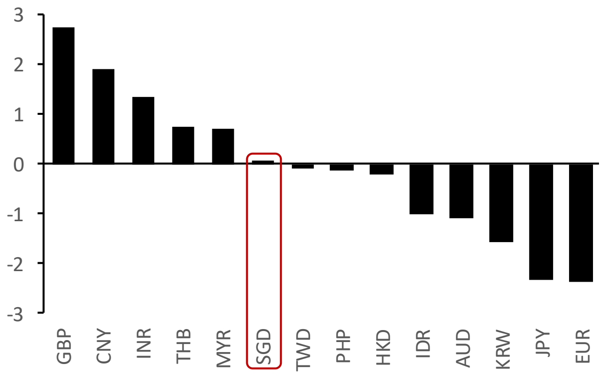
MAS Core Inflation, % YoY



* Professional forecasters' outlook for 2019

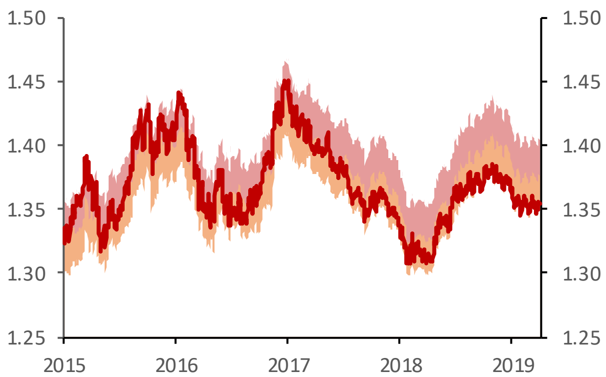
Mixed performances in our model's basket of currencies

% change vs USD, 2 April 2019 vs 7 Jan 2019



The market expects the policy review to be a non-event. The SGD has been in a tight range between 1.3450 and 1.3620 vs USD since January 7. This was consistent with the mixed performances in the basket of currencies of our model. On the one hand, the stronger CNY and GBP reflected hopes of easing trade tensions and the UK averting a disorderly Brexit. Conversely, global growth worries were reflected in the weaker EUR, JPY and KRW.

Risk-reward favours a higher USD/SGD, currently near the floor of its implied policy band around 1.35



Nonetheless, the risk for USD/SGD to rise to 1.40 cannot be totally discounted. Until a US-China trade deal is finalized and a no-deal Brexit averted, China slowdown and Eurozone recession risks cannot be ruled out. A further deterioration in the synchronized global growth outlook will open the door for the SGD to trade into the weaker half of its policy band, which in USD/SGD terms, was last estimated at 1.37-1.40 by our model. Lastly, the implied USD/SGD policy band would also be pressured higher by a flight to safety into the USD.

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).

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