14 October 2021

Global Markets Research

Research Alert

Singapore: MAS Tightens due to 2022 Outlook

The MAS has moved to strengthen the SGD policy, to moderate persistent inflationary pressures

MAS views on elevated inflation and economic recovery open the door to further tightening

Advance estimates 3Q GDP showed some resilience, despite Covid-19 related restrictions

We stay bullish on the SGD compared to other currencies; lesser against a possibly stronger USD

Summary & Implications

The Monetary Authority of Singapore decided to move to a modest and gradual appreciation of the Singapore dollar on 14 October 2021. The MAS maintained a zero appreciation policy since March 2020, due to the Covid-19 pandemic and fall in inflation expectations (Figure 1). We believe that this means that the slope of the SGD NEER policy band will be adjusted to appreciate by 0.5% per annum from now. We think that if the current trend of economic recovery and sustained inflationary pressures continue, there is a high chance that the MAS will tighten slightly again in April 2022, to a 1% per annum slope.

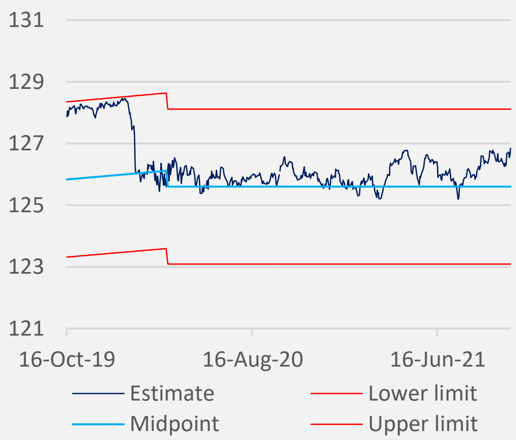
This comes as the economy grew by 6.5% y/y and 0.8% q/q in 3Q, according to advance estimates. The performance was positive, given some dampeners caused by Covid-19 restrictions during this period. Singapore is gradually lifting these restrictions, which bodes well for the economy recovery ahead.

We flagged about our bullish view for the SGD in our 4Q2021 Quarterly Outlook report, and forecast USD/SGD at 1.35 at end-2021 and 1.34 end-2022 (Figure 2 and 3). In our view, there is downside risks to this forecast if there is some USD weakness, which we do not expect at this stage. The SGD will probably perform better than other currencies (e.g. Asian and other G10 FX), especially if their central banks have more dovish/accommodative stances.

Key Takeaways from MAS

The main takeaway from the MAS statement is that inflation will be a key theme in 2022. MAS expects core inflation at 1-2% and headline inflation at 1.5-2.5% in 2022. This is 0.5ppt higher than what we thought they will forecast.

Figure 1: SGD NEER (estimates)



Source: HL Bank

Note: SGD NEER stands for Singapore Dollar Nominal Effective Exchange Rate

Figure 2: USD/SGD

Source: Bloomberg

- The current global inflation outlook is likely driven by supply chain issues and shortages, amid a recovery. This will cause elevated tradables and imported inflation.
- At the same time, accommodation inflation is likely to persist, after prior construction delays.
- "Reopening" inflation will also come in, as "various service fee increases that were put on hold since the pandemic began, such as for transport, healthcare and education, could also resume".
- MAS sees that labour market conditions will be tightening in the coming months.
- MAS views that the current appreciation path will ensure medium-term price stability, while balancing and "recognising the risks" to the economy recovery.

Singapore's Economic Recovery Continued Steadily in 3Q

Concurrently, Singapore's 3Q GDP (advance estimates) rose by 6.5% y/y, alongside an upwardly revised 2Q print (15.2% y/y from 14.7%). This translates to a 0.8% q/q expansion from 2Q (seasonally adjusted).

Y/y growth was broadly supported by all major sectors, manufacturing, construction and services, supported by base effects. However, compared to 2Q, construction, wholesale/retail trade and transport/storage were somewhat adversely affected by Covid-19 curbs.

We note that sectoral value-add for (1) construction, (2), accommodation/food services, real estate, administrative/support & other services and (3) wholesale/retail trade & transport/storage remain at 25.1%, 11.3% and 7.3% respectively below pre-Covid-19 levels. These imply at potential further upsides for these sectors ahead in 2022.

Figure 3: Key forecasts

	2021F	2022F
GDP	6.2%	3.7%
Inflation (avg)	1.9%	1.2%
Core CPI (avg)	0.9%	1.2%
3m SIBOR	0.45%	0.65%
USD/SGD	1.35	1.34

Source: HL Bank

MAS Monetary Policy Statement

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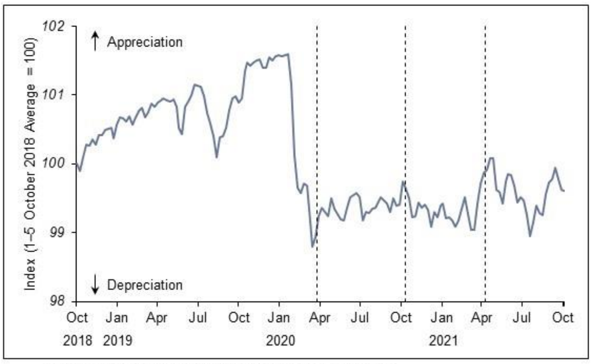
14 October 2021

INTRODUCTION

1. In its April 2021 Monetary Policy Statement, MAS kept the rate of appreciation of the S$NEER policy band at zero percent, with no change to the width of the policy band or the level at which it was centred. This policy stance was appropriate as core inflation was projected to rise only gradually from subdued levels and keep below its historical average.

Chart 1 S$ Nominal Effective Exchange Rate (S$NEER)



----- indicates last three releases of Monetary Policy Statement

2. Over the last six months, the S$NEER broadly fluctuated within the upper half of the policy band, reflecting in part shifting sentiments around Singapore's macroeconomic outlook as the pandemic evolved. On a point-to-point basis, the trade-weighted index weakened as the S$ depreciated against some of the regional currencies and the US$. The three-month S$ Singapore Interbank Offered Rate (SIBOR) was unchanged at 0.4%, while the **three-month compounded S$ Singapore Overnight Rate Average (SORA) eased slightly to 0.1% in October.**

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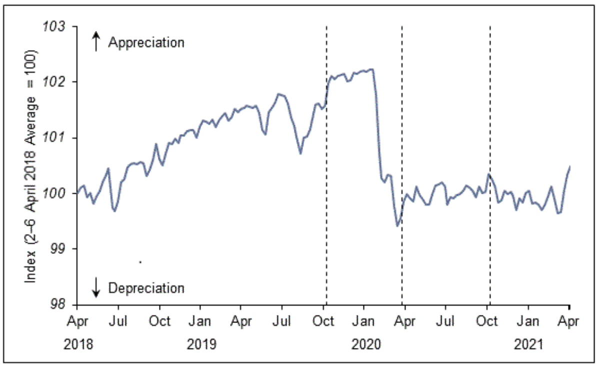
14 April 2021

INTRODUCTION

1. In its October 2020 Monetary Policy Statement, MAS kept the rate of appreciation of the S$NEER policy band at zero percent per annum, with no change to the width of the policy band or the level at which it was centred. This policy stance was assessed to be appropriate in view of the weak outlook for core inflation. While core inflation was expected to rise and gradually turn positive this year, it would stay well below its long-term average.

Chart 1 S$ Nominal Effective Exchange Rate (S$NEER)



----- indicates last three releases of Monetary Policy Statement

2. Over the last six months, the S$NEER has fluctuated slightly above the mid-point of the policy band. The S$NEER has appreciated modestly, reflecting in part the strengthening of the S$ against most reserve currencies as global risk sentiment improved. The three-month S$ SIBOR was broadly unchanged at 0.4%.

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OUTLOOK

3. Despite near-term uncertainties, the global economy should expand at an above-trend pace in the quarters ahead. In conjunction with a gradual domestic reopening, the Singapore economy should also continue on its recovery path and aggregate output should return to potential in 2022. As the labour market slack is absorbed and with imported inflation forecast to remain firm, MAS Core Inflation is expected to rise steadily from below 1% on average this year to 1–2% in 2022.

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OUTLOOK

3. Prospects for global growth have firmed and should provide support to the ongoing recovery in the Singapore economy. Nevertheless, output will still be below potential in 2021. Although MAS Core Inflation is expected to rise gradually this year from its current low levels, it will remain short of its historical average.

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Growth Backdrop and Outlook

4. The Advance Estimates released by the Ministry of Trade and Industry today indicated that the Singapore economy expanded by 0.8% on a quarter-on-quarter seasonally-adjusted basis in Q3 2021, following a 1.4% contraction in the second quarter. With the turnaround, aggregate output

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Growth Backdrop and Outlook

4. Advance Estimates released by the Ministry of Trade and Industry today indicated that the Singapore economy expanded by 2.0% on a quarter-on-quarter seasonally-adjusted basis in Q1 2021, moderating from the 3.8% growth in Q4 2020. The sequential slowdown in Q1 was largely

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returned to its pre-pandemic level after its setback in Q2. The sequential pickup in Q3 was largely due to the modern services sector, where activity was underpinned by firm growth in the information & communications industry. Meanwhile, the domestic-oriented sectors remained weak, with many affected by the tighter measures imposed in response to the increase in COVID-19 infections. In the manufacturing sector, output in the electronics and precision engineering industries expanded in July–August compared to Q2, while other industry clusters contracted. On a year-ago basis, GDP rose by 6.5% in Q3, the third consecutive quarter of increase. 5. The pace of global economic expansion slowed over the past six months as widespread outbreaks of the Delta variant weighed on demand for consumer-facing services and caused disruptions that constrained the fulfilment of goods orders. However, global economic prospects remain broadly intact. As existing vaccines have been effective in limiting severe illness from the dominant COVID-19 variant, and as inoculation rates rise globally, consumption activity should pick up while supply constraints ease. Global growth is forecast to come in above trend for the second consecutive year in 2022, even as uncertainties remain, including around the course of the pandemic. 6. Strengthening external demand and recovering domestic expenditure are expected to sustain a firm pace of growth in the Singapore economy in the quarters ahead. Growth in the trade-related and modern services sectors will be supported by the resilient electronics cycle and improving business activity. Some improvement in conditions in the domestic-oriented and travel-related clusters is also expected as Singapore transitions in a progressive but calibrated manner towards managing COVID-19 as an endemic norm. 7. GDP growth in the Singapore economy is expected to come in at 6–7% this year and register a slower but still-above trend pace in 2022. Barring the materialisation of tail risks such as the emergence of a vaccine-resistant virus strain or severe global economic stresses, the Singapore economy should remain broadly on an expansion path. The slack in the labour market should continue to be absorbed and the negative output gap close in 2022.	driven by the construction sector, where activity continued to be capped by safe distancing measures at worksites. In comparison, the manufacturing sector reverted to positive growth on the back of a rebound in pharmaceutical output. On a year-ago basis, GDP rose marginally by 0.2% in Q1, after three consecutive quarters of decline. 5. Since October last year, prospects for the global economy have improved, reflecting substantial additional fiscal stimulus in some economies and a steady pace of vaccine deployment across several major nations. These developments have underpinned a marked strengthening in business and consumer confidence, which has started to feed through to a more rapid expansion in production and spending. 6. The upturn in external demand will sustain an above-trend pace of growth in the Singapore economy for the rest of 2021. Activity in the trade-related and modern services sectors should expand at a firm pace. However, the virus is unabated in many regions and international mobility restrictions will continue to hinder the recovery in travel-related services. 7. Singapore's GDP growth this year is likely to exceed the upper end of the official 4–6% forecast range, barring a setback to the global economy. The negative output gap in the economy will narrow through the course of 2021. However, significant uncertainties remain, including the possibility of further virus mutations and premature relaxation of social restrictions by governments, which could derail the global and domestic recovery.
Inflation Trends and Outlook 8. MAS Core Inflation, which excludes the costs of accommodation and private transport, rose to 1.1% year-on-year in July–August, from 0.7% in Q2 this year. This mainly reflected the increase in global commodity prices in recent months, which passed through to electricity & gas tariffs and non-cooked food inflation. At the same time, higher wage costs have fed inflation in some domestic consumer items such as food & beverage services. CPI-All Items inflation rose by a smaller extent, to 2.5% from 2.3% over the same period,	**Inflation Trends and Outlook** 8. MAS Core Inflation, which excludes the costs of accommodation and private transport, rose marginally to 0% year-on-year in January–February 2021, from −0.2% in Q4 2020. This mainly reflected the fading disinflationary effects of government subsidies on healthcare and education services introduced in H1 2020. At the same time, inflation in most components of the core CPI basket was modest. Food inflation moderated while prices of most retail goods continued to fall. Meanwhile, private transport inflation turned positive and residential rents registered larger

with the pickup in core inflation partly offset by lower private transport inflation. 9. In the quarters ahead, rising imported and labour costs, alongside the recovery in domestic activity, will support a broad-based pick-up in inflation. Imported inflationary pressures are likely to persist for some time amid strengthening global demand and lingering supply constraints. On the domestic front, wage growth is likely to be firm alongside the dissipation of labour market slack through next year. The accumulating business costs will pass through to consumer price inflation as the domestic economy reopens and private consumption recovers. Various service fee increases that were put on hold since the pandemic began, such as for transport, healthcare and education, could also resume. 10. Private transport inflation is likely to moderate next year against a slower pace of increase in COE premiums and petrol costs. However, accommodation inflation is expected to remain firm amid construction delays. 11. For 2021 as a whole, MAS Core Inflation will come in near the upper end of the 0–1% forecast range, and is expected to increase further to 1–2% in 2022. CPI-All Items inflation will come in around 2% in 2021 and average 1.5–2.5% next year.	increases on a year-ago basis. As a result, CPI-All Items inflation rose to 0.5% from −0.1% over the same period. 9. Core inflation is expected to step up in the months ahead, reflecting in part the low base from the fall in prices in Q2 last year and the turnaround in producer price inflation in a number of major economies. Notwithstanding some upside risks to global price pressures, inflation in Singapore is projected to rise at a more gradual pace in H2 2021. While higher global oil prices will continue to pass through to domestic prices, surplus oil production capacity should cap further large price increases. Lingering negative output gaps in a number of Singapore's key trading partners should also keep overall imported inflation contained. Domestically, more components of the core CPI basket are likely to see price increases as labour market conditions improve and private consumption recovers. However, these would be gradual, in line with subdued wage growth as the slack in the labour market will take time to be fully absorbed. Commercial property rents should also remain low. All in, beyond the near-term pickup, MAS Core Inflation is forecast to rise only gradually for the rest of the year and come in at 0–1% in 2021. 10. Private transport and accommodation costs have risen by more than expected in the first two months of the year, reflecting in part the effects of higher petrol prices and firm demand for cars and rental accommodation. Amid improvements in consumer sentiments, as well as the effects of reduced COE quotas, private transport costs should stay resilient. MAS is revising the forecast range for CPI-All Items inflation in 2021 to 0.5–1.5%, from −0.5 to 0.5% previously.
MONETARY POLICY 12. Growth in the Singapore economy is likely to remain above trend in the quarters ahead. Barring a resurgence of the virus globally or a setback in the pace of economic reopening, output should return to around its potential in 2022. 13. At the same time, external and domestic cost pressures are accumulating, reflecting both normalising demand as well as tight supply conditions. MAS Core Inflation is expected to rise to 1–2% next year, and close to 2% in the medium term. 14. MAS will therefore raise slightly the slope of the S$NEER policy band, from zero percent previously. The width of the policy band and the level at which it is centred will be unchanged. This appreciation path for the S$NEER policy band will ensure price stability over the medium term while recognising the risks to the economic recovery.	MONETARY POLICY 11. The Singapore economy will grow at an above-trend pace this year, but the sectors worst hit by the crisis will continue to face significant demand shortfalls. As the negative output gap narrows, core inflation should rise gradually from its current subdued levels but remain below its historical average. 12. MAS will therefore maintain a zero percent per annum rate of appreciation of the policy band. The width of the policy band and the level at which it is centred will be unchanged. As core inflation is expected to stay low this year, MAS assesses that an accommodative policy stance remains appropriate.

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