MAS Watch: Sweet Spot

Economics & Strategy | Asia ex-Japan

10 Oct, 2024 | Vishnu Varathan | Head Macro Research, Asia ex-Japan

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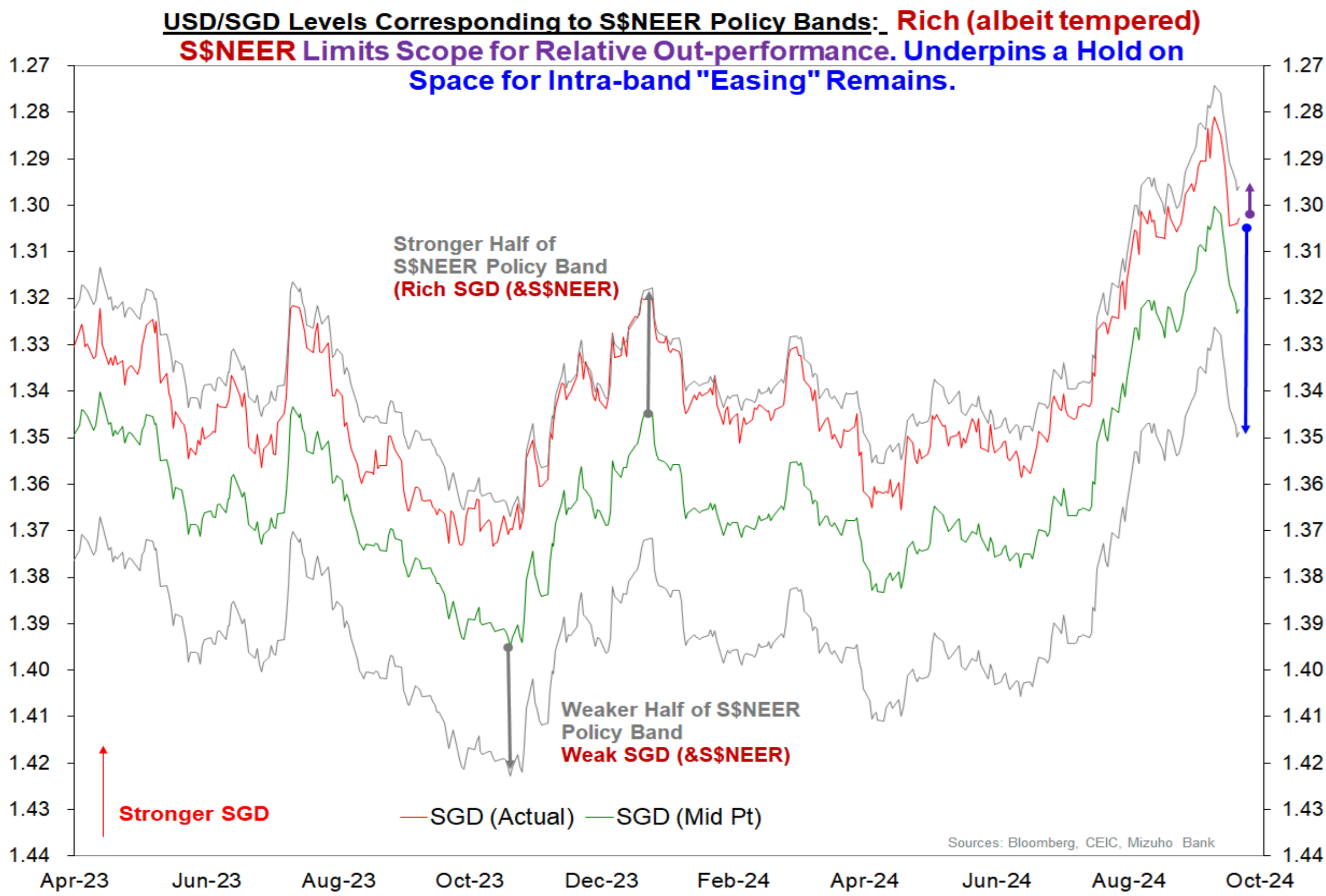
"People say nothing is impossible. But I do nothing every day." **- Winnie the Pooh**

In a Nutshell: The **MAS** is set to **stay on hold**, defying the global easing wave, but arguably still **in a policy sweet spot**. This certainly **derives from balanced growth-inflation risks**. Specifically, *disinflation that is insufficient despite being encouraging* and arguably *sticky price pressures* by some measures. On the other, *growth remains resilient even as the dispersion of two-way risks mount*. But not just that. The **unique self-acclimatizing characteristics of the MAS' exchange rate policy**, articulated *via managed appreciation bias and volatility bounds of a trade-weighted SGD (S$NEER)*, inherently **mitigate the need for over-calibration**. Finally, a **"rich" S$NEER** *(at the hawkish extreme of the policy bands)* **simultaneously** constitutes **emphatic restraint** (to anchor inflation expectations) and **scope for defacto easing within the policy bands** to initially "absorb" demand shocks. ***SGD impact*** from MAS-specific cues is ***likely to be limited***, with *USD-, JPY-* and/or *CNY-induced volatility the far greater risk*.

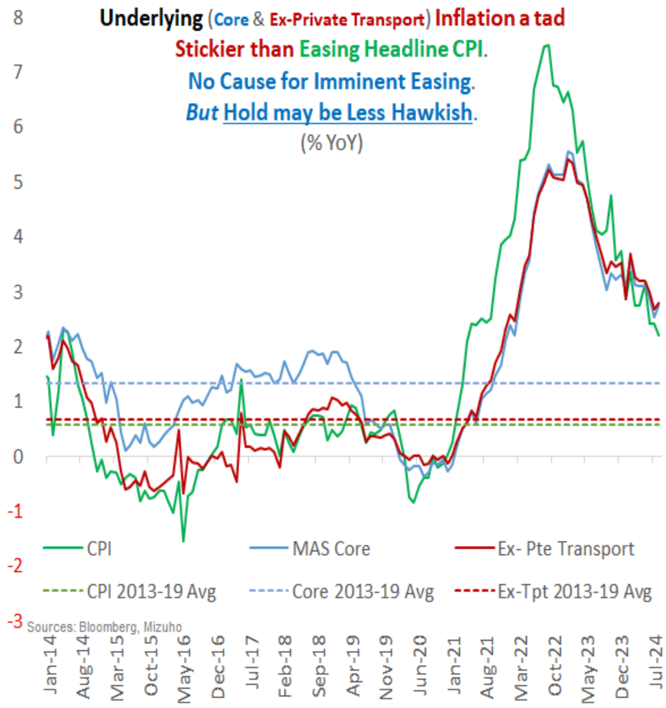


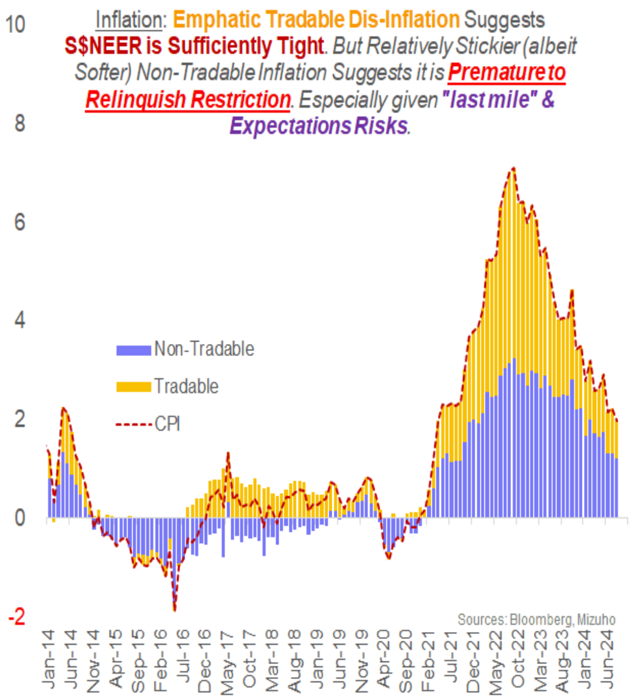
MAS Not Jumping on the Global Easing Bandwagon

- **Despite the wave of global policy easing**, underscored by an aggressive start to the Fed rate cuts in September (with a 50bp cut), **the MAS is not set to ease**. Not just yet.
- In fact, the MAS is *not even likely to concede* a distinct shift *to an unambiguously dovish hold*.
- Instead, the **MAS is likely to convey a neutral hold**, *citing finely balanced risks to the upside* (China stimulus, Fed easing, etc.) *as well as downside* (lagged demand headwinds from policy tightening, brewing trade conflicts and adversarial geo-politics).
- But this isn't necessarily **a precarious policy "tight rope"** imposed by conflicting risks from **two-way uncertainty**. *Instead*, it is **arguably still a policy sweet spot** to ***simultaneously better anchor inflation expectations*** and ***insure against downside risks to the economy***.

1. Inflation to Concede Neutral Hold, Not Condone Easing

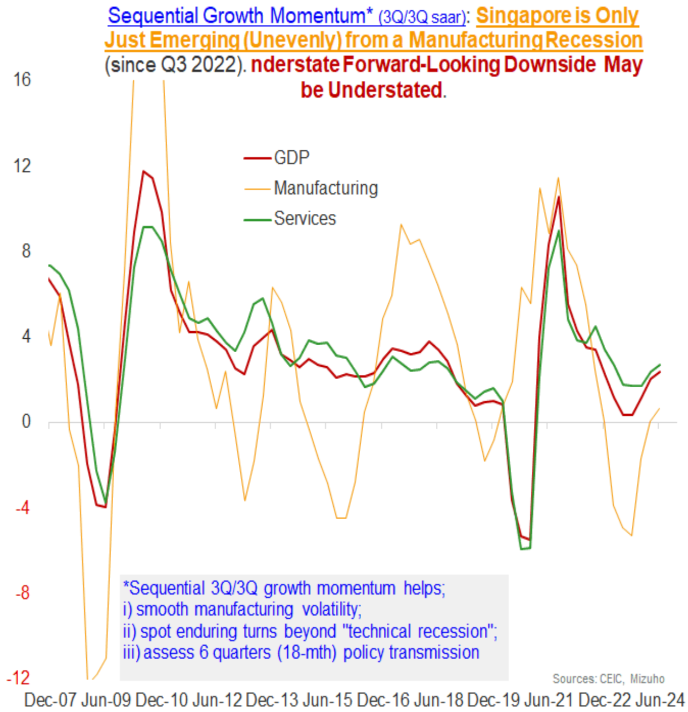
- For a start, while **inflation risks** have **further receded**, it has ***not*** been **resolutely contained**.
- Admittedly, the **path of sustained disinflation** has been **encouraging**.
- In particular, signs of fairly **broad-based reduction in price pressures**, backed by *meaningfully diminished tradable* (imported) inflation suggest further S$NEER tightening is not required.
- In fact, the ***MAS can afford to drop overtly hawkish bias*** in stance.
- *But* inflation risks are not vanquished. First, insofar that the drop in **inflation** is **disproportionately led by COE price base effects**, the *rate of underlying dis-inflation may be overstated.*
- What's more, *non-tradable* inflation, including some *spots of "sticky" services inflation*, may **warrant residual policy restraint** to remain **in both** the **settings** (S$NEER slope) and **signals**.
- And **diminished, but perhaps not "dead-and-buried", wage-price spiral risks** *(as wage inflation cools in tandem with CPI, but with both still above longer-term trend rates)*, square with **policy posture shift to neutral, albeit with inherited restraint intact**.

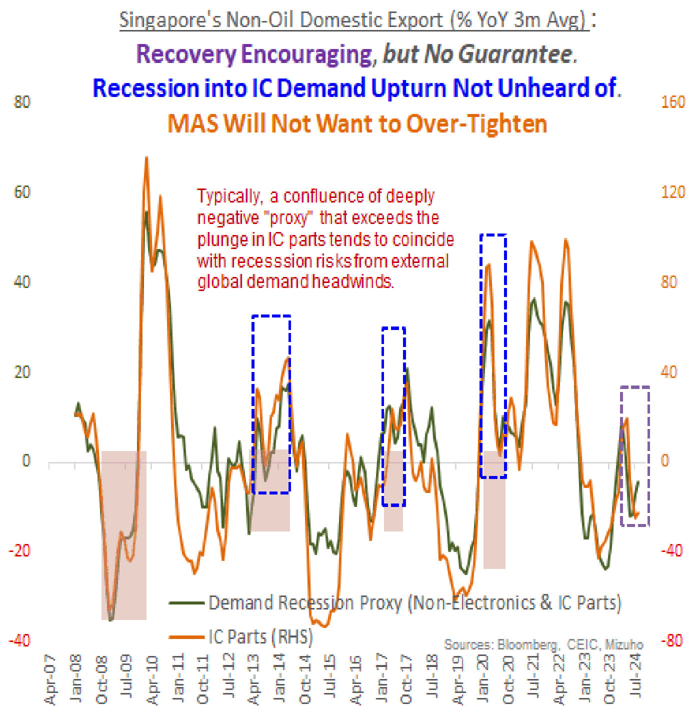




2. Growth Risks: (Fatter) Tail(s), Not Head(ed Off)

- With regards to economic growth, **two-way risks constituting fatter tails**, and not risk extremities headed off, is **what the MAS must contend with**.
- By most accounts, **Singapore's growth momentum appears reasonably healthy**, with **encouraging signs of nascent recovery from the underlying manufacturing recession** coming through, *accentuated by positive spillovers from the global demand for semiconductors*.





- And even amidst signs of normalizing from post-pandemic surge, the service sector remains robust.
- ***But*** with the **uncertainty of US elections** that features, but is not limited to, an *escalation in US-China trade antagonism*, unwelcome **disruption from on-going conflicts** (Middle East and Ukraine) the **lingering threat of demand dent from lagged policy tightening** (not necessarily extinguished with global policy easing) underscore the ***litany of downside risks hidden in plain sight***.
- And to be fair, it is **not as if the risks are clearly tilted to one side either**.
- Fact is, a **frenzy of global policy stimulus**, from *emphatic rate cutting cycles by global central bankers* (with the exception of the BoJ) to *China's "big bang" stimulus*, could unwittingly conspire with the "AI-mania" to set off larger-than-expected demand out-run.
- But the permutations are (far too) many, and the potential dispersion of outcomes exceptionally wide.
- Accordingly, ***confidence around policy setting*** based on demand projections, already a fraught exercise to begin with, ***is rendered even more precarious***.
- And so, the **sweet spot** might be to be on an **"active hold"**.
- More so not only does the **unique nature of the (S$NEER) policy tool** favour a hold, but a **rich S$NEER underscore the desirability of maintaining prevailing policy balance** (between current restraint and potential for defacto easing as and when required).

3. S$NEER as a Dynamic Policy Tool Require Fewer (than Rate) Calibration

- To be sure, the MAS's approach to **"gradual and modest appreciation" of the trade-weighted SGD (S$NEER) as a policy tool**, guided ***within undisclosed volatility bands***, is not directly comparable to rate setting policy. And it certainly does not have one-for-one mapping.
- Point being, this dynamic policy tool has **unique self-acclimatizing characteristics.**
- And so, *managed S$NEER appreciation bias subject to policy trading bands* inherently **do not require active intervention** that commensurate with rate (hike/cut) policy
- And a MAS hold is far more "active" on two counts. First, the trade-weighted S$NEER means that exchange rate strength dynamically adjusts for relative FX moves elsewhere.
- Second, ***dynamic***, **market-driven**, **adjustments** within the (presumed +/-2%) trading bands (**intra-band**) **allow for a more continuous policy calibrations** as inflation and growth conditions evolve.

4. Rich S$NEER Validates a Dynamic Hold:

- **As an extension the "intra-band" adjustment** alluded to above, a **"rich" S$NEER** *(at the hawkish extreme of the policy bands)* further **validate the policy hold** *amid uncertainty* and *rapidly evolving global economic conditions*.
- The upshot is that **a rich S$NEER** ***simultaneously*** constitutes **emphatic restraint** (to anchor inflation expectations) and ***disproportionate scope for defacto easing*** **within the policy bands** to initially "absorb" demand shocks **should adverse demand conditions play out**.
- In essence, a rich S$NEER is more suited as a "dynamic hold" under conditions of lingering inflation that may be juxtaposed against greater uncertainty downside tail risks.

Appropriately Muted SGD Impact

- In our view, proximate MAS impact on ***SGD will probably be muted***, *in the absence of large and unexpected swings from expectations of a predominantly neutral policy stance* (with a tint of remnant rather than intended hawkish bias).
- This is primarily as **relative (rich) S$NEER levels are consistent with inflation** still above MAS' desired levels. And crucially, with no compelling case (and certainly no near-term commitment) to either adjust the slope or shift the mid-point* of the S$NEER policy bands.
- But **lack of SGD response to MAS policy** is ***not*** the same as the **absence of volatility**.
- Instead, we expect **SGD volatility to remain heightened** as the trade-basket influence renders SGD sensitive to not only **broad-based USD swings** (amid rapidly and constantly evolving Fed expectations) but also **sympathetic sway from pronounced and persistent CNY and JPY volatility**.