Mizuho Flash: MAS

Economics & Strategy | Asia ex-Japan

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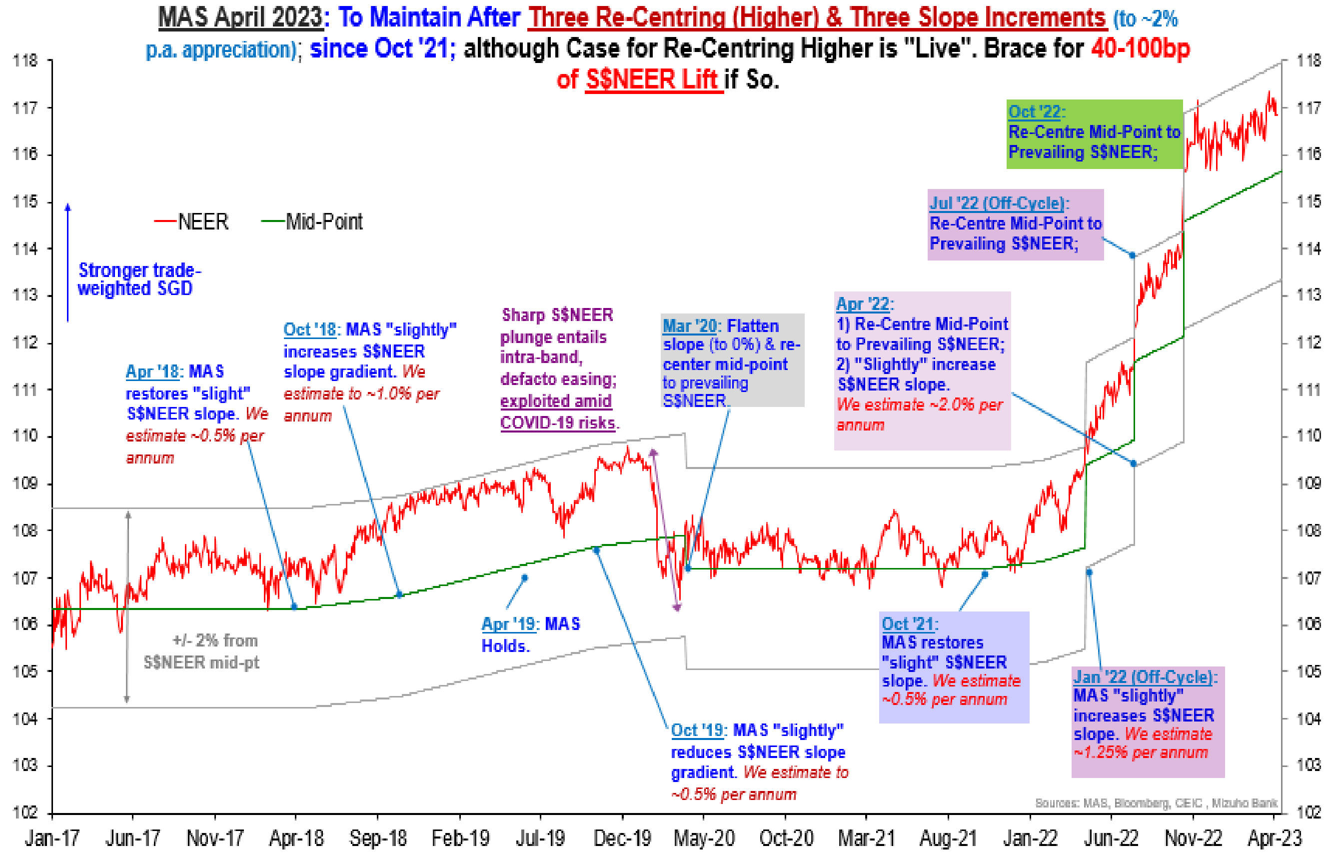
MAS: Constrained Options & Compromised Outcomes

	Option 1	Option 2	Option 3	Option 4
MAS Move	Hold **(Formerly unambiguous base case)**	Re-centre *Higher but Below* Prevailing S$NEER	Re-centre *Higher to* Prevailing S$NEER	Widen the Policy Band
Nature of Move	Neutral	Mildly Hawkish	Hawkish	Neutral (Defacto Mildly Hawkish)
Probability	40%	25%	20%	15%
S$NEER Impact	Declines 10-40bp	Rises 30-50bp	Rises 80-120bp	Rises 20-60bp



"No longer certain that one ever does win a war, I am." – **Master Yoda, Star Wars**

Base Case Hold Challenged; But Without Clarity

Our previous (pre-banking turmoil) **base case for MAS to hold** is now seriously **challenged**, **albeit with little clarity**, as **conflicting externalities** (inflationary shocks amid growing risks of adverse external demand shocks). **More complex calculus of various discrete policy options** suggest **potential for greater S$NEER/SGD volatility on MAS policy** decision.

Up-Front Tightening Down-Plays Inflation Trigger

To be clear, unnervingly elevated inflation is not the reason; at least not directly so Reason being, **aggressively front-loaded tightening** from October 2021 through October 2022, comprising an unprecedented three rounds each of re-centring (S$NEER mid-point) higher and steepening (S$NEER slope) ought to **have set up policy to absorb** most of the **pipeline inflation risks**.

But Diametrically Opposed Banking-Oil Shock Risks Frustrate

Instead, our **comfort with a hold for is compromised by a frustrating juxtaposition of** (*potentially deflationary*) ***global banking sector risks*** and (*latent inflationary threat from*) **steep OPEC+ production cuts**. What's more, these **diametrically opposed risks cannot simply negate** one another; as triggers and nature of impact differ substantially.

Compromised Action from Constrained Options

Nor can monetary policy address inflationary and deflationary risks at **simultaneously**. Which necessarily means that there needs to be a **compromise policy action, derived from four constrained policy options**, **that minimizes risks associated with the inherent and accentuated policy dilemma**:

Option 1 - Stoic Hold: The first is to **stick with the policy hold**. This ***deliberate inaction*** will be **most effective in checking downside economic risks** without undoing prior inflation anchor. Nevertheless, it entails letting the guard down on fresh cost shocks.

Option 2 - Calibrated, Incomplete Re-Centring: Re-centring the S$NEER higher, but below, the prevailing S$NEER level provides the **benefits of additional inflation buffer**, while being relatively less aggressive (than re-centring to prevailing S$NEER levels) and having precedent (in April 2011).

Option 3 - Unrestrained Re-Centring: Re-centring the S$NEER to the prevailing S$NEER level provides maximum **inflation buffer**, but at the highest cost to growth; especially in the event of adverse shocks.

Option 4 – Wider Bands: Admittedly the most controversial tool. This is ***theoretically meant to temporarily accommodate higher volatility***, **not impose a durable policy hawkish/dovish slant**. But this is precisely why this left-field tool may deliver. For a start, *pre-existing upside S$NEER tendencies* render this *technically neutral move* to an *effectively hawkish one* (of more S$NEER upside). *And revoking wider bands* (upside in S$NEER) when external headwinds mount *will inflict the least damage to credibility* (i.e. won't be seen as a hasty reversal of excessive tightening).

Communication Challenge Argues for Status Quo (Hold) …

The pity though is that challenges in communicating policy intent significantly affect the viability of '*Option 4 - Widening Bands*'. Hence we *"only" ascribe a 15% probability* to this **while retaining a hold (Option 1: 40%) as the most likely discrete outcome** given growing headwinds to growth.

… Although Non-Negligible Re-centring Speaks to S$NEER/SGD Upside

But that said, the **likelihood of** measured tightening via **mid-point re-centring higher** simply **cannot be dismissed** (combined 45% in the partial and unreserved iterations). This suggests **potential for pronounced S$NEER** (SGD) **volatility**; as more dispersed policy expectations are forced to converge on MAS policy announcement. **Ironically our preference for a hold (as a discrete outcome) is at odds with a greater combined probability of measured S$NEER (and SGD) appreciation bias**. In any case **binary SGD outcomes are a distinct likelihood**; and *unfortunately "winning" outcomes are precious few*.