

MAS' Surprise Step Appreciation

MAS July 2022: In the Second Off-Cycle Move this year the MAS Re-Centred the Mid-Point (Higher) to Prevailing "S\$NEER; Slope Maintained (at 1.5% p.a. in April).



“However it may prove, one must tread the path that need chooses” – Gandalf Lord of the Rings

In a Nutshell: The MAS’ off-cycle tightening by way of re-centring the policy mid-point higher to prevailing S\$NEER levels was an aggressive hawkish surprise at two levels. First re-centring is the more hawkish iteration that front-loads tightening. Second, not only is this a second off-cycle tightening in the year, but also an unprecedented back-to-back “step appreciation” within three months. Overlooking gathering global headwinds in so doing reveals the necessity imposed by pronounced and pressing inflation threat is, not regard for downside growth risks. Intense tightening has been deliberately front-loaded, vastly diminishing the need for more aggressive tightening down the road. Nonetheless, moderated tightening bias remains the default stance. And a “slight” S\$NEER slope steepening is fair game in October.

The Move: The MAS surprised with a second*, and this time more aggressive, off-cycle tightening; re-centring the policy mid-point higher to the prevailing S\$NEER (we estimate this invoiced a 120-150bp one-off, instantaneous lift in S\$NEER policy bands). This is the second one-off elevation of S\$NEER policy bands this year (April being the first), more loosely known as a “step appreciation”; which tends to be associated with, and akin to, upsized, front-loaded tightening (insofar that it achieves at one go, and upfront, what the gradual slope appreciation might have taken a year to).

In other words, this second step appreciation marks an unprecedented back-to-back front-loaded tightening, within a span of three months. And such an aggressive hawkish stance, despite acknowledging

growing downside risks to the global economy, **speaks to unwavering**, and **slightly more than adequate policy response** *to overriding price shock and pass-through risks* that have *turned markedly more acute*.

The Mechanism: The **resultant S\$NEER “step” appreciation** (and by extension appreciation in SGD) is the **most fundamental mechanism for taming inflation**; delivered via i) import; ii) exports-demand, and; iii) foreign investment channels, which work in concert to dampen imported price shocks, take some edge off excessive demand and cool some asset market inflows at the margin.

- i) **Import Channel:** This is arguably the most important channel for the intended inflation taming effect for a small, open, economy that imports almost all of its consumption goods (food and fuel in particular). Insofar that a **step appreciation immediately blunts imported inflation** pressures, it is **most efficacious against supply-side price shocks**.
- ii) **Exports-Demand Channel:** And to the extent that the MAS also sees demand recovery (in the context of sustained pick-up in industrial activity) conspiring with price shocks to potentially render inflation more persistent, pervasive and profound, the **immediate demand dampening effect from more expensive exports taking the edge off activity is a helpful complement**.
- iii) **Foreign Investment Channel:** Finally, “step appreciation” instantaneously rendering SGD-denominated assets/property **more expensive**; hence, *less compelling for foreign investors*. In turn, **alleviating risks property market froth**. Although this is a **convenient and welcome by-product, not the overriding policy intent**. In contrast, a steeper slope may perversely incite even more demand for SGD assets based on sharper future SGD appreciation expectations.

The Motivation: To **front-load tightening** so as to “*get ahead of the (inflation) curve*”. Specifically, to **tame more aggravated and sustained cost-push pressures** as upstream price shocks cascade more broadly across a swath of imported goods; as elucidated in a rather **discomforting 0.5%-pt bump-up in the outlook of already elevated inflation** (core to 3.0-4.0%; headline to 5.0-6.0%). More so, **taken alongside re-opening demand** that the MAS associated with more persistent wage-price spiral risks. And **acknowledging, but not being deterred by growing risks of a Fed-induced global downturn**, points to an appreciation for how acute and urgent inflation risks a; and is not blatant disregard for downside risks to growth.

The (Policy) Momentum: **While** the **tightening bias in policy is likely to remain intact** through 2022, **hawkish momentum is likely to slow** on two counts. **First**, the **incremental inflationary pressures/price shocks are likely to turn less acute** into 2023 (looking past one-off GST effects**). And given policy lags, the case for more emphatic tightening becomes less compelling. **Second**, **mounting risks of a global recession or downturn** from increasingly outsized Fed rate hikes, **diminishes the need for further, aggressive MAS tightening** into end-2022. But that is not the same as eliminating all prospects for policy tightening altogether.

In fact, **another round of “slight” slope increment for October is fair game**. Fact is, **whilst this re-centring has lifted the S\$NEER to levels** that square with current price shocks, a **slightly faster pace of S\$NEER appreciation (slope) may better adapted help to better anchor inflation expectations**. Especially in the context of vulnerabilities to more **persistent and pervasive price pressures** incited by a **conspiracy of rolling geo-political price shocks, supply-side cost-push, emerging demand-pull and pipeline GST hikes****. Fact is, **further tightening may be a path imposed by need (to anchor inflation expectations)**.

* The first off-cycle tightening in January, at which time the MAS “slightly” increased the S\$NEER slope (by 0.5%-pt to 1.0% per annum by our estimate).

** In view of the 1%-pt GST hike each in 2023 and 2024 to 8% and 9% respectively)

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