

MAS Watch: Double-Barrelled Move

MAS "Slightly" Increased S\$NEER Slope (to 1.0% p.a. from 0.5% p.a. in Oct) in an Off-Cycle Move on 25th Jan. April's Scheduled Meeting is Set to be a "Double-Barrelled" Move, Re-centring Higher & Further "Slight" Sope increment (to 1.5% p.a)



“Always two there are. No more. No less. A Master and an apprentice” – Master Yoda, Star Wars

In a Nutshell: With **geo-political cost shocks**, in the context of pre-existing inflationary pressures and growing wage-price spiral risks, **assessed to overshadow potential negative demand shocks, policy calculus is tilted to more front-loaded tightening sooner.** And so, at the **April policy meeting** we now expect the MAS to deliver a **“double-barrelled” hawkish** move comprised of;

- i) re-centring the S\$NEER mid-point higher, but *below* the prevailing S\$NEER, and;
- ii) “slightly” steepening the S\$NEER slope (further to an estimated 1.5% per annum appreciation rate from 1.0% slope).

As Master Yoda observes, the “two”, with **re-centring to “Master” abrupt inflation shocks of large amplitude** and the **“apprentice” of sustained slope increment to anchor inflation expectations.**

Admittedly, the *rare, off-cycle tightening in January* (via a calibrated S\$NEER slope increase) should, at the margin, have diminished the need for catch-up tightening. But **three overriding factors underpin further, emphatic and front-loaded tightening.**

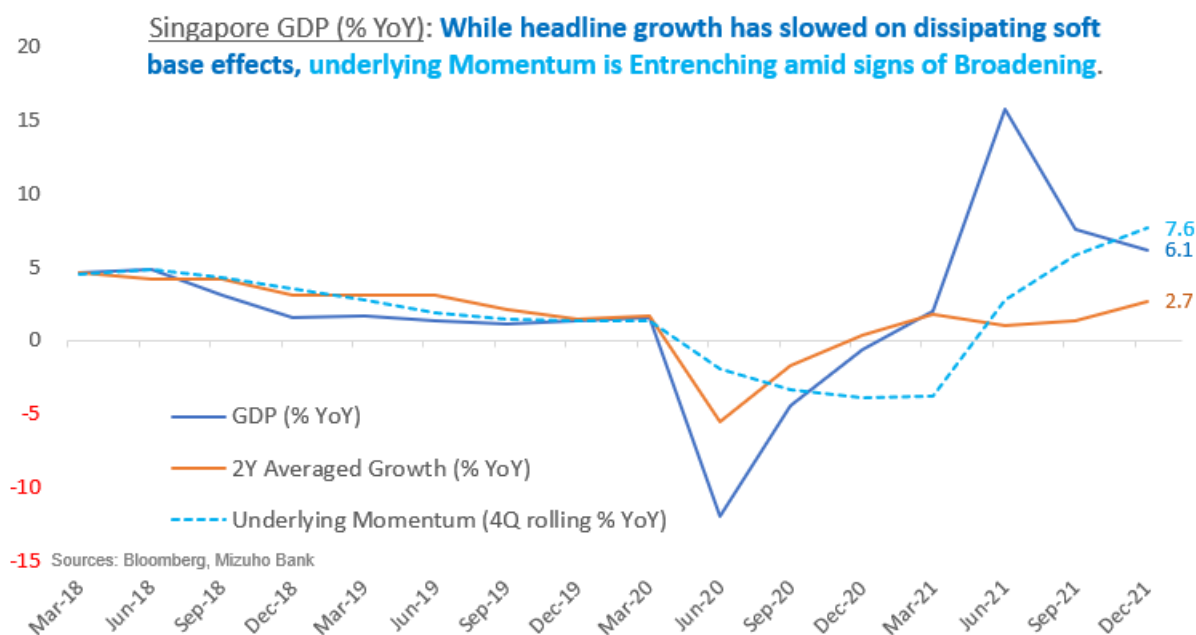
First, **January’s off-cycle tightening** was only meant as a **timely but restrained calibration**, not an **aggressively conclusive hawkish posture**. In other words, the stage was set for more tightening to follow from the outset. **What’s more, profound and pervasive cost-shocks from the war in Ukraine** has **blindsided the world since** late-February; and this simply **could not have been accounted for in January’s off-cycle calibration**. **Crucially, wage-price spiral risks have been accentuated** by a **perfect storm of cost-push** amid pre-existing supply kinks conspiring with a **broadening recovery** that has resulted in robust jobs recovery to the point of a hiring frenzy in some spots of the market.

The **resultant “double-barrelled” tightening response sets the S\$NEER (and corresponding SGD) up for appreciation in the immediate aftermath MAS tightening**; although SGD outcomes beyond may have to defer to broader USD trend amid geo-political risks, a hawkish Fed and downside risks to China’s growth.

Why Further Tightening in April?

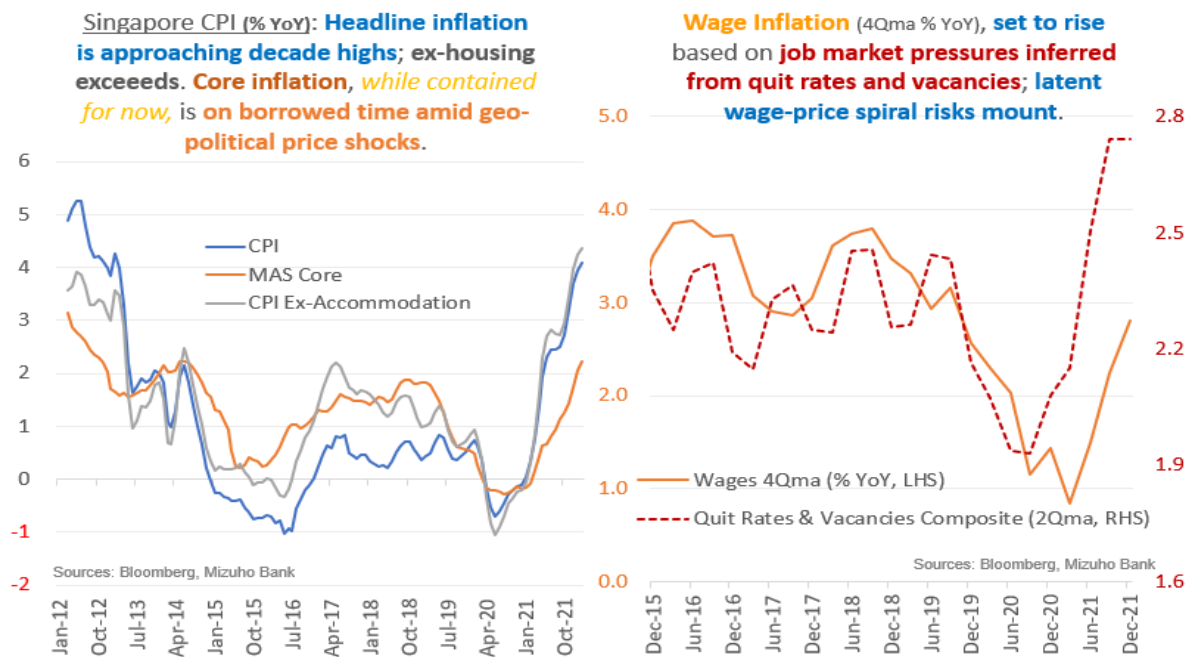
Off-Cycle Jan Tightening Restrained: Despite the **off-cycle tightening in late-January, further tightening in April was never off the table** from the outset. Especially given that the **MAS had meant for January’s off-cycle tightening** by “slightly” increasing S\$NEER slope (to an estimated 1.0% per annum from the 0.5% per annum slope reinstated in October last year) **to be a timely but restrained calibration** that buys time to assess the evolving recovery amid mounting inflation risks more comprehensively.

And **since then, inflation risks have in fact significantly overshadowed**, while **economic recovery has broadened and entrenched**.



Geo-political Price Shocks Inflamm Inflation Risks: Especially with the **war in Ukraine**, the **geo-political cost shocks via energy, hard commodities and food threaten to be even more profound and pervasive**. Apart from the *enlarged magnitude of these upstream price shocks* that tend to ratchet higher and ripple farther, **inflation risks are inflamed** by the **interaction with pre-existing and fairly prolonged inflationary pressures** from COVID-related supply-chain disruptions.

With **headline CPI surpassing 4%** in February, *even before Russia-Ukraine oil shocks are fully passed-through*, the danger is that the MAS’ upwardly revised inflation projections (CPI: 2.5-3.5%; Core: 2.0-3.0%) from January will be breached.



Wage-Price Spirals: In particular, **mounting wage-price risks** mean that the MAS’ **worries of inflation expectations becoming un-moored are even more grim**. Therefore, the MAS is therefore less likely to look past these price shocks” as transitory” ripples and more likely to respond more emphatically. Fact is, **economic recovery has not only endured, but broadened** with the phased lifting of COVID restrictions and resumption of travel; **underpinning the robust labour market** with emerging *evidence of overheating/frenzied hiring in some pockets* of the job market.

To be sure, geo-political uncertainties and China risks mean that the recovery path may remain bumpy yet. But the risks to, and costs of, not decisively tackling inflation risks are clearly overwhelming policy calculus.

Why “Double-Barrelled”?

So how may the MAS respond to dangerously bubbling inflation risks? Our best guess is for an **admittedly hawkish** combination tightening via the so-called **“double-barrelled” move**, which comprises;

- i) a *continuation of a calibrated steepening of the S\$NEER slope* (this time from an estimated 1.0% per annum appreciation to 1.5%), and crucially;
- ii) a *re-centring of the S\$NEER mid-point higher* (typically to prevailing S\$NEER levels, although we see scope for, and prefer, to somewhere below currently rather elevated S\$NEER levels)

For the record, **initial policy normalization via calibrated S\$NEER slope increments** (Oct 2021: estimated 0.5% per annum appreciation bias from 0%; Jan 2022: 1.0% p.a. from 0.5%), *tempered tightening to account for lingering COVID variant risks* to the economy and some degree of *allowance for “transitory” elements of cost-push*. And to be perfectly clear, an economy under-going a gradual recovery and correspondingly consistent pick-up in inflation may be approached with a series of calibrated slope adjustments.

But **inflation risks** both **abrupt and large in amplitude**, with *growing dangers of “second round” effects, increasingly necessitate more emphatic and decisive front-loaded tightening*; precisely what the *S\$NEER mid-point re-centring* delivers. At the same time, the *continuation of S\$NEER slope calibration* in parallel is **consistent with restoring inflation anchor** back to the default “modest and gradual” S\$NEER appreciation bias (which we estimate to be 2% per annum slope appreciation bias).

Re-centring: “Higher but Below”?

The default expectation is for the MAS to *re-centre the S\$NEER mid-point higher to prevailing levels of the S\$NEER*. But that is **not the only option**. Instead, as was the *unprecedented case back in April 2011*, the MAS could choose to re-centre *“higher, but below* the prevailing S\$NEER levels”*.

In doing so, the MAS derives **two advantages**. The first, is the **ability to fine-tune the degree of front-loaded tightening**. Which may be **especially important given** that the current **prevailing** (gauged from the 2-week average) **S\$NEER appears exceptionally rich at +150bps**. And so, the *“higher but below”* approach to re-centring will allow the MAS to temper, and reclaim control over, the extent of tightening.

Second, with the added ambiguity of *“higher but below”*, the MAS also **incorporates a greater degree of uncertainty into resultant S\$NEER (and corresponding SGD) parameters**; thereby further *diminishing risks of inadvertent and unwelcome speculative interest* based off policy expectations.

Corresponding SGD Upside

To be sure, **another slope increment** (the less hawkish part of the “double-barrelled move) **will not materially raise S\$NEER (and SGD) headroom immediately**. Instead, it will at most nudge S\$NEER higher within the existing policy bands on accompanying hawkish signals. However, **re-centring S\$NEER mid-point higher** will **immediately lift the upper bounds of the S\$NEER policy bands**. And assuming that the policy rhetoric (likely underpinning on-going hawkish bias), the **propensity for the S\$NEER to maintain relative traction within the bands**, a *lift in the mid-point will translate into a sympathetic pick-up in the S\$NEER*. Which will correspond leg-up in the **SGD** (barring broad-based USD strength).

That said, the **knee-jerk, post-MAS SGD strength on re-centring is no guarantee of sustained SGD strength** (vs. USD) as MAS tightening, including “step appreciation” only guide the trade-weighted SDG (S\$NEER). Whereas *overarching USD trend amid geo-political risks, a hawkish Fed and near-term headwinds to China’s growth* (that may also be baked in as measured CNY softening) is more likely than not to wash out SGD gains despite a stronger S\$NEER (as trade basket currencies all fall in tandem).

* Technically, the MAS may even choose to re-center above the prevailing S\$NEER mid-point, although given the current +150bps (above policy mid-point levels we estimate) this would be an extremely hawkish oversteer that the MAS may not be inclined to undertake amid risks to demand recovery from geo-politics and China.

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