

Doubling Down on “Double-Barrelled”

In a nutshell: Given persistent inflation overshoot, especially amid risks of wage-price spirals and unmoored inflation expectations, the **MAS is not only set to tighten further, but set to do so aggressively.**

Admittedly, growing recession risks diminish threat from inflation; certainly, price shocks. But trouble is, the **bullish ‘USD shock’ is effectively a proxy price shock.** Specifically, indirect *imported price shocks via brutal USD appreciation* rippling through upstream commodities/energy across supply-chains. Thereby **requiring sufficiently hawkish response** entailing;

- i) **emphatic S\$NEER slope increment**, dropping “slight” calibration in “steepening the S\$NEER” policy slope (*by 1.0-1.5%-pt to an estimated 2.5-3.0% p.a.**) *aimed at stifling inflation expectations*, and;
- ii) **a record third “step appreciation”**, re-centring the policy mid-point higher as a means to *enhance efforts to dampen price shocks* (existing or potential).

This **literal doubling down on** (a **second**) “**double-barrelled**” **tightening** stacks up as cumulatively *uncharted hawkishness*; comprising a **third “step appreciation”** to supplement a more aggressive, **fourth** (instalment of) **slope steepening.**

Admittedly, *gathering headwinds could argue for tempering* re-centring and/or slope increment in the “double-barrelled” *move.* Moreover, aggressive tightening inevitably *assumes risk of sharp policy reversal in worse-case global recession.*

Regardless, **MAS’ aggressive tightening will provide immediate S\$NEER upside. But not sustained SGD defiance of exceptional bullish USD trend.** Point being, “*higher for longer*” USD from unrelentingly hawkish Fed will likely *limit SGD gains against USD in sharp contrast to emphatic trade-weighted SGD surge* in response to hawkish policy triggers.

Already Exceptionally Hawkish

For context, the MAS is already exceptionally hawkish. Fact is, the speed and force of tightening thus far (since last October) is simply unprecedented. **Within the span of less than a year** (9 months as of the last off-cycle move in July, to be precise), the **MAS has delivered** a series of;

- i) **two “step appreciation” moves** by “*re-centring the S\$NEER higher* to prevailing (richly valued) S\$NEER levels” (in Apr ‘22 and Jul ‘22) and;
- ii) **three “slight” increments to the S\$NEER slope** (in Oct ‘21, Jan ‘22 and Apr ‘22) to reinstate

MAS Moves & Inflation Outlook

	Policy Action		Inflation Forecast (2022)	
	Slope	Mid-point	Headline	Core
Oct '21	Raise "slightly" (from 0% to ~0.5% p.a.*)	No change (at April 2020 levels**)	1.5-2.5%	1.0-2.0%
Jan '22	Raise "slightly" (to ~1.0% p.a.)	No change (at April 2020 levels**)	2.5%-3.5%	2.0-3.0%
Apr '22	Raise "slightly" (to ~1.5% p.a.)	Re-centre higher to prevailing (Apr '22 S\$NEER) levels	4.5-5.5%	2.5-3.5%
Jul '22	No change	Re-centre higher to prevailing (Jul '22 S\$NEER) levels	5.0-6.0%	3.0-4.0%

* p.a. refers to per annum appreciation bias

** After the mid-point re-centring lower and slope flattening (to 0% appreciation bias in response to COVID)

Off-cycle Policy Moves

Sources: MAS, Mizuho Bank

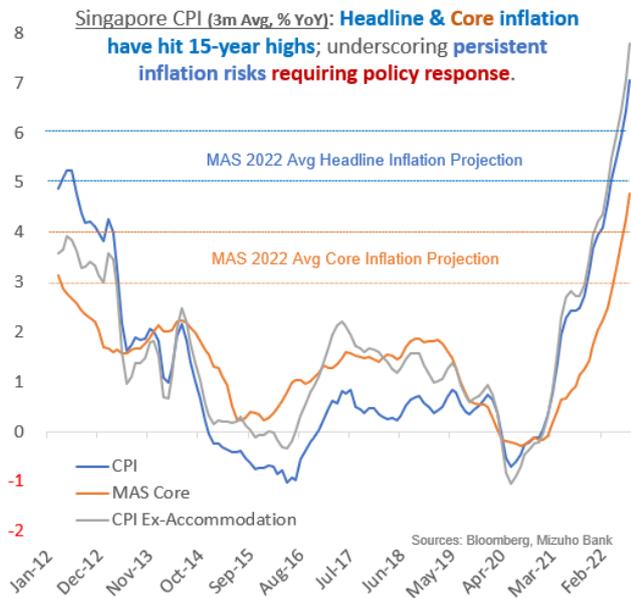
Yet Undeterred into the Uncharted

Yet, evidence and circumstances point to further, potentially **even more aggressive, tightening at the next scheduled meeting** (12-14th Oct). In effect, the MAS will be *charging further out into uncharted tightening territory, undeterred.*

But not just to blindly jump on to the global hawkish doubling down bandwagon. Instead, in response to risks of unmoored inflation expectations as well as USD-induced inflation shocks.

Inflation Forcing Hawkish Hand

For a start, the **unrelenting force of inflation shocks**, which have lifted inflation to 15-year highs, **arguably demand further policy response**.



Fact is, core (headline) inflation at 5.1% (7.5%) for August is not only **uncomfortably elevated** at 15-year highs, but is **perilously close to breaching** the MAS' **already upwardly revised projection of 3.0-4.0%** (5.0-6.0%) average for 2022.

Even in the unlikely event of price levels plateauing at August levels (based on overly benign assumption of sequential price pressures fizzling) average core and headline inflation will hit 3.8% and 5.9% respectively.

Whereas **if price pressures continue to build**, as they are more likely to, **inflation is set to overshoot**; **underscoring inflation risks**.

Consequently, even at first glance, there appears to be a case for the **MAS to pair further upward revisions to inflation forecasts with policy tightening**.

Amid Wage-Price Spiral Risks ...

And the build-up in **wage-price spiral threats** revealed by inflation dynamics unpacked from the hot headline **only reinforces the case for tightening**.

So, **despite soft spots in the recovery** and glimpses of **global headwinds in the horizon**, **tight labour market conditions** – highlighted in elevated quit rates and vacancies – **underscore inconveniently high and sticky wage pressures**. Precisely the conditions that **invoke wage-price spiral risks**.

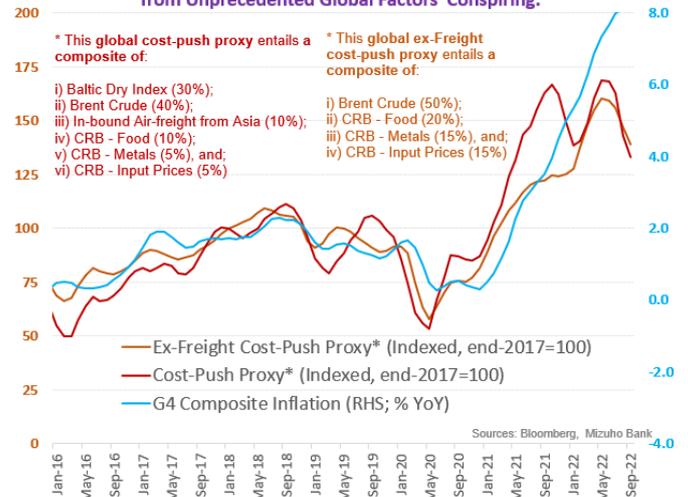
Wage Inflation (4Qma % YoY), set to rise based on job market pressures inferred from quit rates and vacancies; latent wage-price spiral risks mount.



... & Heightened Inflation Uncertainty

Admittedly, *economic theory supports looking past near-term inflation volatility from temporary supply-shocks and one-off price impact* (e.g. GST hikes). In which case, the record, front-loaded tightening by the MAS thus far is arguably sufficient.

Cost-Push Forces (COVID-War) Frustrated late-2021 Peak in Freight-driven Cost Shocks. But Inflation Remains Sticky Despite Cost-Push Abating; Imaginably Due to Uncertainty from Unprecedented Global Factors Conspiring.



But the lived reality of exceptional, one-in a-lifetime cost shocks from COVID (constraints and re-opening) war and US-China conflict (compromising China's ability to export dis-inflation to the world) **conspiring in a hard-to-predict manner** cast far **greater uncertainty over how persistent and profound the resultant inflation shocks** may be.

Of Tightening & Tools

The **logical policy conclusion** then is that **emphatic tightening is virtually unavoidable** if **persistent and profound price pressures are to be tackled**; especially as inflation gets worked into wage expectations.

The critical question though is **how the MAS’ policy tools may be optimally deployed.**

And the upshot is that **insofar that the MAS needs to tackle both inflation expectations and existing/potential price shocks**, the optimal policy mix may be achieved by the so-called **“double-barrelled” tightening** move comprising;

- i. **more pronounced S\$NEER slope increment**, dropping “slight” calibration in “steepening the S\$NEER” policy slope (by 1.0-1.5%-pt to an estimated 2.5-3.0% p.a.*) aimed at stifling inflation expectations, and;
- ii. **a record third “step appreciation”**, re-centring the policy mid-point higher as a means to enhance efforts to dampen price shocks (existing or potential).



(i) Great Expectations & Gradients

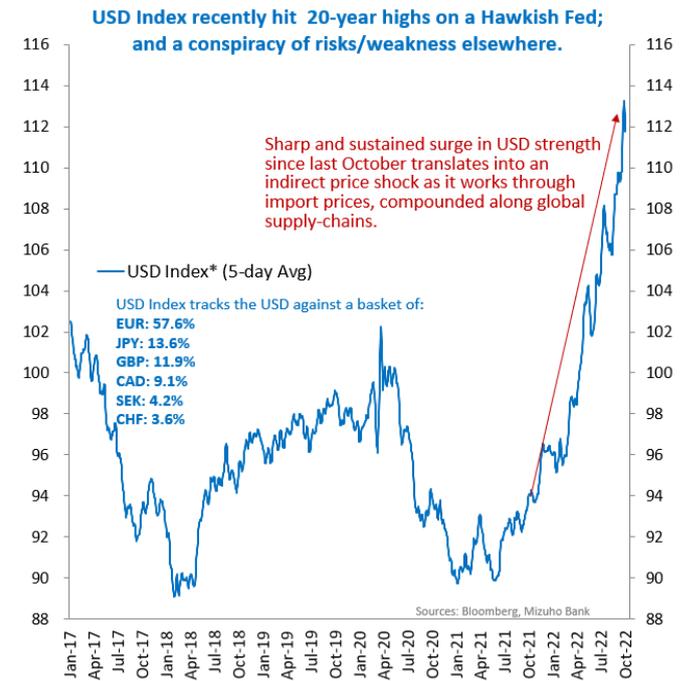
Fact is, **exceptional circumstances have amplified risks of inflation expectations becoming unmoored**; regardless of the technicalities behind inflation drivers. Which in turn **requires appropriately emphatic policy response.**

To that end, a **distinctly steeper S\$NEER slope** is arguably **best suited to rein in and anchor inflation expectations**; as expectations of future price increases are dynamically pre-empted or at least mitigated. In this case, given rising concerns about inflation expectations, we think there is a good chance the “slightly” calibration will be dropped in favour of a **more pronounced (1.0-1.5%-pt) increase in the S\$NEER gradient as stated above.**

(ii) USD-Price Shocks & S\$NEER Shifts

Admittedly, **scope for incremental price shocks have diminished** as “living with COVID” gains traction,

and Russia-Ukraine energy (along with wider commodity) shocks are mostly priced in. **Nonetheless, unexpected price shocks cannot be dismissed** given unpredictable geo-politics.



Crucially, acute and sweeping USD strength (up 18-19% since last October, up 16% YTD and up nearly 3% since the last off-cycle re-centring higher in mid-July) **inevitably imposes an indirect price shock** (via upstream USD-denominated energy and commodity costs); **especially as price pressures pass-through from the strong USD impact on is amplified across global supply-chains.**

Hence, the **justifiable case for “step appreciation”** (re-centring S\$NEER higher) as an **upfront shift higher in the S\$NEER** will help **dampen existing and potential price shocks**; thereby **mitigating second-round effects** in an already “hot” inflationary eco-system.

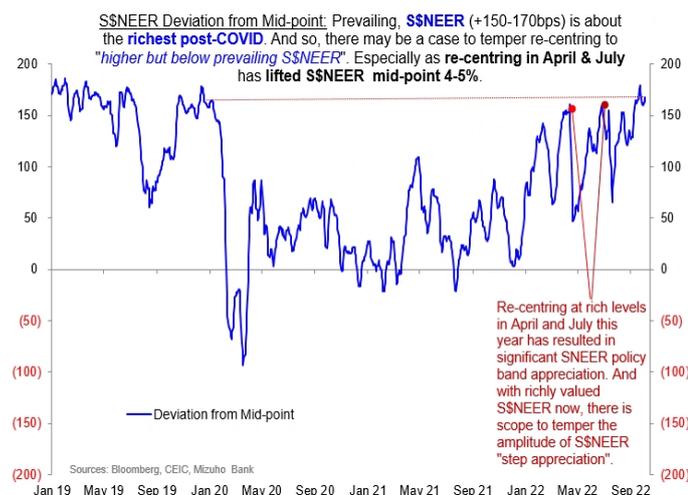
Possible Restraints ...

Whilst inflation risks have rightly dominated the monetary policy agenda, **sharpening trade-offs** accompanying exceptionally aggressive tightening simply **cannot be ignored.**

In particular, the **threat of (Fed-led) policy-induced global recession, while not impending, is nevertheless imposing.** And **doubling down on an aggressive iteration of “double-barrelled” tightening** (that builds on two “step appreciation” and three instalments of S\$NEER slope increment since last October) **heading into gathering global headwinds is admittedly risky business.**

And so, **nuanced hawkish restraint is a distinct possibility, even if not the base case.** Specifically:

Tempered Re-centring (40% probability): Given the two prior re-centring (in April and July) to richly valued S\$NEER, resulting in S\$NEER mid-point being lifted 4-5% since October 2021, there is a case to be made about tempering the current re-centring to “higher, but below prevailing S\$NEER levels”. Especially given exceptionally rich levels of the prevailing S\$NEER vis-à-vis the policy band.



Slope Restraint (25% probability): Similarly worries about global downturn may induce the MAS to exercise more restraint in raising the S\$NEER slope, retaining the “slightly” calibration (estimated to be ~0.5%-pt increment). But this is a lower probability (non-base) case; given our assumption of greater emphasis on anchoring inflation.

... & Potential Pivots

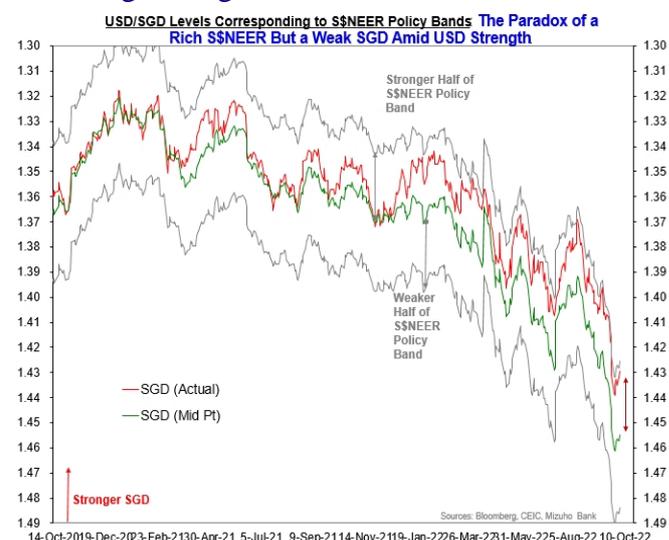
Finally, the base case of a **more aggressive iteration of “double-barelled” tightening** (with more emphatic slope increment) is **inevitably accompanied by risks of an abrupt dovish pivot** down the road; should worse-case scenarios of a global recession and/or hard-landing in asset markets play out.

But this is par for the course given exceptional tensions in global risks and the imminent threats of inflation expectations becoming unmoored. Simply put, **inaction is a greater policy sin** (of neglect) than is policy reversal a sign of mis-step.

SGD: NEER Dominance, But USD Deference

Regardless, given that “step appreciation” cannot be fully front-run by markets (due to prevailing policy band constraints), **it is fair to predict a bullish SGD reflex; although perhaps not sustained bullish trend.**

Despite unprecedented tightening, and resultant 5-6% jump in S\$NEER (trade-weighted SGD), the policy-implied USD/SGD range correspond to far weaker SGD (vs. USD) compared to before MAS started tightening in 2021.



Point being, even with this round of more aggressive tightening, what’s given is emphatic relative **SGD out-performance** (vs. trade-basket peers); **not sustained strength against the USD.** Especially if a “higher for longer” USD continues to impose.

To be sure, a **knee-jerk, post-MAS jump in SGD of up to 1.0-1.5% is consistent** with assumption of “re-centring” that retains a rich S\$NEER.

But *beyond the instant gratification of “step appreciation” fillip* and despite scope for more pronounced S\$NEER appreciation bias, the *wider USD trend will dictate USD/SGD outcomes.* And until otherwise notified by discernible shifts in relative global policies, a **dominant S\$NEER is not absolved of SGD’s deference to (King) USD.**

On the rates end, **if indeed the MAS surprises with a more emphatic slope increment** (as we predict), there may be *resultant shift in USD/SGD forward points to the left* (signalling greater future SGD appreciation expectations). In turn, and as per covered interest rate parity, this may be consistent with *expectations for SGD rates to remain below US rates;* even as it follows the direction of travel in rising US rates.

Important Information

This publication has been prepared by Mizuho Bank, Ltd. (“Mizuho”) and represents the views of the author. It has not been prepared by an independent research department and it has not been prepared in accordance with legal requirements in any country or jurisdiction designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research.

Disclaimer

Unless otherwise stated, all views or opinions herein are solely those of the author(s) as of the date of this publication and are not to be relied upon as authoritative or taken in substitution for the exercise of judgement by any recipient, and are subject to change without notice. This publication has been prepared by Mizuho solely from publicly available information. Information contained herein and the data underlying it have been obtained from, or based upon, sources believed by us to be reliable, but no assurance can be given that the information, data or any computations based thereon are accurate or complete. This publication provides general background information only. It is information in summary form and does not purport to be complete. This publication has been prepared for information purposes only and is not intended by Mizuho or its affiliates to constitute investment, legal, accounting, tax or other advice of any kind and all recipients of this publication are advised to contact independent advisors in order to evaluate the publication, including, without limitation, the suitability of any security, commodity, futures contract or instrument or related derivative (hereinafter, a “financial instrument”), product or strategy herein described. This publication is not intended to be relied upon as advice to investors or potential investors and does not take into account investment objectives, financial situation or needs of any particular investor. It is not intended for persons who are Retail Clients within the meaning of the United Kingdom’s Financial Conduct Authority rules nor for persons who are restricted in accordance with US, Japanese, Singapore or any other applicable securities laws.

This publication has been prepared for information purposes only and is not intended by Mizuho to market any financial instrument, product or service or serve as a recommendation to take or refrain from taking any particular course of action or participate in any trading or other strategy. This publication is not an offer to buy or sell or a solicitation of any offer to buy or sell any security or any of the assets, businesses or undertakings described herein, or any other financial instrument, nor is it an offer to participate in any trading or other strategy, nor a disclosure document under applicable laws, rules, regulations or guidelines. Nothing contained herein is in any way intended by Mizuho or its affiliates to offer, solicit and/or market any financial instrument, product or service, or to act as any inducement to enter into any contract or commitment whatsoever. Neither the author, Mizuho nor any affiliate accepts any liability whatsoever with respect to the use of this publication or its contents or for any errors or omissions herein.

Mizuho and its affiliates, connected companies, employees or clients may take the other side of any order by you, enter into transactions contrary to any recommendations contained herein or have positions or make markets or act as principal or agent in transactions in any securities mentioned herein or derivative transactions relating thereto or perform or seek financial or advisory services for the issuers of those securities or financial instruments.

All of the information contained in this publication is subject to further modification without prior notice and any and all opinions, forecasts, projections or forward-looking statements contained herein shall not be relied upon as facts nor relied upon as any indication of future results. Opinions stated in this publication are subject to change without notice. Future results may materially vary from such opinions, forecasts, projections or forward-looking statements. The information contained in this publication may not be current due to, among other things, changes in the financial markets or economic environment. Mizuho has no obligation to update any information contained in this publication. Past performance is not indicative of future performance.

This is a strictly privileged and confidential publication. This publication contains information addressed only to a specific individual and is not intended for distribution to, or use by, any person other than the named addressee or any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation. Save with Mizuho’s prior written consent, you may not disclose, divulge, reproduce or furnish any information contained herein to any other party. Please notify the sender immediately if you have mistakenly received this publication.

Singapore: Mizuho is licensed as a bank under the Banking Act (Chapter 19) of Singapore, and is regulated by the Monetary Authority of Singapore.

Japan: Mizuho is authorised and regulated by the Financial Services Agency of Japan.

United Kingdom / European Economic Area: In the UK, Mizuho is authorised by the Prudential Regulation Authority and subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of MHBK’s regulation by the Prudential Regulation Authority are available upon request. This publication may also be distributed by Mizuho International plc (“MHI”). MHI is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

United States: This publication is not a “research report” as defined in Commodity Futures Trading Commission (“CFTC”) Regulations 1.71 and 23.605. The content of publications distributed by Mizuho Securities USA Inc. (“MSUSA”) is the responsibility of MSUSA. The content of publications distributed directly to US customers by Mizuho is the responsibility of Mizuho. US investors must effect any order for a security that is the subject of this report through MSUSA.

© 2014 Mizuho Bank Ltd