Singapore Watch

MAS Preview: No swift-flation

15 March 2024

GEM Economics
Asia | Singapore

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MAS – Monetary Authority of Singapore

No change, but policy tone to sound cautious in Apr

MAS will release its policy decision by 12th Apr. We expect no change to policy, but the overall tone could sound cautious – shifting down a gear from the hawkish tone in the Jan MPS (see report), but not neutral as yet. The Jan CPI report has somewhat allayed concerns over second round effects from 1% GST & larger-than-usual admin price hikes. As such, MAS might express greater conviction for further disinflation through 2025 by acknowledging that some domestic cost pressures have started to ease. At the same time, MAS should still be alert to inflation risks by reiterating that inflation would remain elevated in the near-term, and perhaps more explicitly highlighting that output gap might turn positive by year-end (which might in turn spur demand-pull pressures).

Greater hopes of core inflation returning to 2% in 2025

We expect core inflation (ex-GST) to moderate from 2.2% in 2024 to 1.8-1.9% in 2025 (i.e. within the historical 1.5-2% range). The latter is premised on broad downtrend in energy prices, dampened goods inflation, smaller administrative price hikes and tapering of services inflation as upward pressure on prices recedes.

Well on track to meet MAS's Jan '24 implicit core forecast

Core inflation trajectory for 2024 seems to be tracking 10-20bp below our inference of MAS's forecast from Jan. As such, core inflation is more likely to stay within (rather than exceed) MAS's forecast of 2.5-3.5% for 2024. Historical patterns suggest that policy tends to be status quo in the absence of material changes to core inflation forecasts. Since 2010, we have observed that MAS kept policy unchanged in 9 out of 11 episodes when current year core inflation forecast was maintained.

Still alert to inflation risks = Risk skewed towards tightening

MAS is likely to remain vigilant to inflation risks – as also flagged in Budget 2024 (see report) - including wage-price spiral given still tight labour market conditions (even as it pulls back from extreme tight levels) and de-anchoring of expectations. Given MAS's pre-emptive credentials and with effects of past aggressive tightening moves already past the peak, we do not entirely rule out a 50bp slope steepening to deliver more durable tightening. However, the risk is less so compared to the start of this year. *– K.W. Ang*

Strategy - SNEER to stay elevated; rates curve to flatten

Given the steady policy backdrop and reduced chances of a move either way, our strategy views remain focused on earning carry in Singapore FX and rates. While SGD NEER has limited room before it hits the top of the band, it still provides steady carry from slope with low volatility. We expect SGD NEER to trade in the upper half of the band and any dips towards 1-1.5% above mid would likely be short lived. We expect SORA front-end rates spread vs. US rates to compress as SGD fixing would remain sticky until inflation concerns ease further. That makes front-end rates biased to move higher or flatteners appealing for positive carry. Risks to the view come from quick disinflation in Singapore.
– A. Gupta

See pages 2 to 8 for more details

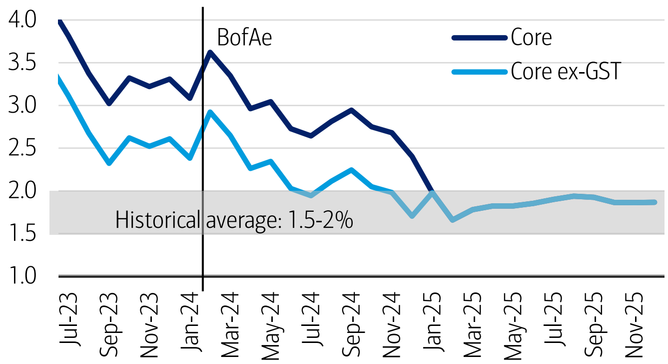
Timestamp: 14 March 2024 10:31PM EDT

Core inflation (ex-GST) still above 2% in 2024…

While core inflation has been on a broad downtrend, we expect MAS to remain alert to inflation risks, also flagged in Budget 2024 (see report). Our latest forecasts are for core inflation to average 2.9% in 2024. Excluding GST impact – around 70bp the pass-through is complete – this implies core inflation averaging 2.2% in 2024, which is still above the historical average of 1.5-2%.

In terms of the trajectory, we forecast core inflation rebounding from 3.1% in Jan (see report) to 3.6% in Feb due to moving holiday effects. Thereafter, we see core inflation moderating to 3.4% in Mar, 2.9% in 2Q'24, 2.8% in 3Q'24 and 2.6% in 4Q'24 (Exhibit 1).

Exhibit 1: Monthly core inflation (%yoy)
We see core inflation (ex-GST) averaging 2.9% & 1.8-1.9% in 2024 & 2025



Source: BofA Global Research, Singstats, Haver

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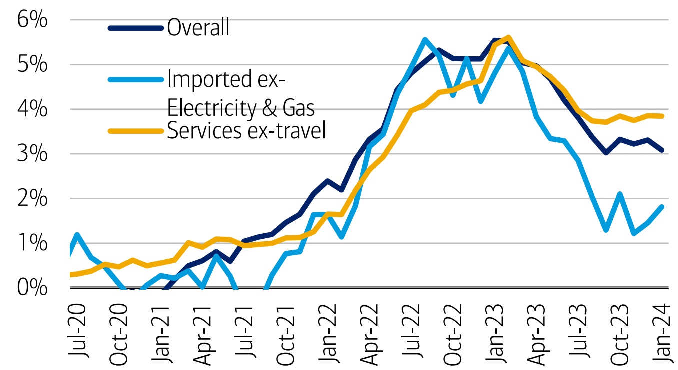
Exhibit 2: Core inflation, by broad components (%yoy)
Imported inflation has eased, but services inflation still sticky



Source: BofA Global Research, Singstats, Haver

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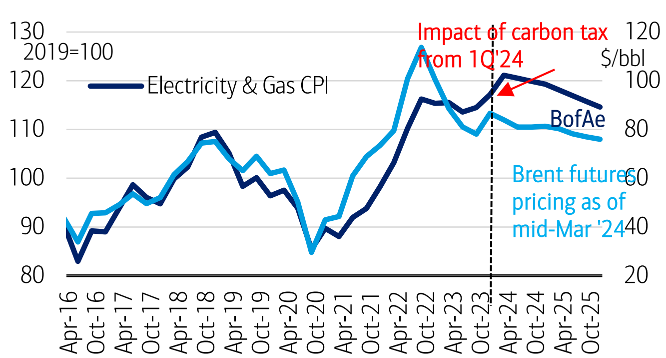
…but greater hopes that it could return to 2% in 2025

Our latest forecasts point to core inflation moderating further to 1.8-1.9% in 2025, premised on the following assumptions:

- **(1) Energy prices on a broad downtrend through 2025.** As at time of writing, futures pricing point to Brent prices falling from slightly above $80/bbl in 1Q'24 to $75/bbl by 4Q'25 (Exhibit 3). Accordingly, we see electricity & gas inflation falling by around 3% in 2025, after rising by >4% in 2024 on the back of higher carbon taxes starting Jan '24[1] (Exhibit 4).

Exhibit 3: Electricity & gas CPI (2019=100) vs. Brent prices ($/bbl)
Electricity & Gas CPI could creep down, based on Brent future pricing



Source: BofA Global Research, Singstat, SP Power, Haver Note: Electricity tariffs are adjusted on a quarterly basis, and based on energy prices in the previous 2/1/2 months

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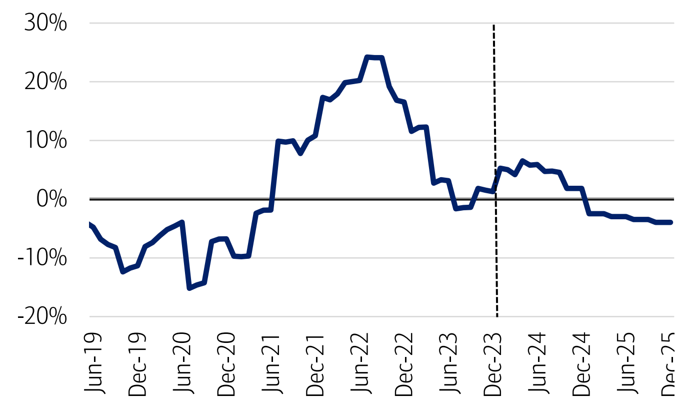
Exhibit 4: Electricity & Gas inflation (%yoy)
Electricity & gas inflation could turn slightly negative in 2025



Source: BofA Global Research, Singstat, Haver

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[1] Carbon taxes was raised five-fold to S$25/ tCO_2e from Jan '24, and will be further raised to S$45/ tCO_2e from Jan '26

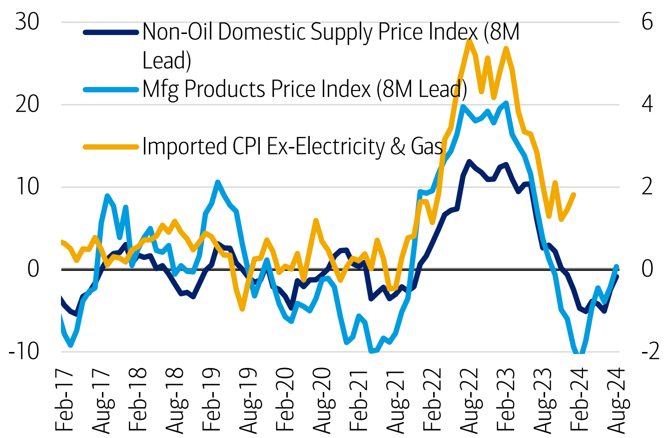
- **(2) Re-acceleration of imported inflation (ex-electricity & gas) seems unlikely,** with y-o-y readings for producer price indices (which lead by 7-9 months) subdued (Exhibit 5).

- **(3) Overall effects from administered prices would likely be smaller** – Price hikes for 2024 were larger-than-usual (Exhibit 6**)**. For instance, fares for bus & train fares were raised sharply by 7% for 2024 (vs. 3% for 2023), and school bus operators were allowed to raise fares by up to 13% in 2024, almost double the increment allowed in 2023.

  We suspect that the catch-up the higher cost levels would likely narrow in 2025, which would in turn facilitate lower price hikes. The only exception would be prices of water supply, whereby the announced quantum of increase would be higher in Apr '25 vs. Apr '24[2].

  Meanwhile, we also factored in the disinflationary impulse from lower childcare fees for government-supported pre-schools from Jan '25[3]. The government aims to provide government-supported pre-school places for 80% of children by around 2025 vs. >60% as of Mar '22.

Exhibit 5: Producer price index vs. imported inflation (%yoy)
Re-acceleration of imported inflation seems unlikely



Source: Global Research, Singstat, Haver

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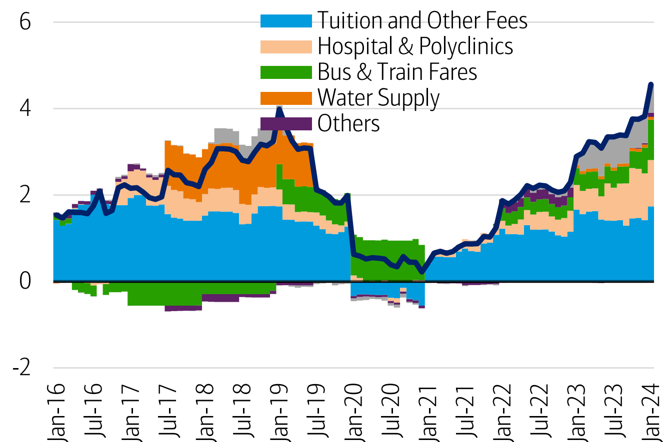
Exhibit 6: Administered prices (%yoy)
Larger-than-usual admin price hikes to lift inflation in 2024



Source: Global Research, Singstat, Haver

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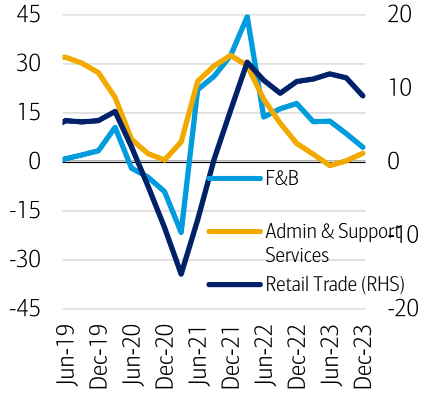
- **(4) Services inflation (ex-travel related items) could taper as upward pressure on prices recede.** Details in the Jan '24 core CPI print showed smaller sequential increase in items less subject to moving Lunar New Year effects**.** For instance, in m-o-m terms, household durables & services [newspapers, books & stationary] rose by a smaller 0.4% [0.3%] in Jan '24 vs. 1% [0.7%] in Jan '23 (GST increased by same magnitude in both months). This perhaps reflect businesses adjusting prices less due to weaker pricing power and/or reduced cost pressures. On the latter, we note that (a) unit labour cost (ULC) of consumer-facing sectors have moderated over the course of 2023 in y-o-y terms (Exhibit 7), and (b) shop median rentals were flat, even as vacancy rates have fallen over the past few quarters (Exhibit 8 & Exhibit 9).

[2] Prices of water supply (1.26% of core CPI basket) will be raised by 18% over 2 phases from Apr '24 (7.2ppt) and Apr '25 (10.8ppt).
[3] Fee cap for full-day childcare will drop by S$40 a month to S$640 for 5 anchor operators (-6.5%) and S$680 for 28 partner operators (-5.9%)

Exhibit 7: Unit Labour Cost (ULC) – consumer-facing sectors (%yoy)
ULC have moderated over the course of 2023



Source: BofA Global Research, Singstats, MOM, Haver Note: ULC in 2020-22 partly influenced by government's co-payment of wages under the Job Support Scheme (last payout in Mar '22)

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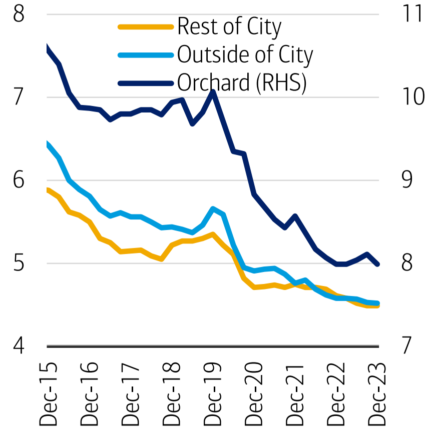
Exhibit 8: Shop median rentals (S$/sq.ft)
Rentals largely flat the past few quarters...



Source: BofA Global Research, URA, Haver

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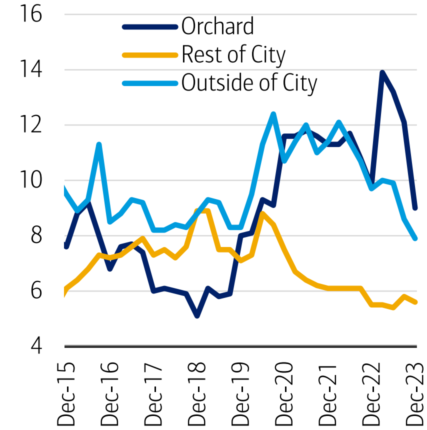
Exhibit 9: Shop vacancy rates (%)
...even as vacancy rates have fallen



Source: BofA Global Research, URA, Haver

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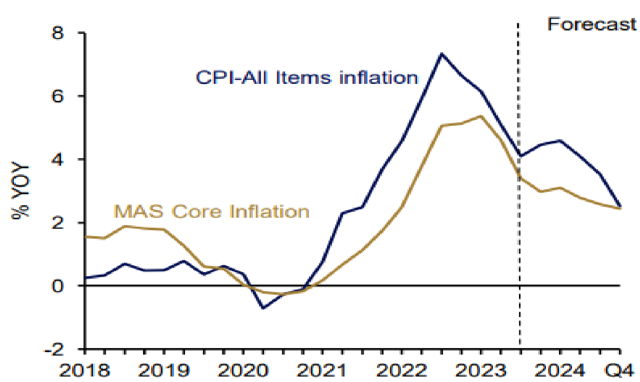
Well on track to meet MAS's Jan '24 implicit core forecast

We currently see 1Q24 and full year 2024 core inflation tracking 10-20bp below our inference of MAS' forecasted trajectory from the 29th Jan MPS (i.e. before Jan CPI was published). **Accordingly, core inflation seems increasingly likely to stay within (rather than exceed) MAS's forecast of 2.5-3.5% for 2024.**

We infer MAS back then estimating 2024 core inflation around 3.5% in 1Q'24, 3% in 2Q'24, 2.9% in 3Q'24 and 2.5% in 4Q'24, such that core inflation averaged around 3% for full year 2024. This mechanically folds in the implied qoq momentum from MAS' Oct '23 forecasts (Exhibit 10) into actual 4Q'23 CPI prints.

Our core inflation forecasts (1Q'24: 3.3%, 2024: 3-3.1%) assume on core inflation rebounding to 3.6% yoy in Feb vs. 3.1% in Jan, after accounting for "back-loaded" Lunar New Year effects and partial rebound in travel-related items (Exhibit 11). In the scenario whereby price pressures in Feb prove stronger than expected and core inflation rebounds above 4%, core inflation could then potentially overshoot our inference of MAS's forecasted trajectory.

Exhibit 10: MAS inflation forecast up till 4Q24 (from Oct '23)
We inferred MAS seeing 2024 core inflation at 2.7-2.8%



Source: MAS Macroeconomic Review (Oct '23)

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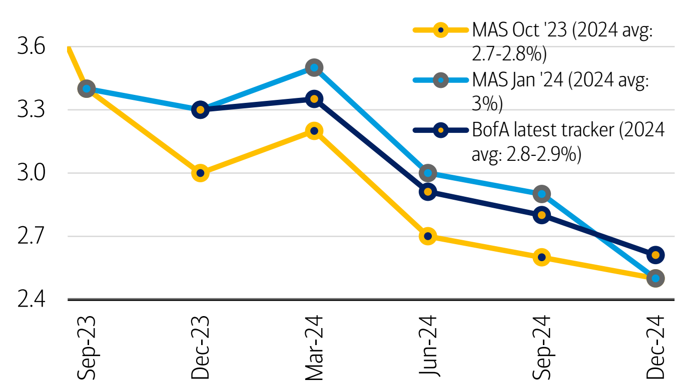
Exhibit 11: Quarterly core inflation (%yoy): Latest vs. our inference of MAS's forecasted trajectory
Core inflation to date tracking below MAS's probable Jan forecast



Source: BofA Global Research, Singstats, MAS, Haver

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Historical patterns point to MAS staying on hold in Apr

Historically, we observed that MAS tend to adjust its FX policy in response to material changes to its current year's core inflation forecast (Exhibit 12). While MAS's policy orientation is focused on the medium-term, material changes to current year's forecast could alter expectations of the medium-term core inflation trajectory. We summarize our key observations below:

- **(1) MAS kept policy unchanged in 9 out of 11 episodes when core inflation forecast was unchanged**. The only exceptions were in (a) Apr '11 – The S$NEER was re-centered upwards, when stronger activities (following the step-up in 1Q GDP) were seen exerting greater pressure on domestic costs, and (b) Oct '18 – the slope was steepened further as part of calibrated moves that commenced in Apr '18.

- **(2) MAS tightened policy in 8 out of 10 episodes when core inflation forecast was raised**; and

- **(3) MAS loosened policy in 5 out of 11 episodes when core inflation forecast was lowered**. The latter two observations also point to higher inertia to loosen vs. tighten policy settings.

To the extent that MAS only adjusts policies in response to material shifts in core inflation forecasts vs. the previous meeting (easier to track since meetings are quarterly), we expect MAS to keep policy settings unchanged in Apr.

Exhibit 12: Observations of MAS policy moves vs. change in current year's core inflation forecasts since 2010

MAS tend to adjust policies in response to material changes to its core inflation forecast

Core inflation forecast		Policy Moves					
Change for current year forecast *	No. of instances	Tighten – No. of Instances	Meeting Dates	No change – No. of Instances	Meeting Dates	Loosen – No. of Instances	Meeting Dates
Higher	10	8	Apr-10; Apr-12; Apr-18; Apr-21; Jan-22, Apr-22, Jul-22, Oct-22	2	Oct-16; Oct-20	0	
No change	11	2	Apr-11; Oct-18	9	Oct-10; Apr-14; Apr-15; Apr-17; Oct-17; Apr-21; Apr-23; Oct-23; Jan-24	0	
Lower	11	0		6	Oct-11; Jan-15; Oct-15; Apr-16; Oct-19; Apr-20	5	Oct-12; Apr-13; Oct-13; Oct-14; Apr-19

Source: BofA Global Research, MAS

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MAS likely to stay on hold for some time with core inflation seen at more comfortable levels in 2025…

Recent guidance suggest that MAS sees core inflation at more comfortable levels in 2025, which reinforces our view for MAS to stay on an extended pause for some time.

- (1) MAS Chief Economist Edward Robinson highlighted on 6th March that "the current policy setting keeps the S$NEER policy band on an appropriately restrictive posture to ensure that core inflation declines to 2% by early 2025".

- (2) MAS noted in its Jan MPS that core inflation should "step down by 4Q24, before falling further next year".

…but would still be vigilant to inflation risks

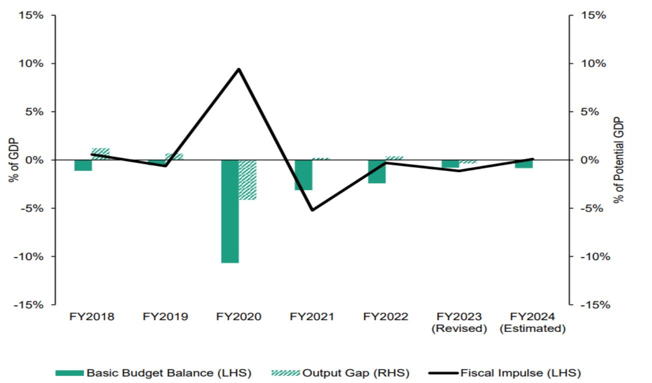
At the start of the year, we suggested that Apr meeting could be "live" amidst concerns over second round effects from larger-than-usual administrative price hikes and 1% GST hike from Jan '24 (see report). Details in the Jan CPI report has since alleyed some of these concerns (see report).

Nonetheless, MAS is likely to remain vigilant to inflation risks, also flagged in Budget 2024 (See Feb' 24 report). MOF adopted a broadly neutral fiscal stance for FY24 to avoid stroking inflation, with the official forecasts pointing to the output gap likely to turn positive towards year-end (but still averaging close to 0% of potential GDP for FY24 itself; Exhibit 13). Factors we are keeping a close eye include risk of wage-price spiral and any de-anchoring of inflation expectations. We elaborate further below:

- **(1) Labour market conditions could remain persistently tight** even as it pulls back from extreme tight levels, which could in turn facilitate pass-through of accumulated business costs. Latest labour market indicators (e.g. vacancies to unemployed ratio, Exhibit 14) remain considerably tighter vs. the pre-COVID averages. We don't expect labour conditions to ease materially in the near-term as (a) hiring intention remain strong (Exhibit 15); and (b) growth of non-resident employment would be capped by multi-year policies aimed at reducing reliance on foreign manpower (see Appendix in Year Ahead).

- **(2) Consumer inflation expectations remaining sticky –** Both 1Y-ahead core and headline inflation expectations retreated in 4Q'23 but remained well above the 2017-19 average of 3.1-3.2% (Exhibit 16). Even as actual inflation moderates, expectations may remain sticky amid continued concerns over cost-of-living pressures.

Exhibit 13: MOF's projected output gap
Officials see output gap broadly flat in FY24 – implying that output might be seen positive in latter part of FY24



Source: MOF Note: Fiscal year runs from Apr of current year to Mar of following year
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Exhibit 14: Job vacancy to job seeker ratio (%)
Ratio rebounded to 1.74 in 4Q23 vs. 1.64 in 3Q23, and still well above unity – suggesting that labour market conditions remain tight

Source: BofA Global Research, MOM, Haver
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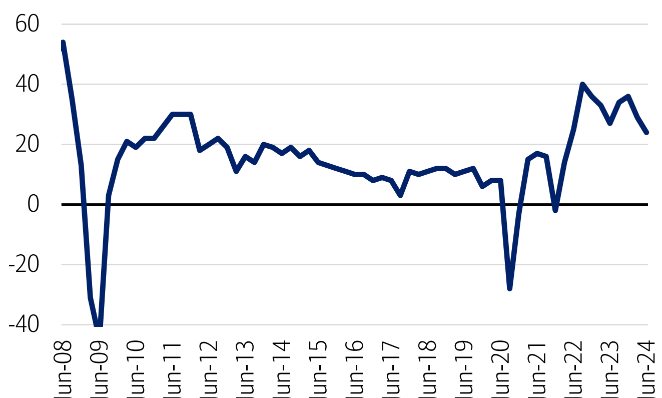
Exhibit 15: Net employment outlook (%)
Hiring outlook remains strong at +24% for 2Q'24



Source: BofA Global Research, ManpowerGroup, Haver
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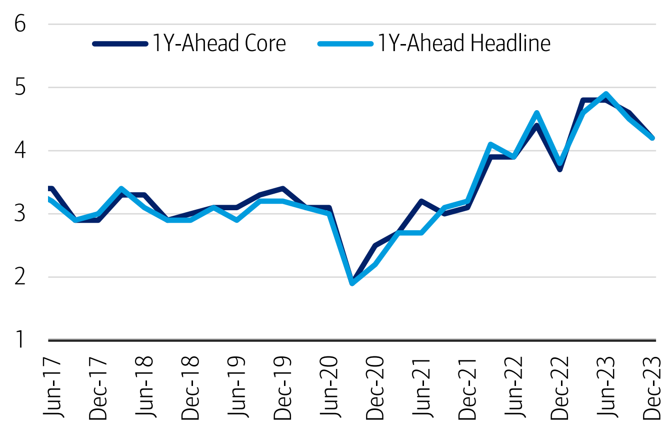
Exhibit 16: Consumer inflation expectations (%yoy)
Expectations have retreated, but still well above pre-COVID averages



Source: BofA Global Research, SMU
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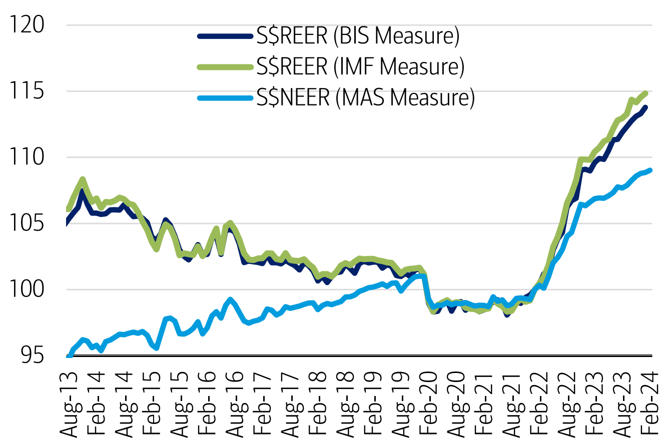
Restrictive policy stance still warranted; Risk skewed towards tightening (but less so than before)

With MAS still alert to inflation risks we think that MAS would be inclined to keep policy restrictive, which can be maintained even if no adjustments are made to the policy parameters. Current policy stance is still slightly tight relative to where we are in the business cycle (economic recovery still incomplete), with the S$REER (based on measures by BIS and IMF) still on an uptrend (Exhibit 17), and the S$NEER continuing to trade on the stronger side of the band (Exhibit 18).

Given MAS' pre-emptive credentials and with effects of past aggressive tightening moves already past the peak, we do not entirely rule out a 50bp slope steepening to deliver more durable tightening. This is especially if core inflation is seen staying sticky above 2% through 2025. We note that in 2012-14, the S$NEER slope was maintained at 2% p.a. when core inflation was seen ≥2% (Exhibit 19).

On the other hand, we think that expectations of formal easing this year seems premature in any view, given scope for MAS to steer the S$NEER lower within the current band if needed. On this count, we note that MAS' Mar '24 professional forecasters' survey suggests that at least 30% of respondents expect some form of formal easing this year.

Exhibit 17: S$REER & S$NEER (Jan 2022=100)
S$REER has risen substantially since the start of 2022



Source: BofA Global Research, MAS, BIS, Haver, CEIC

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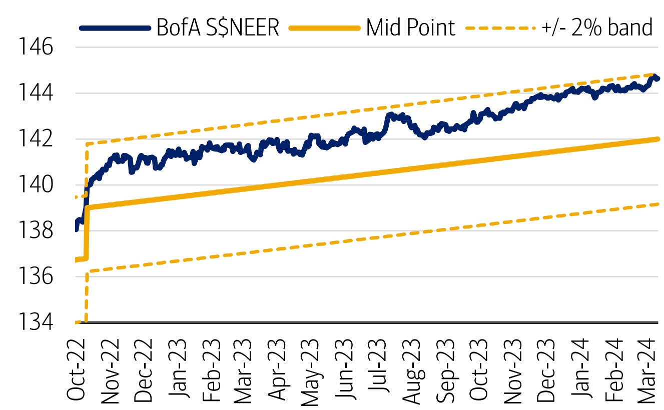
Exhibit 18: BofA S$NEER Index
S$NEER has stayed consistently on the stronger side of the band in our model



Source: BofA Global Research, Bloomberg

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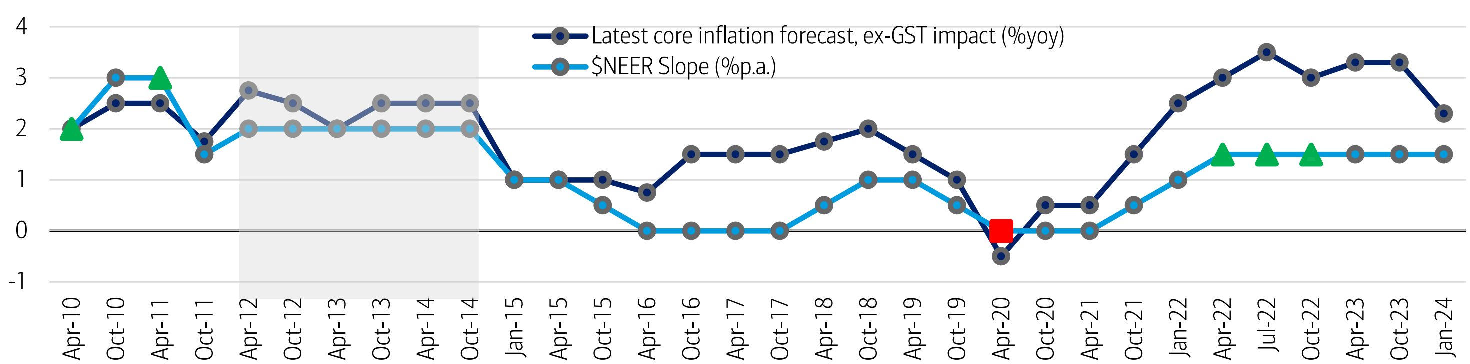
Exhibit 19: Latest core inflation forecast (%yoy) vs. estimated S$NEER slope (% p.a.)
In 2012-14, slope was maintained at 2% p.a. when core inflation forecasts were at least 2%



Source: BofA Global Research estimates, MAS Note: (1) For policy statements in Jan/Apr/Jul, we refer to latest current year's forecast; (2) For Oct policy statement, we refer to following year's forecast; (3) We refer to the mid-point of the latest forecast range, and (4) We assume GST impact to be 70bp in 2023 and 2024

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Strategy - SNEER to stay elevated on carry; flatter rates

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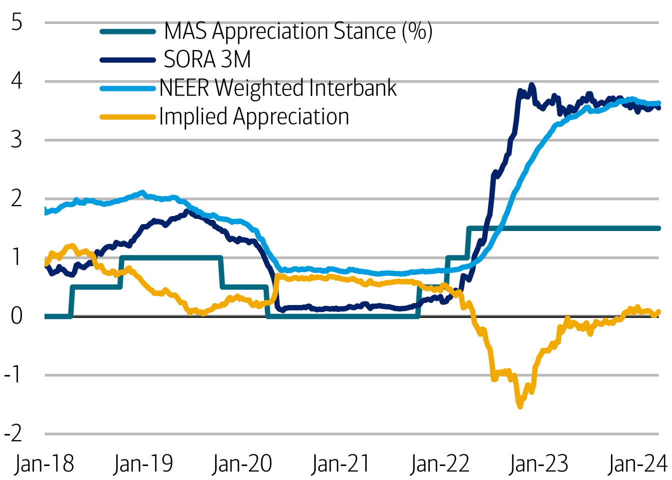
Given the steady policy backdrop and reduced chances of a move either way, our strategy views remain focused on earning carry in Singapore FX and rates. The SGD NEER has moved up slightly to 1.8% from earlier range of 1.4-1.7% above mid, on our model. While that leaves limited room for further appreciation before it hits the top of the band, it still provides steady carry from slope with low volatility. We expect SGD NEER to trade in the upper half of the band and any dips towards 1-1.5% above mid would be short lived.

Basket yields on SGD NEER are in line with Singapore overnight rate average (SORA) 1-year, which indicates that front-end rates remain well above those implied by uncovered interest-rate parity (See Exhibit 20). Higher implied yields on SGD forwards make long SGD NEER an attractive carry position compared with its volatility. Other appealing ways to express SGD appreciation views could be against lower-yielding currencies like CNH, MYR or THB.

We expect SORA front-end rates spread vs. US rates to compress as SGD fixing would remain sticky until inflation concerns ease further. SORA fixings have been steady and monthly average has recently moved back up to 3.69% from 3.53% earlier. Any liquidity injections by MAS due to FX accretion continue to be sterilized via bills issuance and other money-market operations (See Exhibit 21). That reflects the MAS's comfort with the current policy settings as being sufficiently tight and intention to not let lower rates ease financial conditions prematurely. We expect SORA to remain relatively sticky in the front-end and any easing on Singapore rates or global rates to be priced-in the belly of the curve. That makes pay front-end rates biased to move higher and flatteners more appealing for carry. Risks to the view come from quick disinflation in Singapore.

Exhibit 20: Implied appreciation in SGD rates flat on interest rate parity
SGD NEER policy slope stance and implied appreciation using SORA vs NEER weighted average rate (%)



Source: BofA Global Research, Bloomberg

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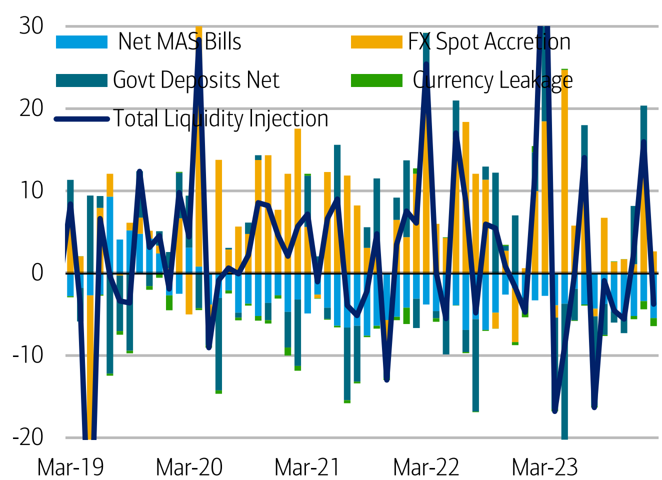
Exhibit 21: Liquidity injection from FX accretion absorbed by bills
Liquidity injection (SGD Bn) due to various factors – MAS bill issuance, government deposits, FX intervention and currency leakage



Source: BofA Global Research, Bloomberg

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