Mizuho Brief: MAS Watch

Economics & Strategy | Asia ex-Japan

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MIZUHO

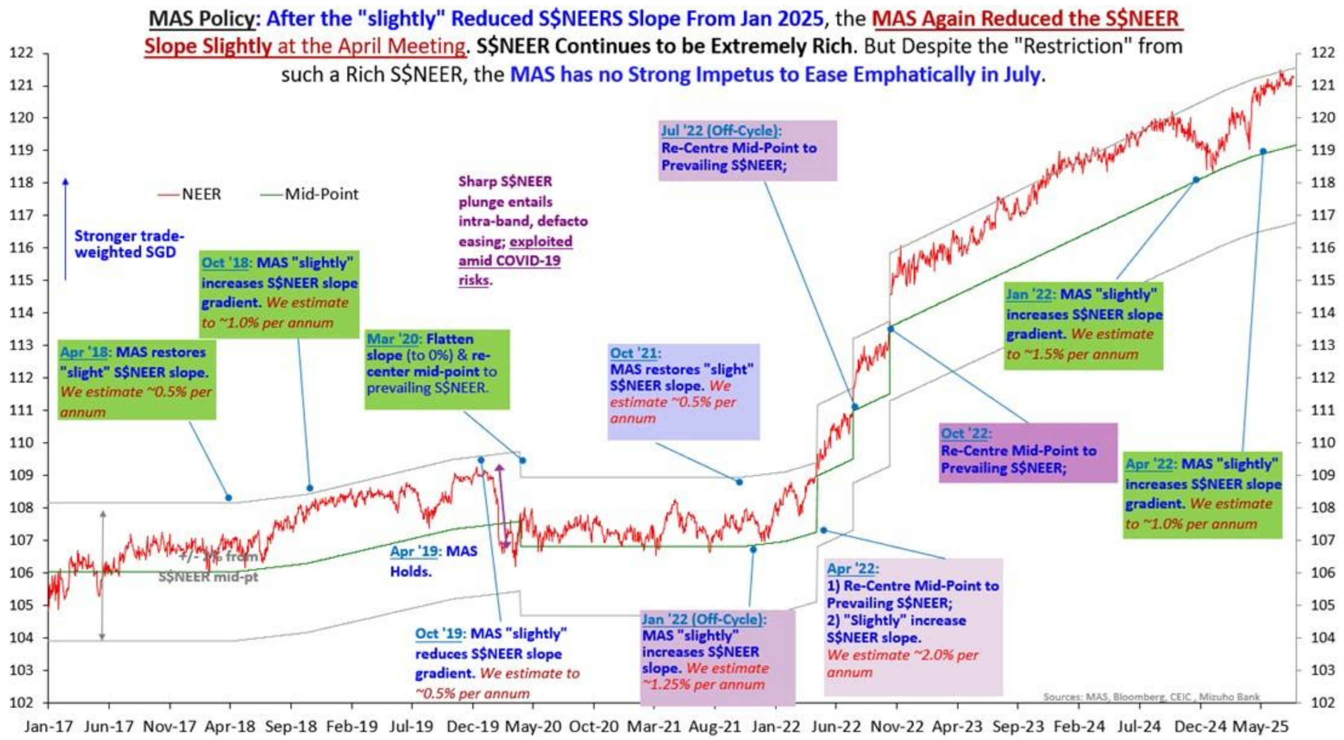
Why the MAS Will Not Ease

"There is nothing more to be said or to be done tonight, so hand me over my violin and let us try to forget for half an hour the miserable weather and the still more miserable ways of our fellowmen." – **Sherlock Holmes**

In a Nutshell:

- At the risk of some exaggeration, **flattening the S$NEER** is **the proverbial hammer**. ***But*** this **economy is not necessarily a nail** (yet).
- For one, despite the sharp drop in **inflation that theoretically lowers the bar** for easing, it has **not durably depressed** enough **to warrant urgent easing**.
- **Neither does** the **resiliency of growth** , which has well overshot previous estimates.
- Especially with **extremely elevated trade uncertainty/risks mitigated by trade deals that lower tariffs** from what was **threatened on "Liberation Day"** back in April.
- Moreover, with **sufficient 'insurance" easing in place**, the **argument for an imminent easing** (by suspending S$NEER appreciation bias) is **neither compelling nor convenient for policy coherence**.
- Finally, **capacity** and **inclination** for more *targeted* and *tailored* **fiscal buffer** favours that the MAS **retains "dry gunpowder"** in view of **fluid risks** and **lingering uncertainty**.
- Notably, **a rich S$NEER** *within the current policy* **allows for significant defacto easing**, **in the event of adverse demand shocks** (from S$NEER adjusting lower from the top-end of the band).
- All said, the **MAS** is arguably **in pole position to stand pat**.

  - S$NEER Impact: Given that the **S$NEER is already rich**, *despite slight slippage on marginal dovish bets.* So, this could **limit any pick-up reflex on MAS restraint disappointing dovish bets to just 15-30bp of S$NEER gains**.



MAS will Stand Pat with a Dovish Hold Rather than Ease

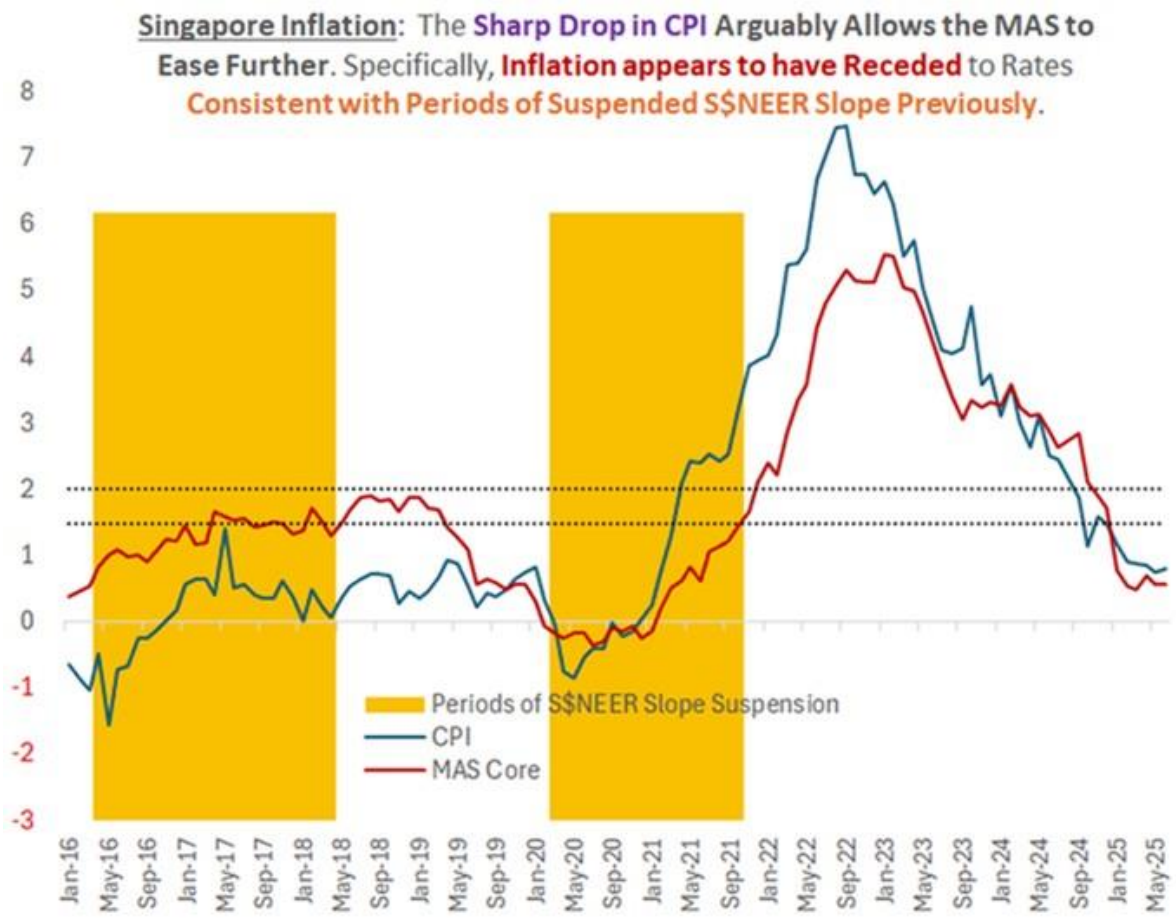
- To be sure, the **MAS arguably has options** and a certain degree of **flexibility for calibrated easing** if it so wishes.
- ***But*** the bottom-line is that the most **optimal choice** may be for the **MAS to stand pat** *rather ease for the third* consecutive meeting by reducing/flattening the S$NEER slope.*
- **Not because** another round **of** easing will risk **unleashing inflationary spirals** or **undermining** wider **SGD** and/or **macro stability**.
- **Rather**, because it can **afford**, and perhaps *benefit more from,* **some "dry gunpowder"** *given exceptionally elevated uncertainty.*

* The MAS eased at the January and April meetings by "slightly reducing" the slope of the S$NEER.

Inflation Has Fallen Significantly

- In fact, **by conventional price stability metrics**, the **sharp inflation deceleration** both headline and core (to below 1%) *ostensibly provides scope for the MAS to ease.*
- Not only has, the **drop in CPI has been** both **profound** and *sustained,* but it is also **pervasive**, spanning across *goods, housing* and *services.*
- What' more, the **current sub-1% inflation range** is **not inconsistent with** periods of a flattened S$NEER slope **previously**.

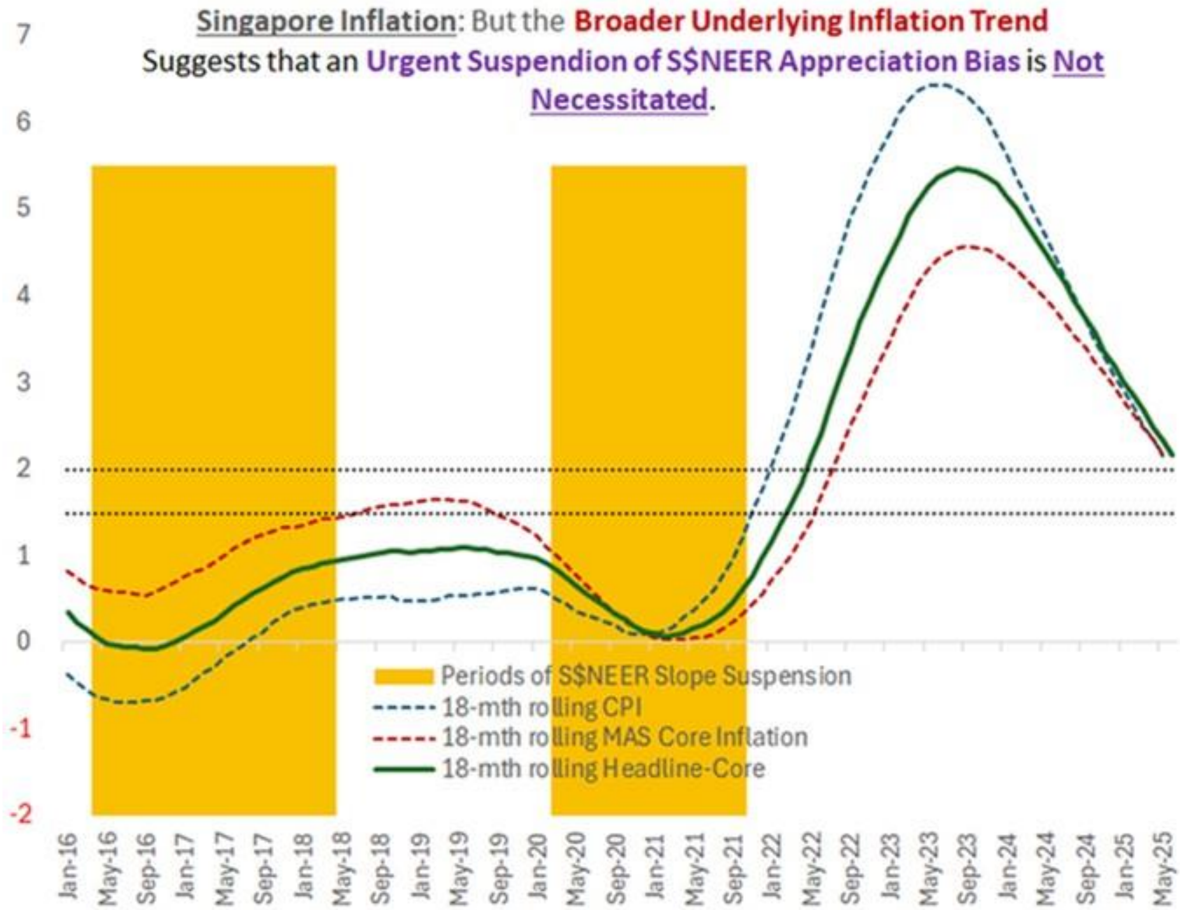
- Simply put, inflation **could *understandably* be construed as a license to ease**. Specifically, **to suspend S$NEER appreciation bias**.



But Not Enough to Suspend S$NEER Appreciation

- ***But* such an overtly dovish reflex** on account of inflation's decline **may prove misguided**.
- For one, the *underlying inflation trend* suggests that the pullback in inflation *falls short of a decisive trigger to suspend S$NEER appreciation.*
- And this is **not just on account of prudent restraint given the recency of extremely elevated inflation**, which may justifiably be criticized for being back-ward looking.
- Instead, the *absence of a distinct economic shock**,* which has **typically the case for a flat S$NEER** (suspended S$NEER appreciation trend).
- Point being, **scope to ease on the back of inflation**, while distinct in the headline, is perhaps **overstated in the wider context**.

** Episodes of suspended S$NEER appreciation (flattened S$NEER slope) were triggered by the "China shock" in 2016 and COVID shock in 2020.



Growth Backstopped, Possibly Resilient:

- What's more, **growth** has also been **counter-intuitively resilient**, backstopped by a mix of global front-loading and service sector buffer.
- Admittedly, those looking into details **could fault under-performance** and **latent fragilities in manufacturing**.
- But with **H1 GDP momentum alone contributing 2%-pts to 2025 growth** (topping the government's 0-2% GDP projection), it *would take a sharp, broad-based, H2 contraction to justify a full-throated dovish response.*
- And so, *given the MAS resisted flattening the S$NEER slope in April* **when trade uncertainties** and **attendant growth fears were arguably greater**, it is even more ***inconvenient*** (for policy signalling) **to do so now**.

Trade Risks Mitigated Despite (Still) Elevated Uncertainty:

- Especially as **nascent trade deals** emerging, *at (generally) lower tariff rates than those threatened in the April Liberation Day* assault o the global trading order, **diminish extreme "tail risks"**.
- To be sure, **US trade policy uncertainties**, *despite being diminished,* **still remain elevated**. Accordingly, the **global demand outlook is shrouded, if not tentative**.

- Nonetheless, the **marginal policy response to diminished uncertainties/"tail risks"** is *probably not to ease aggressively* further, but **perhaps to retain dovish options**.

Sufficient "Insurance":

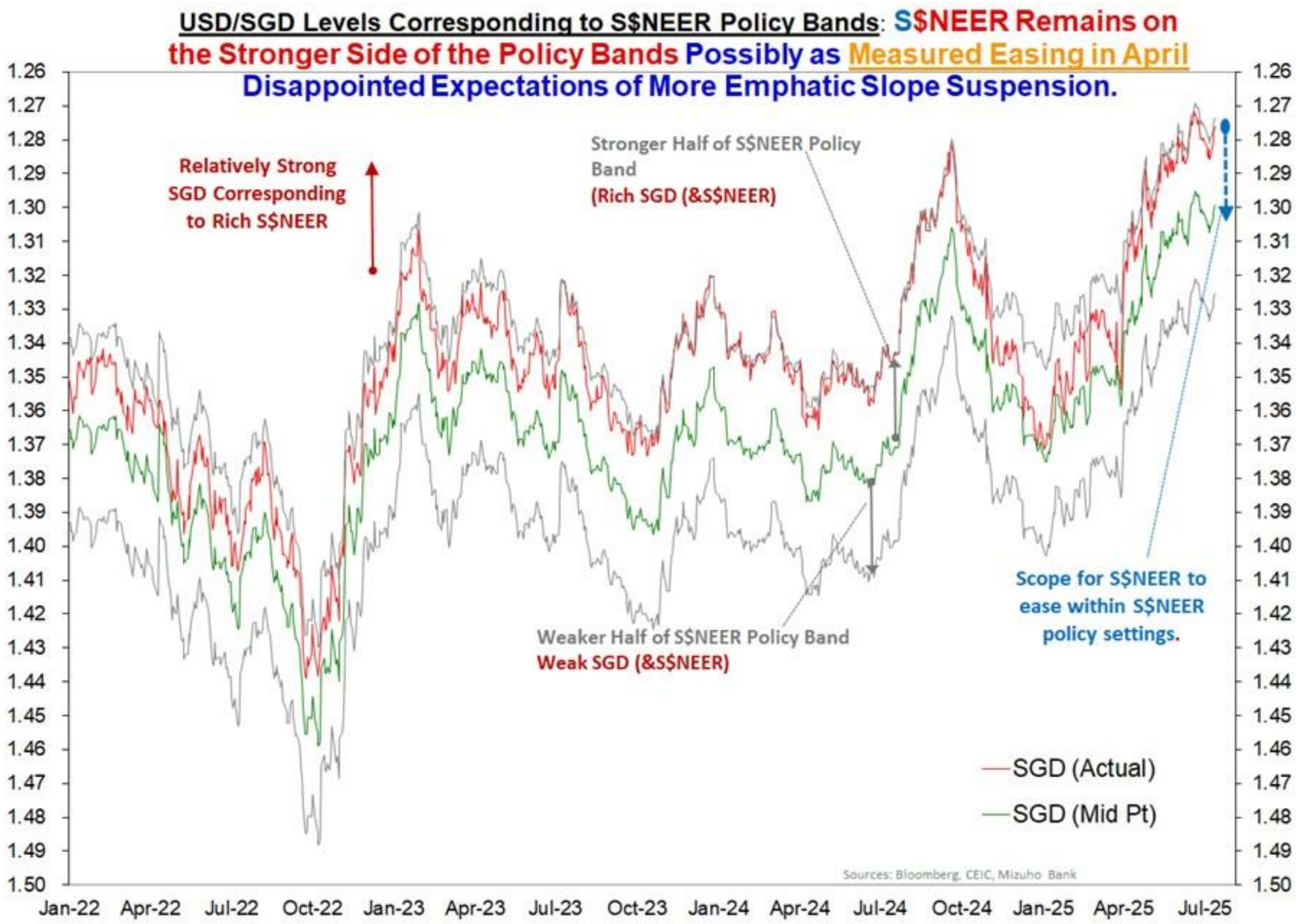
- *More so,* given **sufficient**, *front-loaded,* **"insurance" easing** in 2025 (both at the January and April meetings) that have been **met by diminished risk of adverse demand shocks**.
- With **back-to-back slope reductions**, the MAS has arguably *tempered the expectations of the pace of trade-weighted SGD appreciation.*
- To that end, the **argument for "dry gunpowder"**, and not "over-insuring" downside risks is better *aligned with a highly fluid* and *potentially volatile outlook.*

Fiscal Largesse Picking Up the Slack:

- What's more, there is both **scope** and **inclination for fiscal stimulus to cushion demand shocks** in a more *targeted* and *tailored* manner.
- Already **cash transfers** to households in the current "SG 60" budget have **arguably put in place some "pre-loaded" demand buffer**.
- And **more support for business/industries tailored to address the exact tariff blows** and *knock-on supply-chain impact* is **likely to be forthcoming as needed**.
- Effectively, resulting in **more efficient and effective policy (monetary-fiscal) burden-sharing**, *rather than monetary policy doing all the heavy lifting* at increasingly costly trade-offs.

Backed by Latent Accommodation Within a Rich S$NEER:

- What's more, a **rich S$NEER at the top-end of the policy bands** suggest that SGD is close to maxing out restriction within the current setting.
- Whereas, ***in the event of an adverse global demand shock,*** the S$NEER **could** *adjust down within the policy bands* to **potentially provide effective**, **instantaneous** and **significant easing**.
- In other words, the *MAS has potentially automatic, defacto easing latitude baked into the current policy setting.*
- Which not only reinforces the point that the MAS no urgency to ease imminent, but also wisdom (and greater policy benefit) **"dry gunpowder".**



S$NEER Policy – Of Hammers, Nails & Needles:

- All said, and at the risk of some exaggeration, **flattening the S$NEER** is **the proverbial hammer**. ***But*** this **economy**, in a more holistic sense **is not necessarily a nail**.
- Put differently imminent easing is neither **easing, nor the optimal policy course**. At least *not yet.*
- And if we are right about standing pat, then the **marginal dovish bets that have nudged the S$NEER off the top of the band** are likely to be **disappointed**. *Perhaps even wrong-footed.*
- S$NEER Impact: Given^ **limited policy band headroom**, despite slippage on marginal dovish bets, a **MAS hold reflex may not move the S$NEER (and corresponding SGD)needle much**. Likely **limited to a tight 15-30bp S$NEER uptick**.

^Based on our S$NEER model estimates of a rich S$NEER that is 150-180bp above the mid-point despite slipping from more elevated levels (close to the +200bp presumed limit from policy mid-point).

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