Mizuho Brief: MAS Preview

Economics & Strategy | Asia ex-Japan

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Hard, Hawkish Hold

- The **MAS is set to hold** steady at bi-annual meeting (13th Oct). Specifically, a **hawkish hold** that *errs on the side of inflation anchor*.
- That's to say, a **"hard" hold** that underpins a *hard-line on inflation*, yet also concedes a *"hard" decision; given sharper trade-offs* involving **uneasy downside risks to growth**.
- In fact, *as underwhelming as economic growth may be,* **underlying "tail risks" of a sharper downturn** are ***actually*** **understated by a highly uneven recovery**.
- Especially as *otherwise worryingly extended manufacturing downturn* being offset by **service sector outrun** tempts **complacency**; inadvertently, **over-estimating resilience**.
- *Whereas*, *tourism recovery* and *wealth-driven inflows* amplifying asset market buoyancy and alongside onshore consumption (both first and second-round effects) exaggerate durable underlying demand recovery.
- *Nevertheless*, **mounting "tail risks"** will be a consideration, perhaps a concern, but certainly **not a catalyst for a shift in policy stance**.
- *Instead*, **"sticky" inflation will continue to dominate** the policy thrust, **requiring a hawkish hold**. In particular, to anchor inflation expectations **amid pipeline cost pressures**.
- Crucially, **extreme SGD under-performance vis-à-vis S$NEER** amid exceptional USD, which temporarily diminishes S$NEER inflation buffer capabilities (due to dominance of USD invoicing), **underscore** *the need for a* **hawkish slant to the hold**.

A Hard, Hawkish Hold

The **MAS is set for a hard, hawkish hold**, as it strikes a **delicate,** *albeit increasingly uncomfortable*, **balance** *between sticky inflation* amid susceptibility to fresh price shocks on one hand *and mounting downside risks to growth* on the other.

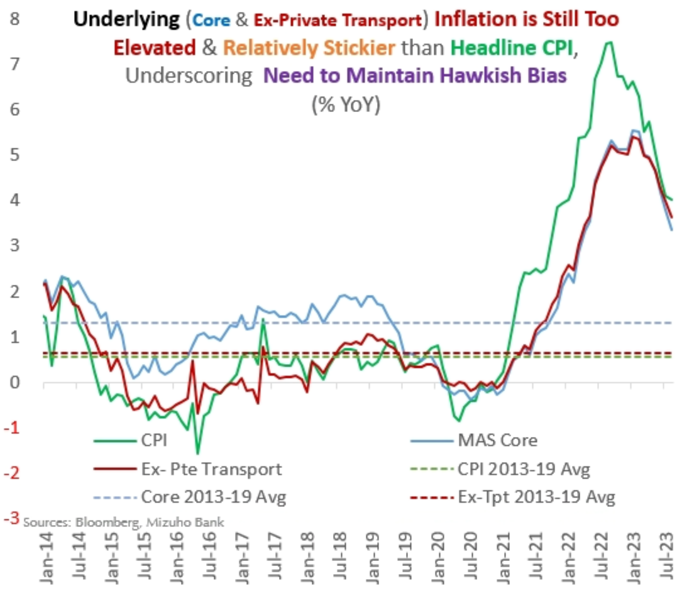
Notably, the **tyranny of growing policy tensions** in the wake of opposing risks is that a **gradual dial-back from hawkish settings is not an option**; as *mere perceptions of premature shift* in stance *threaten to unmoor* earlier efforts to anchor *inflation expectations*.

Especially in the context of a relatively hawkish US Fed (Federal Reserve), resulting in **exceptional USD strength**; which, *erodes the efficacy of the trade-weighted SGD (S$NEER) to rein in imported inflation*.

And so, **erring on the side of inflation anchor** is **necessitated**; at least *until visibly overriding threats to growth emerge*. Necessarily, this accentuates *odds of a "hard" and abrupt dovish transition* further out should economic conditions deteriorate sharply.

The Tenacity (of Inflation)

Nonetheless, the **tenacity of inflation remains the North Star** for the MAS' policy formulation.

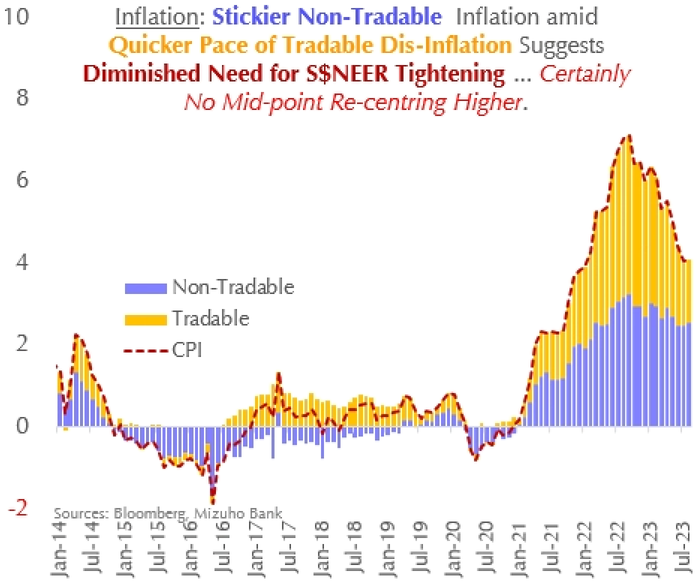


Admittedly, fairly distinct peak inflation is welcome. But, *insufficient deceleration across a wider the breadth of price pressures* means that the **hurdle to dialling back on tightening** stance is **higher** *than the decline in headline inflation would suggest*.

The (Policy) Tensions

But equally, mounting **policy tensions**, diminish need for further, urgent tightening; thereby **supporting a hold** (*albeit a hawkish one*).

For one, policy tightening has been **front-loaded, and out-sized** since October 2022. In fact, the *degree and speed of tightening was unprecedented;* with *three rounds each* of *re-centring* the S$NEER mid-point *higher* (aggressive, front-loaded to buffer cost shocks) and *S$NEER slope increments* (incremental but sustained to anchor inflation expectations).



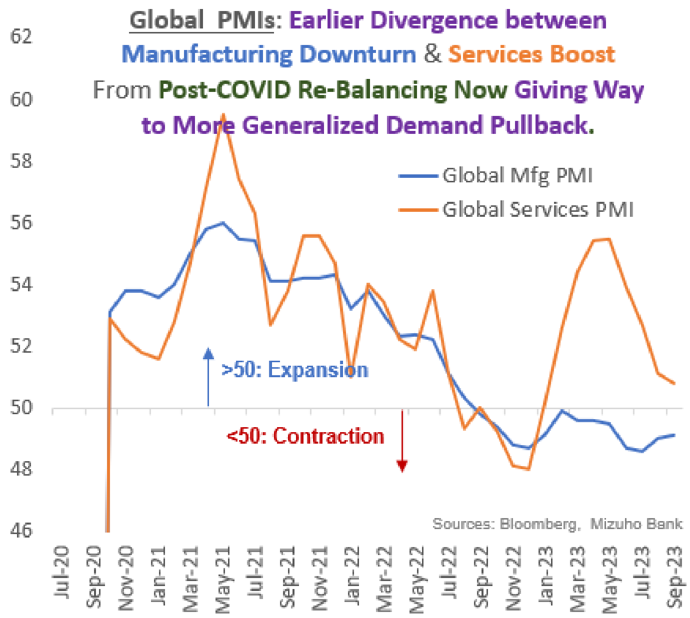
What's more, with the **trend of dis-inflation** suggesting that *non-tradable price pressures* are *far stickier than tradable inflation*, the **case for more S$NEER tightening** is significantly **diminished**. Especially arguing against further step appreciation (re-centring $NEER higher).

Instead, such **non-tradable inflation stickiness**, *subject to the broader dis-inflationary trend* remaining intact (even if dampened) underscores the **case for a hawkish hold** to be maintained.

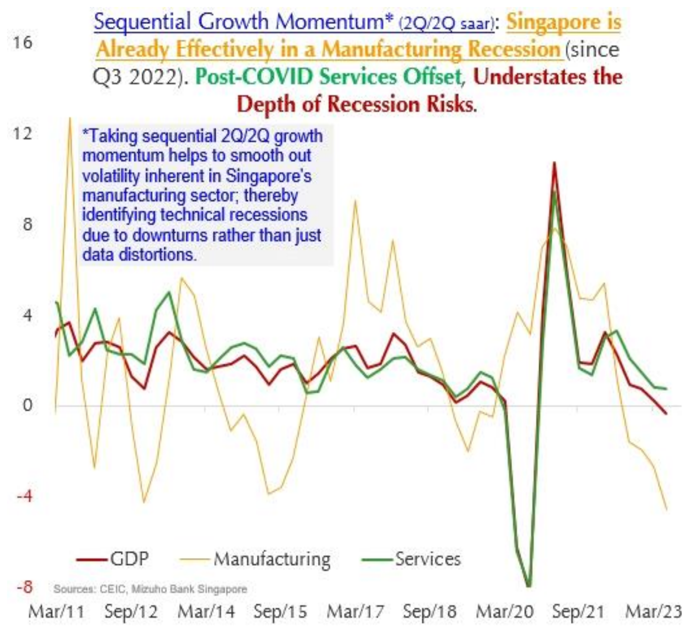
But above all, the case to extend the second is reinforced by **growing global recession risks**.

Admittedly, a **hard-landing scenario** is not the base case for many policy-makers, including the Fed. But even as a "tail risk", it is not insignificant; **a "fat tail risk"**, so to speak.

In any case, the **drag in global aggregate demand** coming through (in Global PMIs) warns of extended external headwinds, **to which a small, open economy like Singapore tends to be particularly sensitive to**.



In particular, **tail risks of a deeper recession from an extended global goods demand downturn** that *has* pummelled exports and *plunged the manufacturing sector in a prolonged recession* is **understated** in **headline growth** outcomes (and outlook) *amid offsetting service sector resilience*.

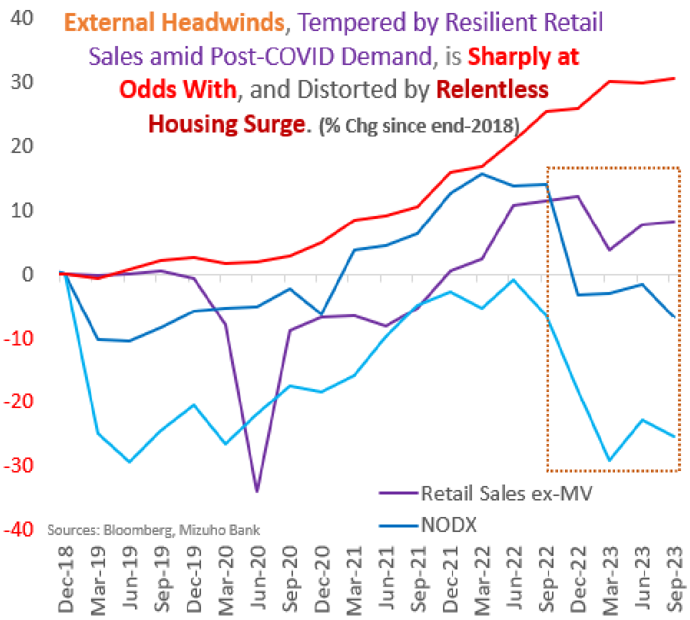


Uncomfortably Uneven

And to be sure, this huge offset stemming from a very **uneven recovery** is in and of itself poses **a significant policy challenge**.

Not just due to the ***collateral damage involved in wielding a blunt policy tool*** in an effort to calibrate a for vastly different demand conditions across sectors.

But crucially, also because there may be a **tendency to under-account for downside risks** *via industrial and financial channels*. Particularly **as robust services cast a harsh glare on second-round inflation risks**.

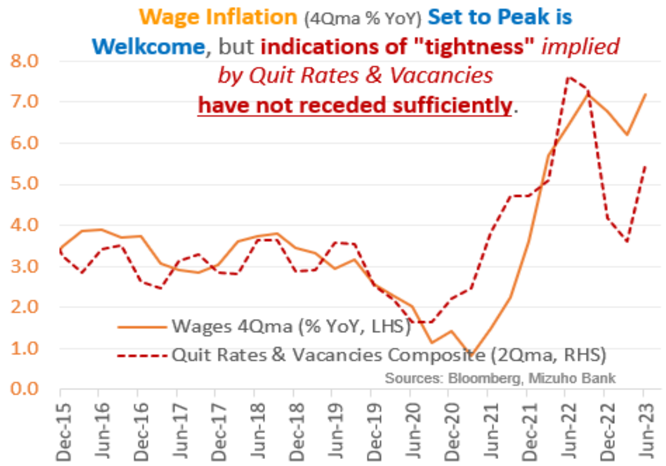


Moreover, **distortions from post-COVID service sector resilience**, which in turn has been boosted by "deprivation demand" conspiring with tourism restoration, may be overstating the underlying (and sustainable) pace of demand recovery.

Finally, a **booming property market** *in tandem with* **outsized "wealth inflows"** have a tendency to ***flatter*** not only *consumption of, and* ***resilience*** *in. non-tradable services*, but also *overstate* the ***strength of*** *the underlying* ***job market*** – thanks to ancillary services related to housing/wealth.

But "Tail Risks" Not a Trigger (Yet)

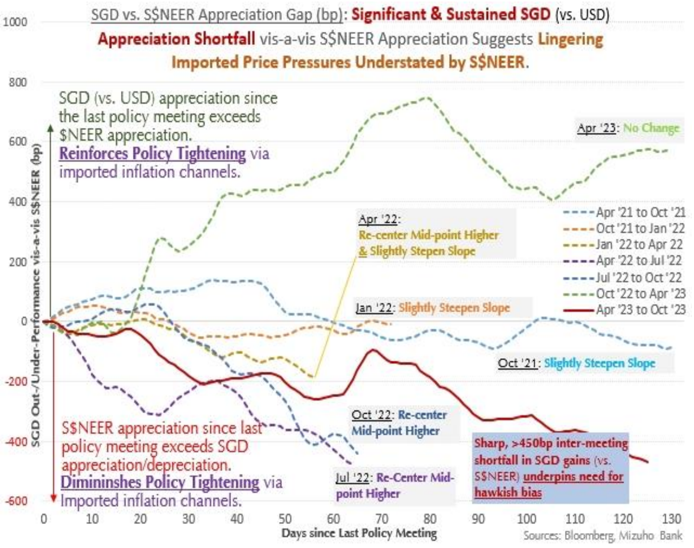
The tyranny though is that even as **tail risks** mount, this merely **polarize policy outcomes down the road**, rather than allowing a gradual policy shift.



Whereas underlying dampening in activity and latent inflationary pressures required to meet the **threshold for triggering a policy shift eludes**.

Especially as **underlying wage pressures**, *while having peaked*, are still **a tad too uncomfortably elevated** for the MAS to dispense with wage-price inflation risks.

Exceptional USD Strength



Finally, while not the decisive policy consideration, as we recently* pointed out, **exceptional USD strength** also **underpins the need to retain a hawkish bias**. Specifically, *as extreme SGD* (vs. USD) *vis-à-vis the S$NEER inadvertently overstates the inflation-dampening effects of policy* given the gap between trade-weights and disproportionately high USD invoicing in practice.

Whereas **under less severe FX market conditions**, *correspondingly less pronounced S$NEER-SGD divergence* would have posed **less significant challenges to policy efficacy**.

And **as extreme USD strength is likely to wash out** over time (on reversion of relative valuations) as (Fed)policy normlaizes, *a hawkish hold by the MAS* rather than policy over-reaction (further tightening) *will be optimal*.

*Mizuho Chart Speak - MAS: Currency of a Hawkish Hold, 2 Oct