Mizuho Insights: MAS

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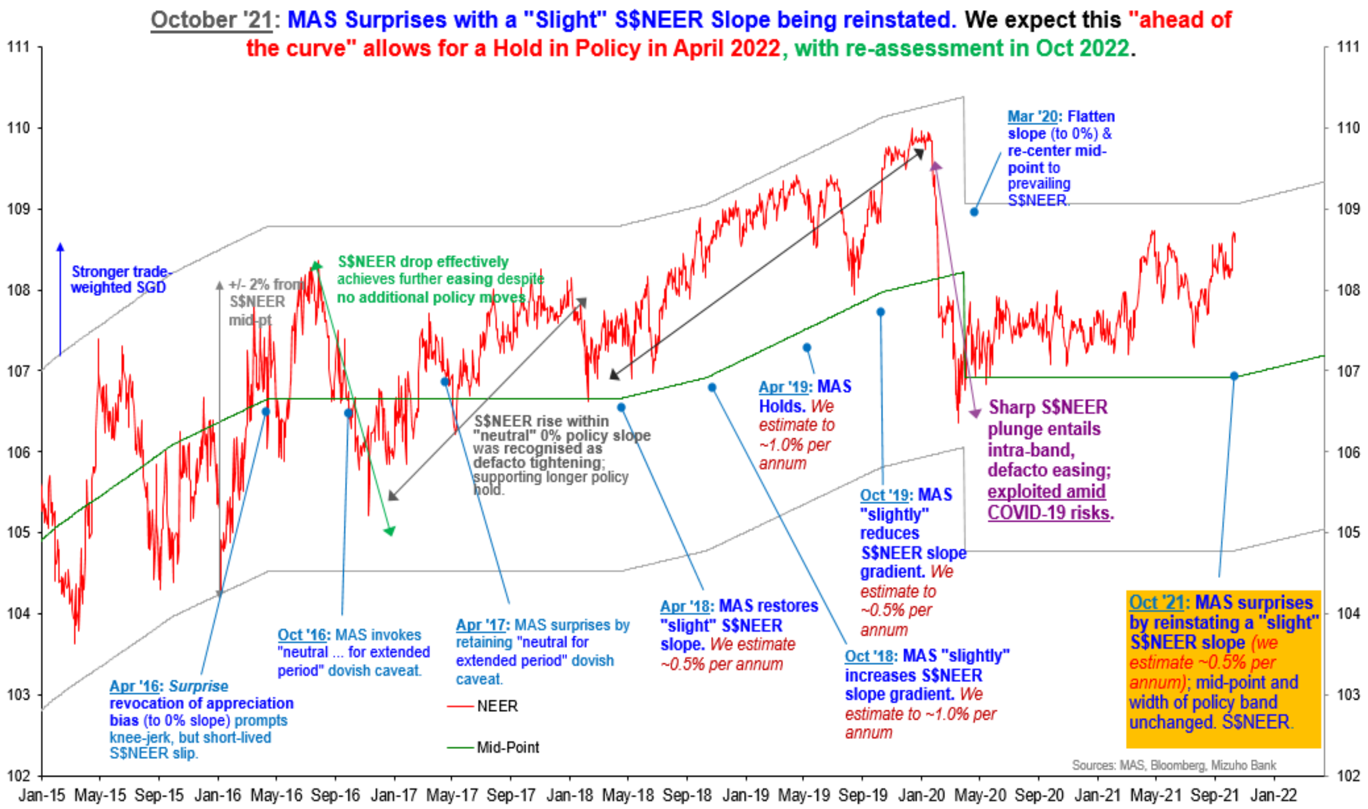
The What, Why & How of MAS "Surprise"



"A wizard is never late, nor is he early, he arrives precisely when he means to."
– Gandalf, Lord of the Rings

In a Nutshell: The MAS **surprising with an "ahead of the curve" calibrated reinstatement of S$NEER appreciation slope** (~0.5% per annum) is ***arguably a "wizard move"***. For one, it **checks the box on delivering pre-emptive signals** on growth-inflation risk shifts amid improving prospects despite lingering "tail risks" from COVID variants and other potential global shocks (including a plethora of China risks). Crucially, the move also helps **anchor inflation expectations amid surging cost-push pressures** amplified by capacity disruptions and supply-chain kinks, which threatens to induce "second round" effects. Especially amid improving job conditions, re-introducing **wage-price spiral risks**.

Above all, this move has the **benefit of in-built restraints on S$NEER tightening** (thanks to a conspiracy of rich $NEER and calibrated appreciation bias working in concert). And in all likelihood, it will buy policy space to pause in April 2022. Correspondingly, MAS tightening will not result in significant SGD trade-weighted out-performance; while USD trend and any spill-over from China risks will be the more prominent determinant of UISD/SGD exchange tendencies.

1. The What Behind the MAS Move

A Calibrated, "Ahead of the Curve", Slope

The Monetary Authority of Singapore (MAS), while **leaving the width and level at which the policy band is centred unchanged** as was widely expected, **surprised with an "ahead of the curve" calibrated**

reinstatement of S$NEER appreciation slope (we estimate to be ~0.5% per annum). It is ***arguably a "wizard move"*** that **checks the boxes on signalling**, crucially, **anchoring bubbling inflation** expectations yet offer the **benefit of in-built restraints on S$ tightening**.

Only 1/6 of a Surprise?

But despite elements of surprise, MAS did not shock. Fact is, the **direction (tightening) and form (calibrated slope increment) were not a surprise**; ***only timing was***. And **even then**, ***only half a surprise*** given the growing toss-up between pulling the trigger at meeting and April 2022. So we figure that half of one-third of the elements (direction, form and timing) makes for ***merely one-sixth of a surprise***.

Advanced (Normalization), Not Alarmed (Tightening)

In other words, this is a **considered decision to arguably advance policy normalization**, amid **signs of broadening recovery** (on the right track) and crucially, **emerging inflationary pressures**, What it is ***not,*** is a an ***alarmed policy response*** **to higher global inflation** or alignment with policy normalization elsewhere (e.g impending Fed taper, rate hike by the BoK).

Calibrated Balance, Not Cavalier Brashness

Nor is it a cavalier brashness of full restoration of S$NEER appreciation bias. Far from. Instead, a **delicate S$NEER slope** (appreciation bias) restoration **in the context of rich S$NEER** at the top quartile of the policy band, is a highly **calibrated balance between pre-emptively anchoring inflation expectations**, yet s**afe-guarding against downside risks**.

2. The Why (& Why Now?) Behind the MAS Move

Growth Recovery *Mostly* Entrenching "Above Trend" …

Clearing the way for the MAS to pull the trigger is **expectations of economic recovery to entrench and** *"remain above trend in the quarters ahead"*. Aided by a gradual re-opening of borders is expected provide low-hanging boost, albeit initially restrained; as travel and hospitality **catch-up with, and lean into, further external demand recovery**. The latter accentuated by the electronics up-cycle in the broader context of global re-opening demand amid rising vaccination rates. Accordingly, growth outlook is fairly upbeat, with 6-7% 2021 growth followed by "*slower but still above-trend pace in 2022*".

… Albeit in the Foreground, Not Rear-View

This **guarded optimism about the outlook** is what **helps to override reservations about the shortfall of recovery thus far** (that is well below *comparable levels consistent with past S$NEER slope reinstatement* in past crises), **which otherwise might have held the MAS back**.

And Premised on Averting "Tail Risks"

What's more, **the MAS is clear about "above trend" assumptions** being **premised on averting "tail risks"** such as "*the emergence of a vaccine-resistant virus or severe global economic stresses*"; the latter encompassing China risks amongst others.

Nevertheless, Inflation Tips the Balance

Arguably, **the rejection of policy paralysis on account of "tail risks"** is not unequivocally a trigger for tightening. But **what tips the decision** is the **MAS' anticipation of concurrent build-up in inflationary pressures**; as demand recovery conspire with supply-chain kinks and reflation cost-push.

In Particular Amid Revived Wage-Price Mechanics

Potential for **extensive "pass-through" of prominent energy inflation colliding with harder-to-untangle supply kinks** sets the stage for **"second round" risks**. Especially as this **threatens to entrench wage-price spirals given** "*dissipation of labour market slack*" being projected.

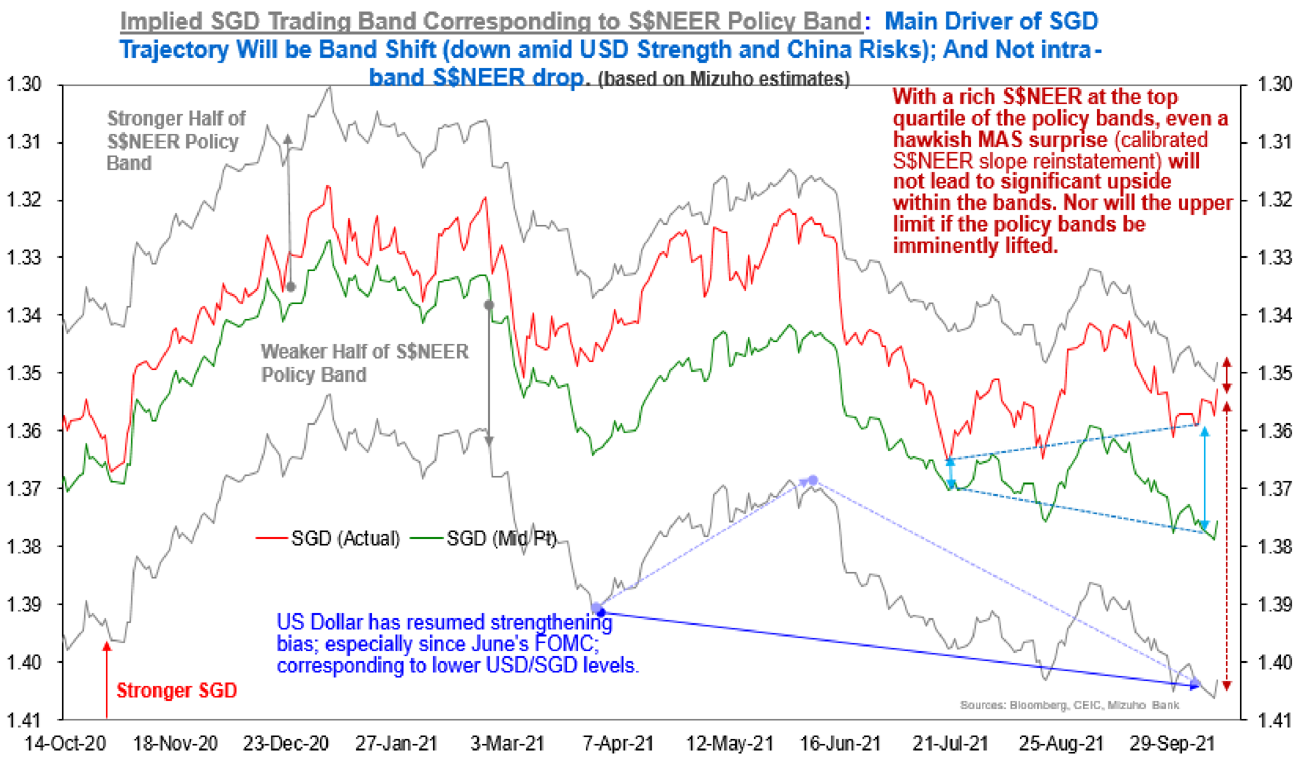
Crucially, Long Policy Interval Ups the Cost of Missed Inflation Anchoring Signals

Above all, the **decisive reason why the MAS** timed calibrated S$NEER slope restoration sooner in October is that the **long (6-month) lags between meetings raises the cost of (normalization) signalling forgone**. Especially given the **backdrop of potentially more persistent, cost-pressures seeping through** to core inflation; with the threat of flirting with expectations.

3. The How(ever) Behind the MAS Move

How this calibration is Even More Measured than it First Appears

However, **a "rich S$NEER"**, at the strong half (if not top quartile) of the policy band for a while now, **alongside finely calibrated S$NEER** slope essentially only allows for **very controlled and measured tightening** given very) limited NEER appreciation headroom at the outset, which only rises incrementally. **Regardless**, **moving pre-emptively** in October also likely **buys policy space to pause in April 2022**.



How Will SGD Trajectory May (Not) Be Impacted

The temptation is to conflate MAS tightening (including S$NEER slope) with pronounced appreciation bias in the SGD. **However**, MAS's "slight" slope is **not poised to be hugely consequential to SGD trajectory**. For one, upside potential under current policy parameters is mostly already exhausted by a rather rich S$NEER. Moreover, **in combination with linear and very incremental S$NEER ceiling lift** (based on 0.5% per annum appreciation assumption) **only provides 0.2%-0.3% of headroom for the trade-weighted SGD to appreciate in the next 6 months before the next MAS meeting**.

In other words, binding constraints of policy means that MAS tightening will induce only a very modest appreciation bias. Upshot being, all else equal, slightly accentuated appreciation bias - albeit uneven across various currencies - for the SGD will dominate. **Whereas USD trends and China risks may be the more prominent determinants of the larger shifts and turning points**.

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