Mizuho Insights: MAS Watch

Economics & Strategy | Asia ex-Japan

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Unhurried & Unfazed

"Short cuts make long delays." – **Lord of the Rings**

In a Nutshell: **Despite Singapore's economy being on track for a resounding vaccine-driven rebound**, the **MAS will remain unhurried about reinstating S$NEER appreciation bias**. And **quite rightly so**. Fact is, **the MAS will be unfazed by GDP growth outperformance poised to surpass earlier target of 4-6%**, which was already well above trend, to likely pick up to **an exuberant 6.0-7.5%.** Two reasons. One, the **recovery path appears as bumpy as it is uneven**; therefore rendering 2021 resurgence an overstatement of sustained growth resumption further out into 2022 and beyond. Second, and crucially, the **unprecedented depth of drop in 2020 means even with a sizable out-run in 2021 growth rebound**, **activity levels remain muted**. Undeserving of awe; and certainly not policy response. Equally, the **decision to maintain policy accommodation will be unfettered by inflation projections being lifted substantially** from "mildly positive" to close to the 1-2% range **as reflation-driven commodity, energy and logistic costs begin to feed through**. For one, despite inflation being appreciably less subdued, **cost-push pressures accentuated by impaired capacity fall well short of self-sustaining demand-pull inflation**. Above all, **subdued wage-price dynamics alongside transitory cost-push** argue for prolonged policy accommodation.

Upshot being, in-coming **and on-hand economic evidence**, while a tad firmer than envisaged, **do not distract from MAS' October policy view** that "*an accommodative policy stance will remain appropriate for some time*" **given that the** "negative output gap will only narrow slowly". At least while global and regional economies trace an uneven path herd immunity. Meanwhile, the; i) **current mid-point**; ii) **0% appreciation slope of the S$NEER policy band**, and; iii) **presumed +/-2% band width remain appropriate**. That said, **S$NEER bias may be to the stronger side of the (static) policy bands as sustained recovery ahead invokes expectations of appreciation bias being resumed**, albeit in a calibrated manner, **in the next 6-18 months**. And so, the focus may be on ***forward guidance about how long policy accommodation remains appropriate*** may; or the lack thereof.

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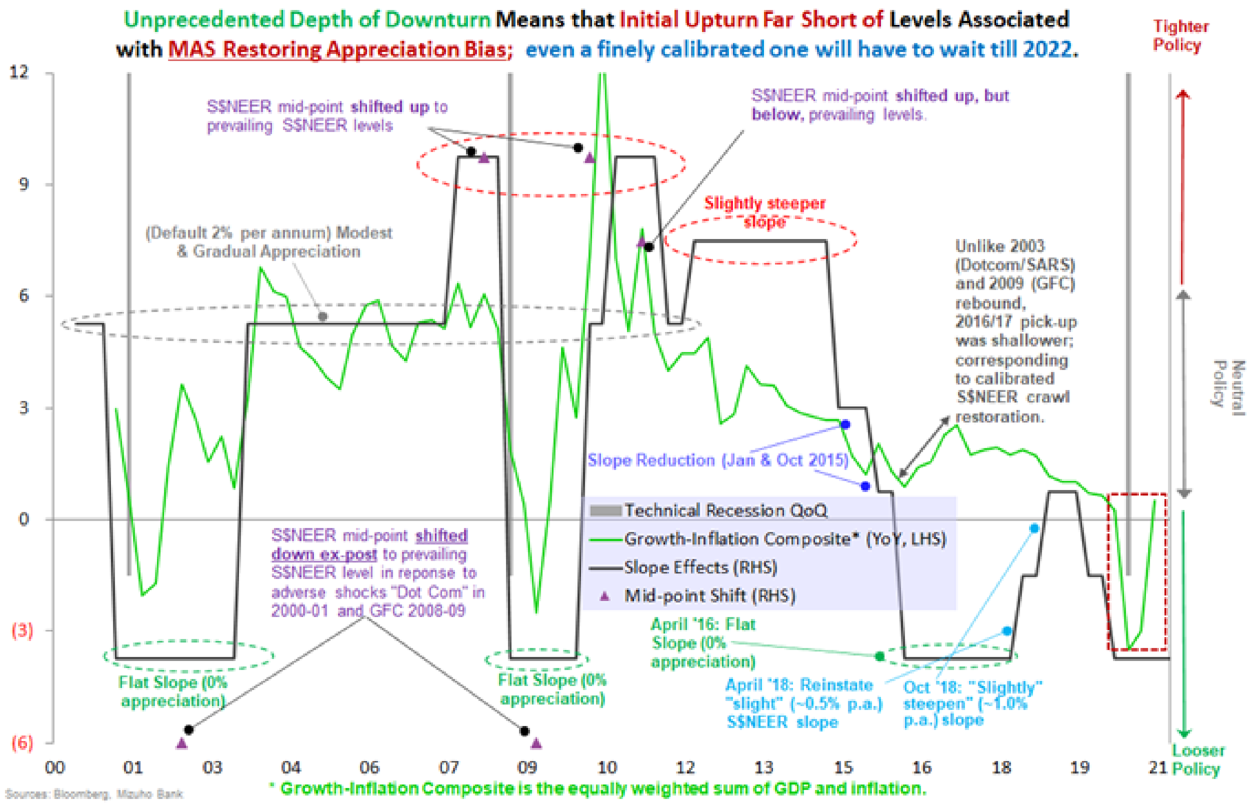


Uncontentious, Not Unambiguous

The **consensus call for the MAS to stand pat, maintaining a flat S$NEER slope** (0% appreciation bias) is **uncontentious, arguably even unanimous**; as **relatively dire growth-inflation dynamics remain consistent with exceptional policy accommodation** (Chart 1). By contrast, **guidance on how long this policy will be maintained remains highly debatable**. Specifically, **timing the reinstatement of S$NEER slope appreciation bias** (defacto "modest and gradual" appreciation of the trade-weighted SGD) **is critical**. Especially against the **backdrop of vaccine-dependent step-up demand restoration and reflation** fired up by unprecedented global stimulus led by the US being **juxtaposed against exceptionally uneven recovery**. To say the least, **despite current policy consensus, the course ahead is ambiguous**. And **Appreciating** (no pun intended) **triggers/conditions for reinstating S$NEER appreciation bias** requires congnizance that *cutting short accommodation "make (for) long delays" to recovery*.

Not Jumping the Gun

Table 1. Twenty Years (2000-2020) of Flat S$NEER Policy Response

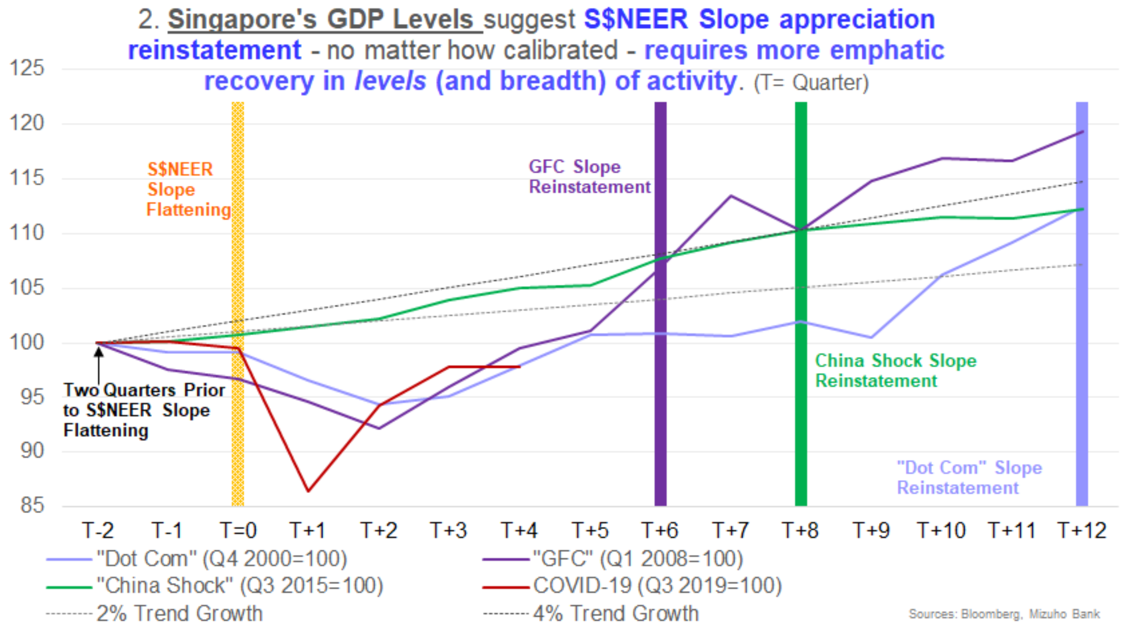
Crisis Response to	Date		
	Flatten Slope	Reinstate Appreciation bias	Months of Flat S$NEER Slope
"Dot Com"/SARS	Jul-01	Apr-04	33
"Lehman Shock" GFC	Oct-08	Apr-10	18
"China Shock"	Apr-16	Apr-18	24
COVID-19	Mar-20	*Apr-21 (??)*	*12 (??)*

Source: MAS, Mizuho Bank

Right off the bat, it appears **premature to restore S$NEER slope appreciation bias**, even if finely calibrated, **a mere 12 months after a flat (0% appreciation) S$NEER slope was instituted**; in response to the unprecedented COVID-19 pandemic. And the **MAS has no reason to jump the gun**. **On the contrary**, it has **every reason to exercise an abundance of caution in favour of supporting an entrenched recovery in growth**.

Even a superficial glance reveals **no precedent to revoke the flat S$NEER accommodation so soon**. For one, **prior to COVID-19**, this sparingly exercised **flat S$NEER slope response** to adverse shocks (such as; i) the back-to-back "Dot Com" and SARS shocks; ii) the Global Financial Crisis (GFC) precipitating from the "Lehman Shock", and; iii) the aftermath of the "China shock" of 2016) has **spanned 18-33 months**. And quickest reversal (in 18 months) was in the context of roaring surge in demand and commodity prices post-GFC, which is clearly not the case now. The bigger picture is that the **severity of economic downturns/adverse shocks which invoke a flattening of the S$NEER slope by the MAS, only experienced on four occasions in the last 20 years** (including in response to COVID-19 last March), **typically require a longer period of policy accommodation** for adequately self-sustaining recovery.

Growth Recovery: Welcome Improvement, but Lacks Depth & Breadth



And it is on account of the unprecedented negative shock to growth coupled with a more uncertain and bumpier recovery path that suggests that the **MAS justifiably ought not only to be unhurried in restoring S$NEER appreciation bias**, but **more importantly** it should be **unfazed by the headline out-performance in GDP** growth.

Admittedly, **rosier-than-feared numbers on growth surprising since H2 2020**, culminating **in 2021 GDP growth being primed for a headline outperformance of 6-7%** (by most analysts' estimates) to compensate for the 5.4% drop in 2020, **appears to set the stage for a resounding rebound** in economic activity. But this is **a distortion that masks the severity of the pandemic downturn** on two counts.

First, and critically, the depth of the downturn not only has a propensity to leave more lasting damage, impeding sustained and full recovery, but a highly uneven and bumpy recovery across sectors and countries, undermine the ability to sustain the low-hanging rebound from 2021.

Second, the **unprecedented depth of the downturn means** that **even with solid headline growth rate rebound**, **activity levels remain far more subdued vis-à-vis pre-crisis compared to corresponding periods of previous crises, when S$NEER slope was flattened** (Chart 2). So necessarily, whether the **timeline for reinstatement of S$NEER appreciation bias** is 18, 24 or even 36 months will **depend on the course of economic recovery in a post-pandemic world in which US-China tensions will persist, if not proliferate further**.

Inflation: Looking Past Transitory Cost-Push

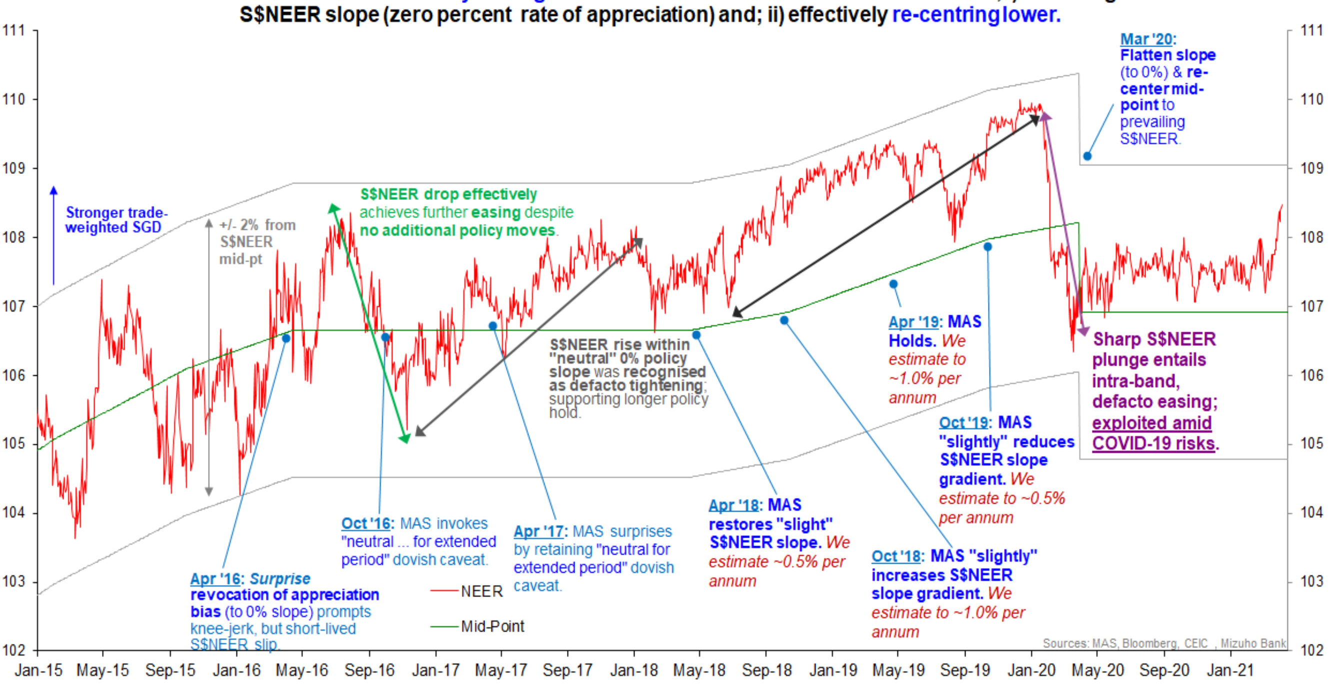
Admittedly, with the **sooner- and stronger-than-expected rebound in cost-push pressures**, **led by oil/energy** prices along with other **commodities** and **logistics**, **fired up by reflationary policies** and **accentuated by capacity constraints** from COVID restrictions/impediments means that inflation is expected to pick up more briskly alongside growth. And we expect the **MAS to revise up inflation projections from "mildly positive" to substantially closer to the 1-2% range**. But this is **a technical note not a cause for tectonic policy recalculation**.

Point being, the **MAS will look through transitory cost-push pressures** that are **exacerbated in the headline by exceptionally soft base effects due to the pandemic**. More importantly, given expectations for subdued wage dynamics resulting in **suppressed wage-price risks**, the MAS will be rightly assess that **not all inflation are equal and critically, not all inflation equals to policy response**.

In short, **inflation will take a backseat as policy is trained on lingering risks of bumpy, uneven growth recovery**. In fact, quite perversely, in the case of unexpected negative revenue shocks into late 2021, cost-push pressures risk being ultimately deflationary insofar that it will suppress demand via weaker profit/discretionary income mechanics.

S$NEER Policy: Holding Levels

3. MAS to Maintain Current Policy Settings After March 2020's "Double Barelled" Move of; i) flattening the S$NEER slope (zero percent rate of appreciation) and; ii) effectively re-centring lower.



Working back from the policy consensus for a hold, specifically to maintain policy bands with 0% appreciation bias, what is notable is that **the policy intent is for broadly stable S$NEER levels over the next six months at least**. However, the **accepted and inadvertent policy impact is calibrated tightening** at the margin **as the S$NEER has drifted further to the strong side of the policy bands**.

Two take-aways from that are; i) **policy settings have been fine-tuned** within the presumed +/-2% "free-play" of the policy bands to adjust **for positive surprises to economic growth**, but ***without undermining the policy accommodation intended*** and; ii) **as a result, the MAS has fewer reasons to rush into reinstating appreciation bias** for the S$NEER.

So the **S$NEER policy band is set to be held in place in April**; and more likely than not through 2021 as lingering risks to growth (both the depth and breadth) remain a bugbear. **But a static policy band is not necessitate an inanimate S$NEER that has fair wiggle room**; albeit a lot more to the downside at this juncture. Critically, S$NEER policy bands do not correspond to fixed USD/SGD range.

SGD: Mainly USD-Driven; Decreasing Scope for Out-performance

Instead, **USD trend will remain as the predominant force in determining USD/SGD moves** as was the case with a depreciating USD through most of 2020, lifting SGD (lowering USD/SGD) trading range corresponding to the fixed S$NEER policy band (Chart 4). Meanwhile, even as **SGD out-performance on a trade-weighted basis** remains compelling, ***in anticipation of MAS shifting gears as a result of vaccine recovery***, this "outperformance" has **been baked in to a large extent**. And so, **scope for sustained SGD out-performance** in the absence of imminent upside in S$NEER policy bands could get **somewhat more limited in coming months**.