Maybank Kim Eng

ECONOMICS

Singapore

Singapore Economics

MAS Preview: Hold on Slower Growth & Trade War Risks

Divided Views on MAS Policy

Consensus view is that MAS will tighten and shift to a modest (from slight) appreciation bias, because of core inflation – which stood at 1.9% in August. This remains within but is near the upper bound of the MAS core inflation forecast range of 1% - 2%. Core inflation may also creep higher on rising oil prices and wages. The employment outlook is the most optimistic in 3 years. Wage pressures may remain high as foreign manpower policies will be further tightened, with hikes in qualifying salaries for S-passes in Jan 2019 and 2020.

Expect Hold on Slowing Growth & Trade War Risks

We think that the MAS will likely stay on hold and maintain the current "slight appreciation bias" at the mid-Oct meeting, given visible signs of slowing growth. Headline inflation remains benign, currently at only 0.7% in August. Monetary conditions are already tightening, with the 3M SIBOR set to climb further to 1.85% by end-2018 and 2.2% by end-2019 on Fed rate hikes. The escalating US-China trade war presents downside risks for both growth and inflation. We would ascribe roughly a 70% probability to a hold and a 30% probability to a shift to a steeper or modest S$NEER appreciation slope. The S$NEER is trading at +1.1% above the mid-point, by our estimates, with room for further appreciation within the band.

Flash 3Q GDP Around +2.6%, Below +4.2% in 1H

Third quarter GDP growth likely slowed to around +2.6% on a year-on-year basis, as both manufacturing and services posted softer numbers for Jul-Aug. Hospitality and transportation & storage services are the two bright spots. Exports and trade-related services may be temporarily inflated as firms frontload orders and shipments before the tariffs come into effect. Disruption and impact on trade will be more acute in 4Q and 2019 when both the US and China tariff are hiked to their full extent. Latest property measures will also hurt business services and construction, as residential property transactions plunge.

US-China Trade War: A Known Unknown

The US-China trade war presents binary risks to the outlook. Some compromise could see growth and exports rebound, alongside inflation risks. But escalation to a full-blown trade war with tariffs hiked to as much as 25% on half of US-China trade starting Jan 2019 will be deflationary for Singapore. The consequently weaker RMB will reduce prices of made-in-China imports. Both the US and China may divert their excess supply and inventories to third countries, reducing prices. Commodity prices may also tumble if global capex collapses, as companies delay investment plans. Probability of further escalation and a full blown US-China trade war is our current base case, with some halfway deal likely only in 2019.

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MAS Preview: Expect Hold but Cannot Rule Out Tightening

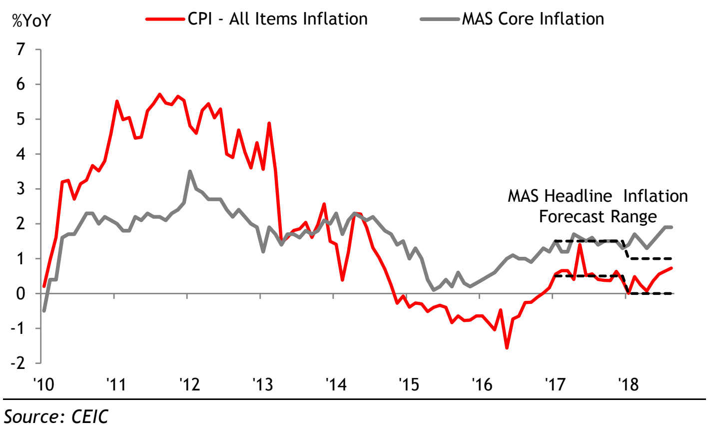
Our base case scenario is for MAS to maintain the current "slight appreciation bias" for the S$NEER (70% probability), given visible signs of slowing growth and downside risks from an escalating US-China trade war. GDP growth likely slowed to about +2.6% in the third quarter, down from +3.9% in 2Q and +4.5% in 1Q. Both manufacturing and services growth are cooling off.

We cannot however rule out a tightening move and assign a 30% probability that the MAS may further tighten and steepen the slope at the mid-October meeting. Such a tightening may be defended on core inflation risks, given rising oil prices and wages. We are not expecting a change in the level or width of the S$NEER band.

We think downside risks to growth have risen compared to the last meeting in April, with the intensifying US-China trade war. Singapore will feel the collateral damage as it is one of the most open economy in Asia: exports of goods & services accounted for nearly 200% of GDP in 2017. Trade-dependent sectors such as wholesale trade and transportation & storage will likely be hit, and the slowdown could potentially broaden to domestically-oriented sectors. Based on AMRO's estimates, the trade war can deduct -0.2% to -0.8% points from Singapore's GDP growth in the first 12 months (see *ASEAN Economics - US-China Trade War: Raising the Stakes*, 25 Jul 2018).

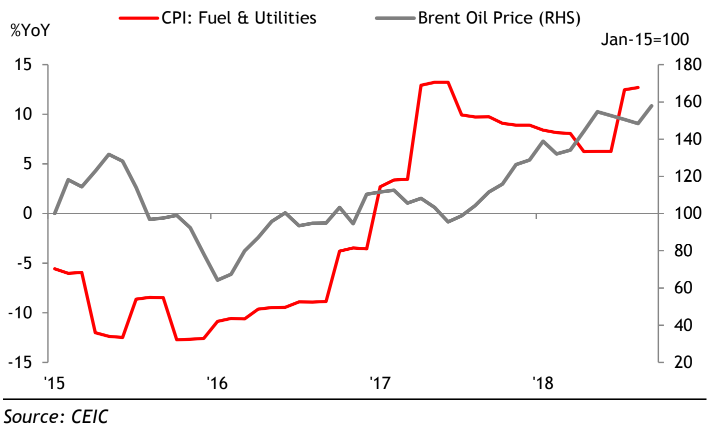
Inflation risks are moreover to the downside, given the escalating US-China trade war. A full blown trade war will likely be deflationary for third countries like Singapore, as [1] businesses will scale back investments, which will lower commodity prices, including oil; [2] diversion and "dumping" of Chinese and US goods to third countries will reduce imported goods prices; and [3] a depreciating CNY – which has weakened some 9% from its peak - will lower prices of made-in-China products.

Figure 1: Core Inflation Edged Up to +1.9% in Jul/Aug 2018



Source: CEIC

Figure 2: Brent Oil Price Continues to Rise



Source: CEIC

What makes this a difficult call for MAS is that core inflation continues to creep higher, while labour market conditions have tightened. Core inflation will likely approach +2% as early as Sep-18 (see Fig 1). With oil prices continuing its uptrend to breach $85/barrel recently (for the first time since 2014), electricity tariffs will rise by around +2.1% in 4Q from the previous quarter[1] (see Fig 2). Fuel and utility account for about 3.4% weight of the CPI basket. The labour market is likely to

[1] Straits Times, "*Electricity tariffs to increase from Oct 1 to Dec 31 period*", 29 Sep 2018.

remain tight as the government maintains its tight foreign worker policy, with qualifying salaries for S-passes set to rise in Jan 2019 & Jan 2020[2].

We expect core inflation to average +1.7% in 2018 (within the upper range of MAS' forecast of 1-2%) and +1.8% in 2019 (see Table 1). The gradual opening of the electricity market to the rest of the Singapore's zones starting 1 Nov will help cap the rise in utilities costs. According to the Energy Market Authority, households in Jurong that have switched to authorized retailers paid an electricity rate 20% lower than the regulated tariff on average[3]. The MAS may narrow its core inflation range to a point forecast within 1.5%-2% for 2018 (from the current 1%-2% range).

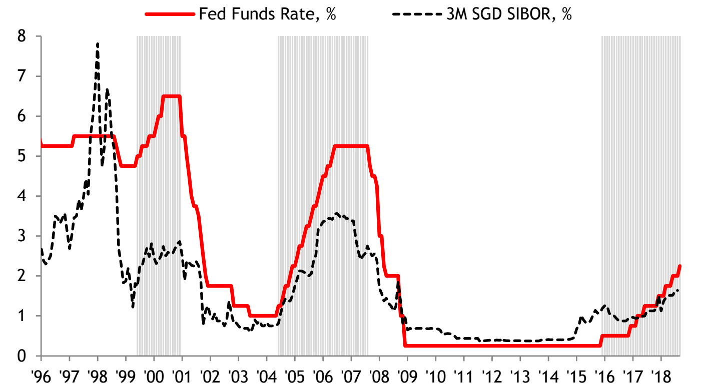
We revise our headline inflation forecast for 2018 to +0.6% (from +0.7%), given the weaker than expected pace year-to-date (+0.4%). We forecast headline inflation climbing higher to +1.2% in 2019. Headline inflation continues to be weighed down by the private transportation component, as COE prices have been falling since the start of the year, reaching 8-year lows. MAS may narrow its current headline inflation forecast to 0.5%-1% for 2018, from the current 0-1%.

Table 1: Headline Inflation and Core Inflation Forecasts

	Headline Inflation	Core Inflation
	%YoY	%YoY
2013	+2.4	+1.7
2014	+1.0	+1.9
2015	-0.5	+0.5
2016	-0.5	+0.9
2017	+0.6	+1.5
2018F	+0.6	+1.7
2019F	+1.2	+1.8

Source: CEIC, Maybank Kim Eng

Figure 3: Forecast 3M SIBOR Rising to 1.85% end-2018 and 2.2% end-2019

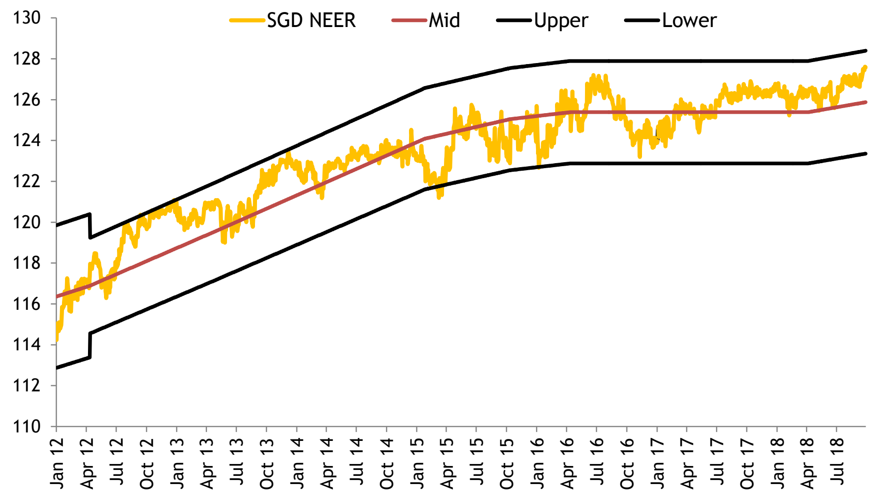


Source: Bloomberg

We forecast 3-month SIBOR to continue rising as the Fed is expected to stick to its hiking cycle as the US economy strengthens. We expect the Fed to hike another +25bps in Dec to bring the total count to 4 rate hikes in 2018, and 3 more hikes in 2019. We expect 3M SIBOR to reach <u>1.85% by end 2018</u> and <u>2.2% by end 2019</u> (see Fig 3). Monetary conditions are therefore already tightening, even if the MAS maintain the current policy stance. The S$NEER is trading at around +1.1% above the implied mid-point, by our estimates (see Fig 4).

[2] Today Online, "*S Pass salary criteria to be raised to S$2,400 over 2 years: Lim Swee Say*", 5 Mar 2018.
[3] Business Times, "*Singapore's open electricity market to be extended islandwide in phases from Nov 1*", 21 Sep 2018.

Figure 4: SGD NEER Currently Trading at +1.1% Above the Mid-point

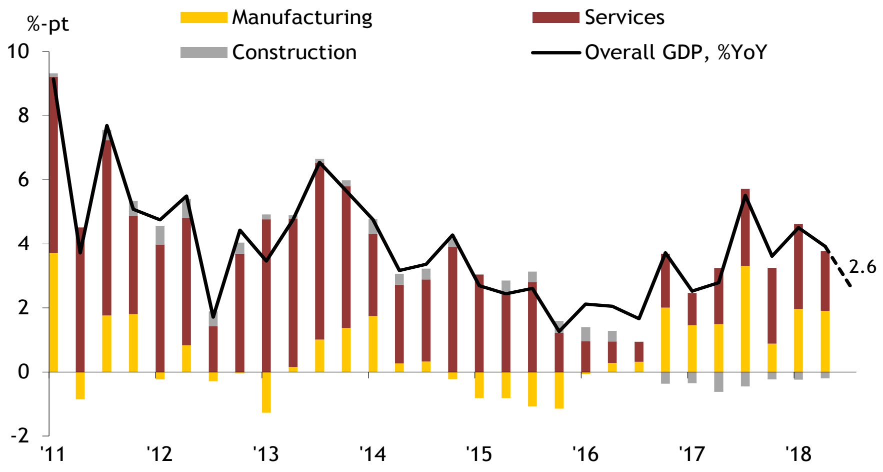


Source: Bloomberg, Maybank GM FX Research

Slower 3Q GDP as Manufacturing Slumps

Flash 3Q18 GDP growth estimate is expected to come in at around +2.6%, given slower manufacturing growth in July and August. This is much lower than the +3.9% in 2Q and +4.5% in 1Q, and also the lowest GDP growth in 6 quarters (see Fig 5). High base explains part of the slowdown, as GDP surged by +5.5% in the third quarter last year, the fastest pace in nearly 4 years. On a quarter-on-quarter seasonally adjusted annualized basis, we forecast GDP expanding by +5.5% from 2Q.

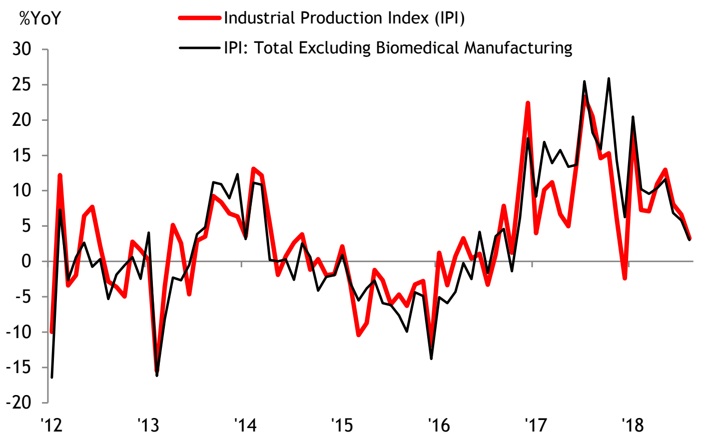
Figure 5: 3Q18 GDP Likely Slowed to +2.6%



Source: CEIC, Maybank KE

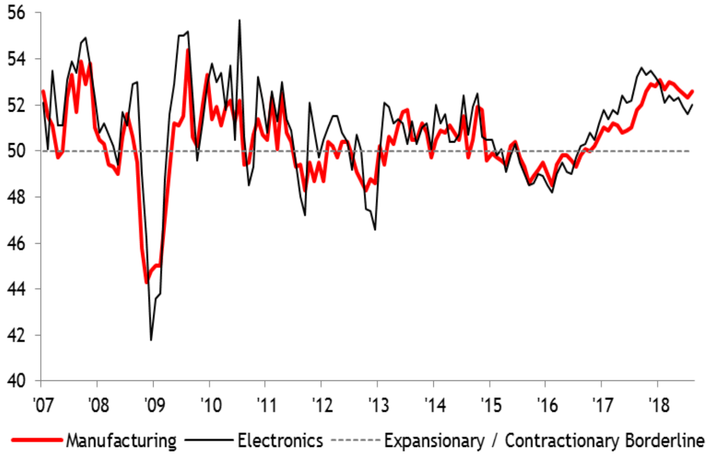
Manufacturing continues to outperform services but the momentum is waning as the global electronics cycle fades. Industrial production decelerated to +5% in Jul-Aug period from a year ago, following the near +11% surge in the first two quarters of the year (see Fig 6). Semiconductors (+7.2% in Jul-Aug), the star performer that drove growth for the past two years, has halted its double-digit growth rally and will likely ease further in the coming months. Singapore’s PMI numbers are trending lower in recent months (see Fig 7). Electronics demand seems to be tapering off, as reflected by softer orders for the new iPhones and potential disruption to the supply chain from the escalating US-China trade war.

Figure 6: Industrial Production on a Downward Trend



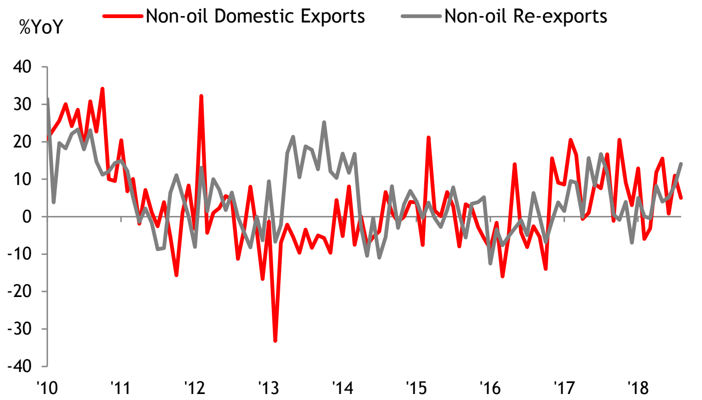
Source: CEIC

Figure 7: Overall and Electronics PMI Continue to Slide



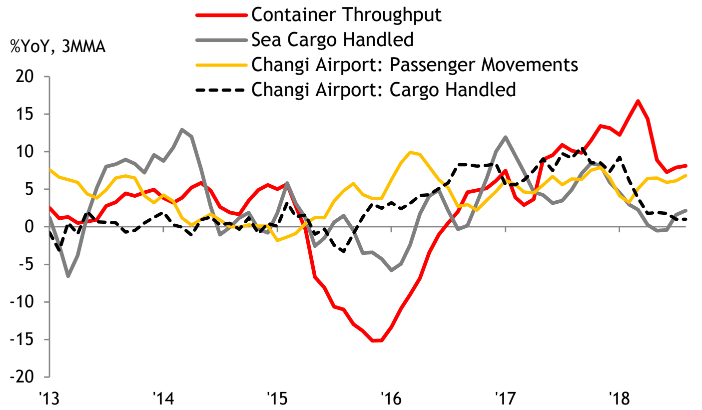
Source: CEIC

Figure 8: Trade - NORX Accelerating and NODX Still at Healthy Pace in Jul-Aug 2018



Source: CEIC

Figure 9: Transport - Indicators for Both Sea and Air Transport Activity Improved in Jul-Aug



Source: CEIC

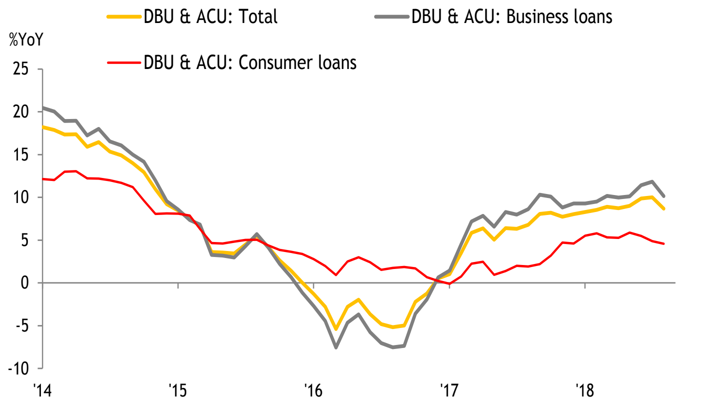
Trade numbers still look robust but we think 3Q numbers are distorted as firms are frontloading and shipping their goods before tariffs hit. Risk is that the trade volumes will suddenly pullback in 4Q or 2019, as the higher tariffs come into effect. Non-oil domestic exports (NODX) expanded by +7.9% in Jul-Aug (vs. +9.3% in 2Q), driven by non-electronics exports such as pharmaceuticals (see Fig 8). Non-oil re-exports (NORX), a proxy for wholesale trade services, surged by +11.2% in Jul-Aug (vs. +5.7% in 2Q), which may reflects some frontloading prior to the latest round of US tariffs on $200bn of Chinese imports that started on 24th September. Similarly, trade-related indicators such as container throughput (+8% in Jul-Aug), sea cargo (+2.4%) and air cargo (+1.9%) are picking up pace compared to 2Q (see Fig 9).

The financial sector likely slowed in 2Q as loans growth and trading activities started to moderate. Total loans, DBU and ACU combined, softened to +8.7% in Aug (vs. +10% in Jul) as ACU loans (+12.1% vs. +15.1% in Jul) showed signs of slowing on the back of loans to businesses (see Fig 10). Under DBU loans (+5.6% in Aug), housing & bridging loans (+3.7%) have started slowing since July following the property measures. Trading volumes are also weakening with turnover on SGX securities (-6.5%) and FX market (-1.3%) starting to decline in Jul-Aug, which could offset the growth in derivatives volume (+18.6%).

Business services will also likely be hit by the property tightening measures effective 6th July. Private residential sales by developers fell by -34% in Jul-Aug (vs. -26% in 2Q), and will likely see steeper declines given that July numbers were boosted by rush purchases before the measures hit. Subdued bids in recent government land tenders also point to potential weakness in the real estate segment going forward (see *Singapore Property: Subdued Bids Underscore Caution*, 5 Sep 2018). URA's private property price index decelerated to +0.5% in 3Q (on a quarter-on-quarter basis) and the HDB resale price index dipped to a decline (-0.2%), suggesting housing demand is starting to cool (see Fig 11).

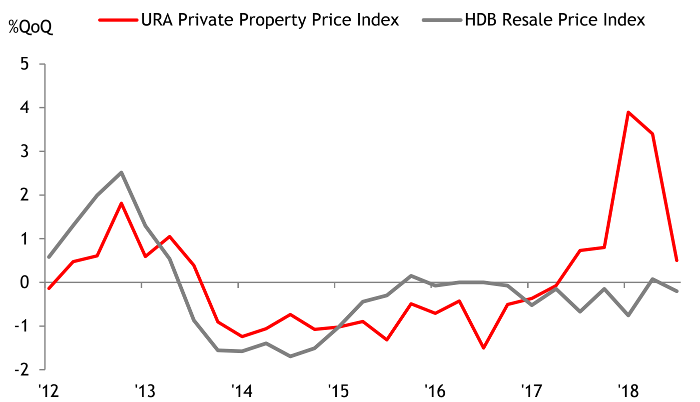
The construction sector likely continued to contract in 3Q18, but is starting to bottom out. Latest Jul-Aug numbers for certified progress payments (a proxy for construction output) are still coming below the amount recorded in the same period last year. We think the construction sector will likely return to positive growth in 2019 on the back of the bringing forward of some public infrastructure projects and redevelopment of en bloc sites sold last year. Overall growth for the construction sector will however still be negative for 2018.

Figure 10: DBU & ACU Loans Growth Peaked in July, with Both Business & Consumer Loans Slowing in August



Source: CEIC

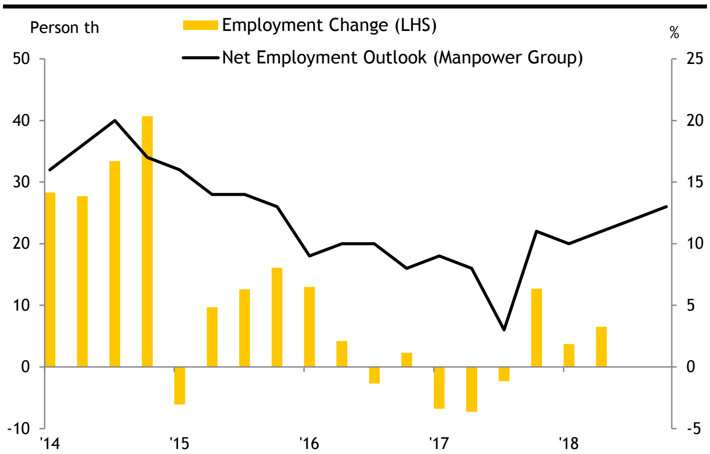
Figure 11: URA's Private Property Price Index Retreating, While HDB Resale Price Index Declined in 3Q



Source: CEIC

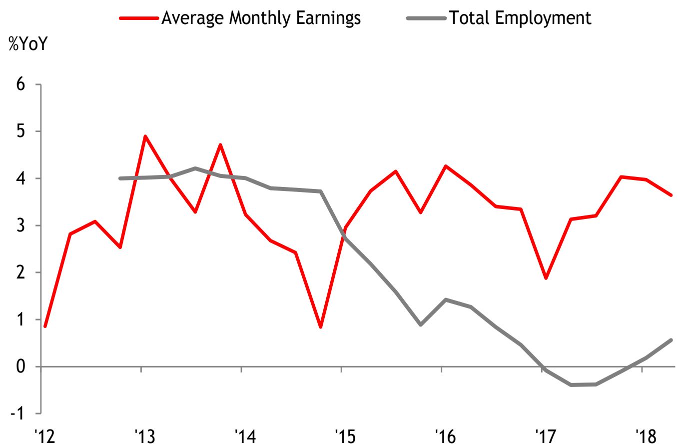
The labour market has improved in 2Q18 with employment (+6.5k) rising on the back of services and job vacancy to unemployed person ratio (1.1) rising to a 2-year high (see Fig 12). Average monthly earnings also continued rising at a healthy pace (+3.6% vs. +4% in 1Q) (see Fig 13). ManpowerGroup's Employment Outlook Survey for 4Q is the most optimistic in 3 years. The Ministry of Manpower sounded upbeat in its outlook for the second half, supported by services sectors such as information & communications, financial & insurance services and professional services. We maintain our forecast of <u>net employment growth of +20k for 2018</u> (first half at +10.2k), a strong turnaround from the disappointing numbers (-3.7k) in 2017.

Figure 12: Employment Outlook More Optimistic in Second Half of the Year



Source: CEIC, ManpowerGroup

Figure 13: Average Monthly Earnings Rising as Employment Recovery Strengthens



Source: CEIC

Latest population statistics show that Singapore's immigration and foreign worker policies remain tight. Maintaining overly tight policies however risks intensifying wage cost and inflation pressures, against the backdrop of a slowing economy. Total population only rose by +0.5% in 2018 (vs. +0.1% in 2017) as Permanent Residents (-0.8%) declined, and non-residents (-0.1%) contracted for the second consecutive year (see Table 2).

Table 2: Singapore Population Rose by +0.5% in 2018, Weighed Down by Decline in Permanent Residents and Non-Residents

	Numbers (as at June, in '000)					Average Annual Growth (Per Cent)				
Year	**Total Population**	Total Resident	Singapore Citizens	Singapore Permanent Residents	Non-Residents	**Total Population**	Total Resident	Singapore Citizens	Singapore Permanent Residents	Non-Residents
1990	3,047	2,736	2,624	112	311	2.3	1.7	1.7	2.3	9.0
2000	4,028	3,273	2,986	287	755	2.8	1.8	1.3	9.9	9.3
2005	4,266	3,468	3,081	387	798	2.4	1.6	0.8	8.6	5.9
2006	4,401	3,526	3,108	418	875	3.2	1.7	0.9	8.1	9.7
2007	4,589	3,583	3,134	449	1,006	4.3	1.6	0.8	7.5	14.9
2008	4,839	3,643	3,164	478	1,197	5.5	1.7	1.0	6.5	19.0
2009	4,988	3,734	3,201	533	1,254	3.1	2.5	1.1	11.5	4.8
2010	5,077	3,772	3,231	541	1,305	1.8	1.0	0.9	1.5	4.1
2011	5,184	3,789	3,257	532	1,394	2.1	0.5	0.8	-1.7	6.9
2012	5,312	3,818	3,285	533	1,494	2.5	0.8	0.9	0.2	7.2
2013	5,399	3,845	3,314	531	1,554	1.6	0.7	0.9	-0.3	4.0
2014	5,470	3,871	3,343	528	1,599	1.3	0.7	0.9	-0.7	2.9
2015	5,535	3,903	3,375	528	1,632	1.2	0.8	1.0	0.0	2.1
2016	5,607	3,934	3,409	525	1,674	1.3	0.8	1.0	-0.6	2.5
2017	5,612	3,966	3,439	527	1,646	0.1	0.8	0.9	0.4	-1.6
2018	**5,639**	**3,994**	**3,472**	**522**	**1,644**	**0.5**	**0.7**	**1.0**	**-0.8**	**-0.1**

Source: CEIC

We maintain our full-year GDP growth forecast at +3.5% in 2018 and +2.7% in 2019 (see Table 3). Manufacturing growth will likely continue slowing to low single digits for the rest of 2018, as the electronics cycle fades. The escalating US-China trade war will dampen growth in 2019, but will not likely tip Singapore into a recession. Trade diversion to neighbouring ASEAN countries may support intra-ASEAN trade and partly cushion the impact. The improving job market and continued wage growth will provide some support to the domestically-oriented sectors such as retail trade and other services. Construction is past its worst and should return to positive growth by late 2018 and 2019. Risks are however on the downside as the US-China trade war intensifies, while the property measures will also slow business and financial services.

Table 3: Sector Growth Rates

	3Q17	4Q17	2017	1Q18	2Q18	3Q18	2018F	2019F
	%YoY Change							
Total	**5.5**	**3.6**	**3.6**	**4.5**	**3.9**	**2.6**	**3.5**	**2.7**
Goods Producing Industries	**12.2**	**2.7**	**5.7**	**7.1**	**7.1**			
Manufacturing	19.1	4.8	10.1	10.8	10.2			
Construction	-9.3	-5.0	-8.4	-5.2	-4.6			
Services Industries	**3.5**	**3.5**	**2.8**	**4.0**	**2.8**			
Wholesale & Retail Trade	3.3	3.0	2.3	2.5	1.5			
Transportation & Storage	5.2	5.3	4.8	2.7	1.3			
Accomm & Food Services	1.3	2.9	1.2	2.0	4.0			
Info & Communications	5.1	6.0	3.3	5.4	5.2			
Finance & Insurance	7.1	6.3	4.8	9.2	6.7			
Business Services	0.5	0.4	0.6	2.6	2.1			
Other Services Industries	2.0	2.7	2.6	2.3	0.7			
	Annualised QoQ Growth % (SA)							
Total	**11.2**	**2.1**	**3.6**	**2.2**	**0.6**	**5.5**	**3.5**	**2.7**
Goods Producing Industries	**26.0**	**-11.8**	**5.7**	**19.7**	**-1.1**			
Manufacturing	34.9	-14.8	10.1	26.2	1.8			
Construction	-2.4	-0.2	-8.4	0.8	-15.4			
Services Industries	**6.5**	**6.3**	**2.8**	**-1.6**	**0.4**			
Wholesale & Retail Trade	9.0	6.5	2.3	-12.9	5.4			
Transportation & Storage	5.2	7.2	4.8	-4.2	-2.7			
Accomm & Food Services	6.2	2.2	1.2	-4.7	13.3			
Info & Communications	11.7	4.8	3.3	2.0	3.0			
Finance & Insurance	11.7	12.6	4.8	4.8	-1.8			
Business Services	0.0	1.0	0.6	11.4	-3.2			
Other Services Industries	2.5	5.2	2.6	-2.4	-2.0			

Source: CEIC, Ministry of Trade & Industry, Maybank Kim Eng

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