Singapore

A model of sound public finance management

Singapore is highly vulnerable to contagion effects of US trade hikes on Chinese imports due to its large dependence on tech exports and integration Asian value chains. Exports have contracted since last November and economic growth has slowed. Monetary policy tightening, which started last year, should pause in the short term while the government is expected to increase public spending to support activity. Its fiscal room for maneuver is significant given the strength of public finances. This will also enable the authorities to continue to implement their strategy aimed at stimulating innovation, enhance productivity and improve Singapore's medium-term economic growth prospects.

Weakening exports

Economic growth slowed from 3.9% in 2017 to a still solid 3.2% in 2018 (table 1). Growth lost steam principally due to the contraction in investment and weakening support from the export sector. It is projected to decelerate further and reach 2.5% in 2019.

Total exports of goods declined by 0.3% year-on-year (y/y) in November 2018-February 2019, after increasing by 12.5% y/y in January-October 2018. Non-oil domestic exports have contracted by 6.5% y/y since November 2018 (graph 2). This has resulted from the slowing global tech sector as well as supply-chain disruptions and weakening exports to China in response to US tariff hikes. Singapore is highly vulnerable to US protectionist measures given its exposure to Chinese demand (13% of its exports, or 16% of GDP), large participation in the high-tech industry value chain (exacerbated by its role of regional trade hub) and limited diversification of its export structure (semiconductors account for about one-fifth of total exports). In the very short term, the export outlook remains weak; it will notably depend on the outcome of ongoing trade negotiations between the US and China.

As volume growth in imports of goods and services slowed to a greater extent than volume growth in exports, the contribution of net exports to real GDP growth was positive in 2018. However, weaker activity in the export sector has started to have spillover effects on the rest of the economy. In Q4 2018, it contributed to inventory destocking and falling investment in machinery & equipment (which declined by 4.1% y/y after four quarters of growth). Moreover, employment in the manufacturing sector reverted to its trend decline after expanding in Q3 2018.

Investment contracted by 3.4% in real terms in 2018, after rising 5.3% in 2017. The decline affected all main investment components, and most particularly the residential construction sector (-11.8%). Investment in machinery & equipment was first more resilient but started to contract in Q4 2018. In the short term, investors in the manufacturing sector will remain prudent as long as export prospects are darkened by protectionism threats. Private investment in housing construction should remain sluggish. However, public investment in construction projects is projected to rebound, thus helping total investment growth to stabilize.

Private consumption remained an important contributor to GDP growth in 2018 even though its real growth slowed to 2.4% y/y from 3.2% in 2017. Labor market conditions have remained tight, with still firm wage growth (+3.5% in 2018) and stable employment (supported by the services sector). In 2019, private consumption growth is likely to continue to slow, mostly due to spillover effects of the weaker export-sector performance on the labor market, lower wealth effects (as the property market has entered a new period of downward correction) and continued slight tightening in domestic financial conditions.

1- Forecasts

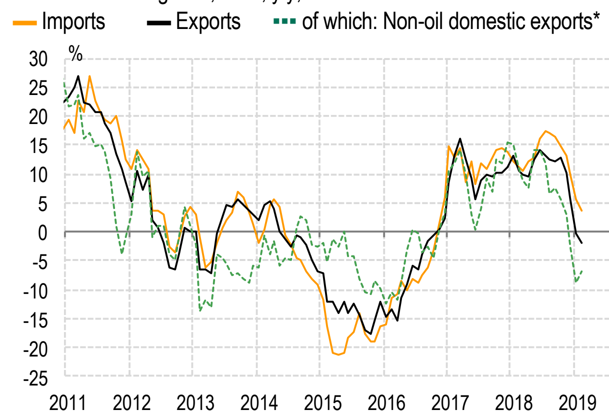
	2017	2018	2019e	2020e
Real GDP growth (%)	3.9	3.2	2.5	2.7
Inflation (CPI, year average, %)	0.6	0.4	0.9	1.0
Budget balance / GDP (%)	2.3	0.4	-0.7	1.0
Gross government debt / GDP (%)	108.0	112.2	115.0	118.0
Current account balance / GDP (%)	16.0	17.7	17.0	17.0
Forex reserves (USD bn)	280	288	296	321
Forex reserves, in months of imports	6.8	6.4	6.4	6.3
Exchange rate USDSGD (year end)	1.3	1.4	1.4	1.3

e: estimates and forecasts BNP Paribas Group Economic Research

2- Hit by the drop in tech exports

External trade of goods, USD, y/y, 3mma :

Imports — Exports — of which: Non-oil domestic exports*



Source: International Enterprise Singapore

** Non-oil domestic exports mostly comprise electronic and chemical products. They represent 65% of domestic exports, which themselves account for half of total exports. The other half is made of re-exports.*

Monetary policy tightening may first pause

Short-term interest rates have increased slowly since late 2016, in line with US/global interest rates. The Monetary Authority of Singapore (MAS) also started to tighten its policy last year in response to modestly higher inflation pressures (graph 3). It increased slightly the appreciation slope of the SGD-NEER policy band in April and then in October (with no change to its width or central parity) raising it to 1% from 0% in 2016-2017[1].

Credit conditions have become slightly tighter. Growth in bank credit to the domestic private sector lost speed in 2018 after two years of slow recovery (it reached 3.9% y/y in real terms at the end of 2018 vs. 4.8% at the end of 2017). Moreover, in July 2018, the authorities introduced tightening measures to cool the property market (through higher stamp duties and reduced loan-to-value ratios). As a result, after a period of recovery from mid-2017 to mid-2018, property transaction volumes and mortgage loan growth decelerated in H2 2018, and property prices have followed suit.

The monetary policy tightening is likely to pause in the very short term, before resuming before the end of 2019. In fact, the increase in US fed fund rates should pause while the deterioration in external trade and lower global energy prices should lead the MAS to revise its short-term expectations compared to last October (to slower-than-previously expected inflation and less favorable labor market conditions).

Fiscal policy should remain moderately expansionary

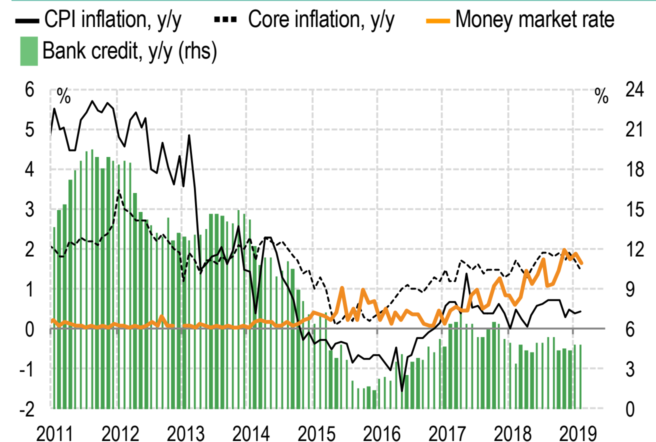
While monetary policy is aimed at supporting price stability, the authorities have recourse to fiscal policy measures to stimulate domestic demand in the short term and improve economic growth prospects in the medium term.

In FY18 (fiscal year from April 2017 to March 2018), the government reported a fiscal surplus of 0.4% of GDP, down from 2.3% in FY17. The FY19 budget will remain moderately expansionary and projects a small deficit of 0.7% of GDP. A broad increase in public expenditure is expected, including in welfare spending (especially health-related), infrastructure projects and support to SMEs. The FY19 budget does not include major revenue-raising measures, but an increase in the Goods-and-Services Tax (to 9% from 7%) was announced last year and is due to be implemented in 2021-2025.

In the medium term, the government plans a continued increase in structural public spending (infrastructure upgrade, education and health, innovation, etc.) in response to the ageing population and economic growth slowdown. The authorities pursue a strategy aimed at boosting productivity and making Singapore's economy shift towards an even more technology-driven and innovation-based growth model.

[1] The SGD is managed through the Nominal Exchange Effective Rate (NEER), which is allowed to fluctuate within a band and its rate of appreciation is announced every six months by MAS. As the exchange rate is the monetary policy target and capital movements are free, domestic interest rates are mainly determined by foreign interest rates and fx market expectations.

3- Very slight tightening in domestic credit conditions



Source: Department of Statistics, MAS, IMF

The government has a very comfortable leeway to absorb an increase in spending. It has long remained committed to a series of rules of fiscal discipline. Each administration has to keep a balanced budget over its five-year mandate. Borrowing proceeds can only be invested and not used for recurrent or operating expenditure, Moreover, the payment of interest on debt must be fully covered by returns on public investment.

This strict policy discipline has led to the accumulation of large buffers by the government, which posts a very strong net asset position. Its gross debt-to-GDP ratio seems high (112% in 2018), but the debt is in reality mostly made of non-tradable bonds issued for the national pension fund as well as government securities issued to develop local bond markets and Savings bonds providing individual investors with a safe long-term saving option. In addition, the government also has large public assets mainly managed by two Sovereign Wealth Funds (Temasek and GIC). The government does not fully disclose its public assets, but they are estimated to be very large and exceed the level of its debt. High returns on investment of the sovereign wealth funds allow them to be major contributors to government revenue. The government is therefore well equipped to face fiscal challenges in the medium term.

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