Economics

DBS Focus

Singapore budget: Eye on the future

Group Research

25 January 2018

Irvin Seah
Senior Economist

Please direct distribution queries to
Violet Lee +65 68785281 violetleeyh@dbs.com

Key Themes:

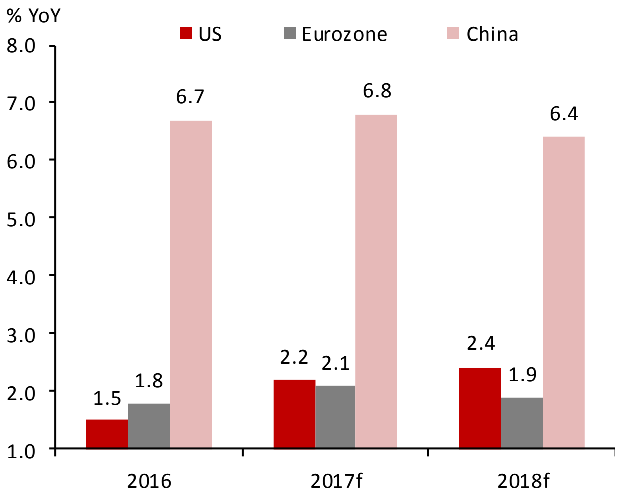
- Budget 2018 will be presented on 19 February. Amid an improved growth outlook, the budget will likely focus on further refinement of restructuring-related policies and longer-term fiscal planning.
- Policy measures to promote innovation, deepen critical capabilities across industries, and support the internationalisation of local firms are likely to be featured in the budget.
- We expect to see some longer-term fiscal planning parameters.
- Tax-rate increases and some streamlining of government spending are likely.
- Fiscal policy will turn contractionary, with overall fiscal surplus likely to rise to SG$6.5bn (1.5% of GDP) in FY18, up from a revised SG$5.0bn (1.2% of GDP) in FY17. Given the strength of the cycle, this would be a prudent step.

Budget 2018

Finance Minister Heng Swee Keat will be announcing Budget 2018 on 19 February. This will be a highly anticipated budget, given an improved growth outlook and talk of recalibrating the fiscal position.

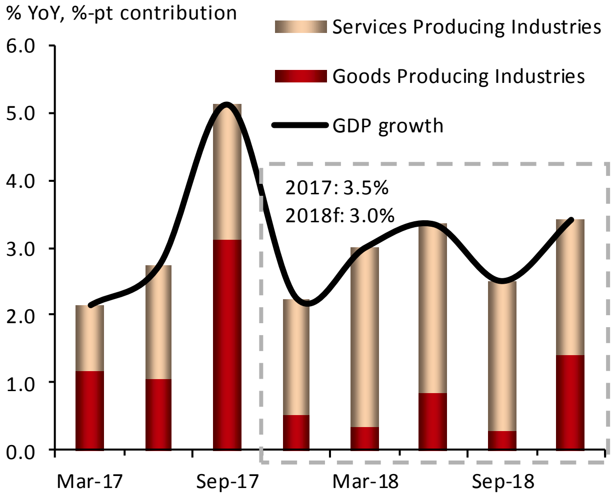
The external environment has improved significantly. Singapore's economy has benefited from a synchronised recovery in the US and the Eurozone, while growth in China should remain relatively strong and likely more sustainable, given its supply-side reforms. While this would likely be tempered by tighter liquidity conditions, given the monetary-policy normalisation by key central banks around the world, we expect the growth outlook for Singapore to remain sanguine in 2018.

Growth prospects for key markets remained positive



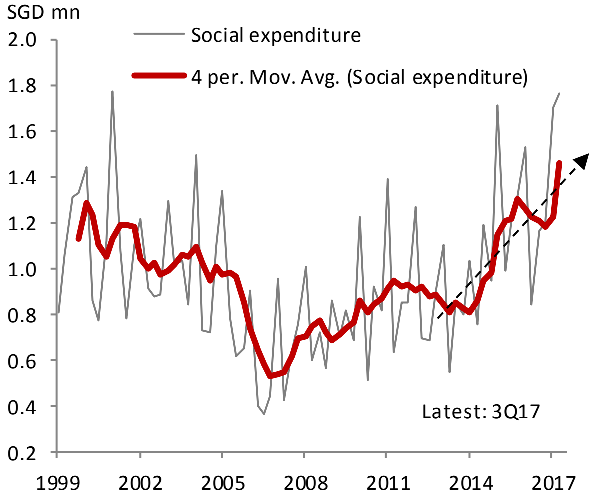
Singapore should register growth of 3.0% in 2018, a tad slower than 3.5% in the previous year amid the global normalisation phenomenon. But most encouraging is the broadening out of the recovery to other segments of the economy, particularly the service sector. Note the sector accounts for two-thirds of GDP and employment. Continued improvement in the service sector will be crucial in ensuring a more sustainable growth path and brighter job prospects going forward.

Services to become key driver of growth



Amid the improved growth outlook, the budget will likely focus on further refinement of the medium-term, restructuring-related policies instead of counter-cyclical measures. Expect some attention on the rebalancing of the fiscal position (i.e. tax hikes) as well, given the recent official rhetoric on that issue, due to the increased spending in recent years and going forward, given an aging population.

Rising social expenditure



Supporting local enterprise development

The budget will skew towards longer-term structural issues, especially on executing the recommendations put forth by the Committee on the Future Economy. Note the Finance Minister is also the Chairman of the Committee.

There will be more measures to strengthen the Industry Transformation Programme (announced in Budget 2016). The aim is to promote innovation and deepen critical capabilities across industries and within individual enterprises at different stages of growth (i.e., from startups to large local enterprises). Most of the Industry Transformation Roadmaps (ITMs) for the 23 targeted industries/clusters under the programme have already been announced. In this regard, expect the authorities to step up efforts in the implementation of the ITMs to ensure that local companies can truly benefit. Defined KPIs, progress markers to monitor the effectiveness of the initiatives, as well as targeted facilitation in the adoption process of the ITMs at the firm level would also help yield higher success for the programme.

Beyond that, **there could be further enhancement to the Automation Support Package,** with a bigger grant quantum and higher risk-sharing by the government to help companies invest in digital technologies, additive manufacturing, and robotics. There could also be more measures or tax incentives to help companies venture overseas. Enhancements also could be made to initiatives such as the SME Go Digital Programme and the International Partnership Fund to help local companies scale up and internationalise. Possible improvement to the scope and the quantum of the Double Tax Deduction (DTD) on internationalisation expenses would also go a long way in achieving those aims.

Concomitantly, more public communication on this aspect and targeted consultancy for local companies will surely help enhance the take-up rate of these schemes. Companies must also realise the potential of overseas markets and be willing to scale up their business models and take the plunge abroad. **With Singapore assuming the ASEAN chairmanship this year, we need to step up our regionalisation efforts**. Not only will this create more opportunities for local companies, Singapore could also share best practices and new technologies with her neighbours and contribute to their economic advancement.

On the issue of regional integration, there is significant scope for Singapore to capitalise on its ASEAN chairmanship to further buttress the efforts in this direction. An ASEAN focus investment fund could be set up to catalyse economic development in the region. This can be spearheaded by key government institutions, with participation from local enterprises or the general wider public. This will be a win-win arrangement. While helping promote regional economic development, it would also allow Singapore's institutions, companies, and public to generate good returns from the growth prospects in the region. Moreover, this is also very much in line with Singapore's macro priority to regionalise local companies. **Contributing to the growth of the region will surely benefit local companies and the Singapore economy at large**.

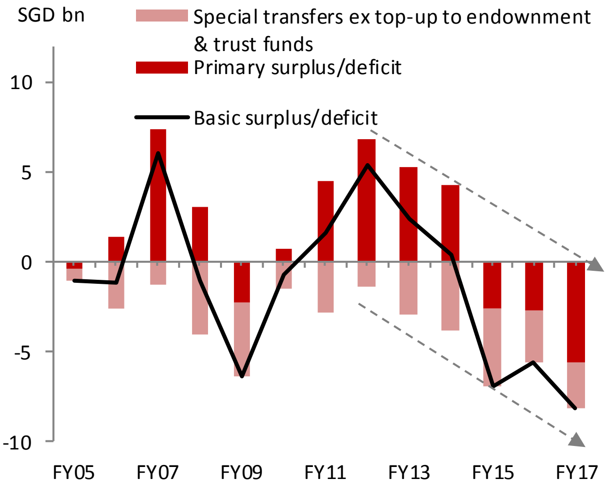
Besides helping established companies, resources may also be directed towards startups. Given that there are already many such assistance schemes and "incubator" facilities, a new stock exchange for startups could be an option worth exploring, as is being considered in Thailand. Beyond addressing the funding needs of startups and boosting investor interest in small local companies, such an exchange could raise the visibility of Singapore as a global centre for startups and entrepreneurship**.** It could also provide a steady stream of new companies which could potentially move up to the main board.

Fiscal rebalancing

Besides refining the efforts in structural adjustment, policymakers will likely embark on some long-term fiscal planning. The primary deficit was originally projected to more than double to SG$5.6bn (1.3% of GDP) in FY17, from SG$2.7bn in FY16. Expenditure on special transfers was expected to rise about SG$110mn previously. Even though we expect the primary deficit to turn out better than projected (see later section), Singapore will still register three consecutive years (including FY17) of deficit in the primary balance.

Continuously wider deficits are not sustainable. This explains the need to rebalance the fiscal position by finding new sources of revenue and/or lower spending. The diesel tax, hikes in the water tariff, and the permanent 2% downward adjustment to budget caps of government agencies introduced in Budget 2017 were part of the aim. While the return on Singapore's foreign reserves, in the form of the Net Investment Returns Contribution (NIRC), has helped offset the basic deficit and allowed

Primary and basic deficits deepening



Singapore to enjoy overall fiscal surpluses for many years, there are limitations on relying on the NIRC going forward [1]. Hence, expect hikes in some taxes and/or cuts in subsidies in the upcoming budget.

A GST hike will help generate revenue to offset the deficit but there are political considerations [2]. We expect an announcement on a hike in the goods-and-services tax of 2%-pts, although the actual date of implementation is still debatable, given the political constraint. GST on e-commerce transactions and the consumption of Internet content will most likely be introduced, although the mechanics of such an initiative remain to be seen. Hikes in other taxes such as property, wealth taxes, or betting tax, as well as excise duties on tobacco and liquor or on the import of vehicles should also not be discounted.

Concurrently, subsidy expenditure may be lowered. For example, the Productivity and Innovation Credit (PIC) will expire in 2018, which will ease some strain on the official coffers. Some broad-based restructuring-related assistance schemes may also lapse or could be reduced as policy measures become more targeted.

Reduction in subsidies may help lessen the need for more aggressive tax hike. This is a trade-off that all fiscal policymakers are aware of but one that needs to be communicated to the public thoroughly.

Raising taxes and/or cutting subsides will help but cost management is just crucial too. Healthcare inflation averaged 2.6% in 2017, significantly higher than the overall inflation rate of 0.6%. There is a need to review the current cost structure and streamline the administrative processes of Singapore's healthcare system. Ultimately, no matter how much we increase healthcare subsidies, it will never be enough if costs are not kept in check, particularly given the aging demographic profile.

Ensuring fiscal sustainability

The FY17 overall surplus is likely to be about SG$5.0bn (1.2% of GDP), significantly higher than the budgeted amount of SG$1.9bn. This comes largely on the back of a less-than-projected operating expenditure, given the self-imposed 2% downward adjustment to the budget caps of all ministries and Organs of State, as well as lower development expenditure arising from low inflation (0.6% in 2017). Total expenditure is likely to register SG$73.6bn, against a budgeted SG$75.1bn. Conversely, operating revenue in the first half of FY17 already accounts for about 55.2% of the budgeted amount. Coupled with the much-better-than-expected growth performance, the revised revenue number could surprise on the upside.

Singapore's overall fiscal position

	Budgeted FY2017 SGD bn	Estimated FY2017 SGD bn	Projected FY2018 SGD bn
Operating revenue	**69.45**	**70.94**	**72.71**
Less:			
Total expenditure	**75.07**	**73.61**	**74.53**
Operating expenditure	56.30	55.17	55.72
Developmental expenditure	18.77	18.44	18.81
Primary surplus/deficit	**-5.62**	**-2.67**	**-1.82**
Primary balance as % of GDP	**-1.30**	**-0.63**	**-0.41**
Less:			
Special transfers	6.58	6.51	6.00
Add:			
NIRC	14.11	14.20	14.30
Overall surplus/deficit	**1.9**	**5.0**	**6.5**
Overall balance as % of GDP	**0.4**	**1.2**	**1.5**

For FY18, fiscal policy will remain conservative, given the need to rebalance the fiscal position and the expiry of some earlier subsidy schemes. **We expect a smaller primary deficit of SG$1.8bn (0.4% of GDP).** Both revenue and expenditure are likely to rise marginally, given slightly slower growth and still benign inflation this year. With both special transfers and the NIRC expected to remain stable, **overall fiscal surplus is likely to rise to SG$6.5bn (1.5% of GDP) in FY18.**

While fiscal policy will turn contractionary, it is necessary to tighten the primary balance, given the past three consecutive years of deficit. Any potential negative impact on the economy could also be easily offset by the relatively more conducive economic climate. Importantly, while Singapore's overall fiscal position remains strong, given the robust NIRC, **policymakers will continue to adopt a prudent and forward-looking approach in planning for the future**. This includes possible tax adjustments, which may be unpopular but are necessary to safeguard the sustainability of Singapore's longer-term fiscal health.

Footnote:

[1] See our publication "Singapore: Ensuring fiscal sustainability" dated 20 Mar17 for more details.

[2] See our publication "Singapore: Biting the GST bullet" dated 17 Nov17 for more details.

Group Research

Economics & Strategy Team

Taimur Baig, Ph.D.

Chief Economist - G3 & Asia

+65 6878-9548 taimurbaig@dbs.com

Gundy Cahyadi

Economist - Indonesia, Thailand, & Philippines

+65 6682-8760 gundycahyadi@dbs.com

Nathan Chow

Strategist - China & Hong Kong

+852 3668-5693 nathanchow@dbs.com

Eugene Leow

Rates Strategist - G3 & Asia

+65 6878-2842 eugeneleow@dbs.com

Chris Leung

Economist - China & Hong Kong

+852 3668-5694 chrisleung@dbs.com

Ma Tieying

Economist - Japan, South Korea, & Taiwan

+65 6878-2408 matieying@dbs.com

Radhika Rao

Economist - Eurozone & India

+65 6878-5282 radhikarao@dbs.com

Irvin Seah

Economist - Singapore, Malaysia, & Vietnam

+65 6878-6727 irvinseah@dbs.com

Samuel Tse

Economist - China & Hong Kong

+852 3668 5695 samueltse@dbs.com

Duncan Tan

FX and Rates Strategist

+65 6878-2140 duncantan@dbs.com

Philip Wee

FX Strategist - G3 & Asia

+65 6878-4033 philipwee@dbs.com

Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).