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Reinventing Singapore

Boosting Productivity, Understanding Budget 2015, and Looking Ahead

DBS

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Boosting Productivity, Understanding Budget 2015, and Looking Ahead

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Introduction

This year, Singapore celebrates half a century of independence. Decades of hard work, innovation, and strong policy direction have resulted in transformative national development. For many years, ever higher productivity delivered prosperity and growth, taking the island state's economy from third world to first world.

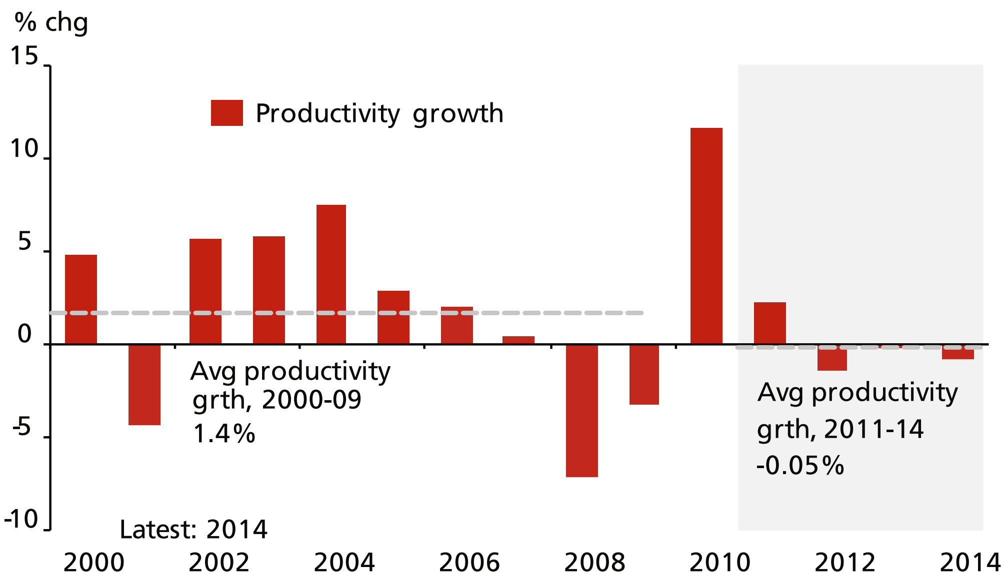
But the economy is maturing and things have been slowing down. What can Singapore do to revive its productivity growth? How can Singapore stay ahead of the economic curve? How should Singapore re-invent itself to secure its prime position within the world's fastest-growing region?

In this report we look at the issues surrounding productivity and restructuring. We examine the key measures and policy directions found in Budget 2015. And, finally, we present our June Quarterly Outlook for Singapore's economy.

Productivity and Restructuring: Old Problems, New Approaches

Singapore launched a ten-year economic restructuring program in 2010. But now, as it passes through the half-way point of this process, productivity growth is languishing (see Chart 1). Productivity growth declined by 0.8% in 2014, implying average productivity growth of minus 0.05% per annum since restructuring began in 2010. This is well below the government's target growth of 2-3% per annum and lower than the 1.4% annual growth averaged between 2000-2009.

1 **Productivity growth continued to languish**



Source: DOS, DBS Group Research

Better indicators

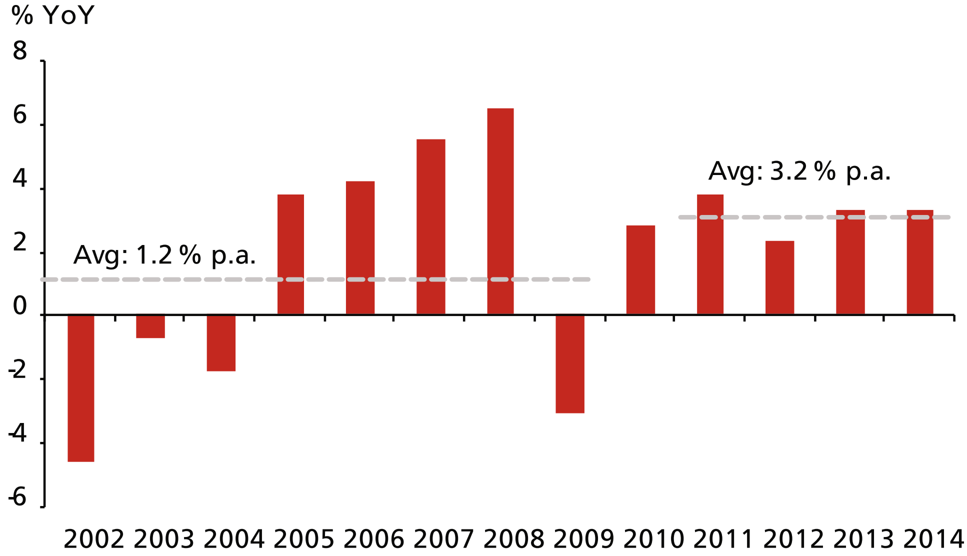
We argue that the headline productivity growth figure may not be the best indicator of productivity gains in the near-term [1]. As productivity is widely defined as GDP per worker, the small and open nature of the Singapore economy implies that productivity is mainly a function of the global business cycle, especially in the short term. Efficiency gains get disguised by short-run swings in GDP.

Real median income growth – which the Economic Strategies Committee (ESC) aims to raise by 30% over ten years – may be a better gauge of restructuring success. Real median income grew by 3.2% per year between 2011-14 and by this measure restructuring appears to be on track (Chart 2).

The jury is still out on whether restructuring is working

Nevertheless, the dismal productivity growth figure has led to concerns that progress on productivity has been slow. The jury is still out on whether restructuring is working, but the pain felt by companies due to tightening in foreign manpower policies suggests a review may be required [2].

2 **Real median income growth**



Source: DOS, DBS Group Research

New Approaches

As restructuring moves through its halfway mark, it is timely to take a fresh look at old problems. There are two broad areas that could be improved upon. First, more accurate and relevant productivity indicators would be helpful. Second, a shift in policy focus towards top-line growth, rather than crimping headcounts and subsidising investment costs, is worth considering as well.

Industry-Specific Efficiency Indices

Having a more accurate measurement of productivity would allow policymakers to devise more targeted initiatives to raise it. Apart from headline productivity growth and real median income growth, one way would be to employ a set of micro-based, industry-specific productivity indices.

...a more accurate measurement of productivity would allow policymakers to devise more targeted initiatives...

Firstly, a range of indicators can be used to develop an industry-specific composite productivity index. For example, indicators such as square metre per man-day can be used to measure the speed of construction in that sector. For food and beverage, table turnover rates might be better efficiency indicators. Each industry should have its own set of micro-economic indicators.

These could then be indexed and averaged to obtain an economy-wide efficiency measure.

Cross-industry comparisons can also be made if these indicators are indexed to a common base year. From these, policymakers might then be able to better gauge the progress made and come up with better ways to help improve productivity.

Focus on Top-Line Rather than Input Costs

More targeted

In the second half of the ten-year program, policy measures are likely to become more targeted and less painful. Broad-based measures such as hikes in foreign workers' levies will no longer be required. Instead, possible reductions in levies may be considered at some point, particularly given that the Productivity and Innovation Credit (PIC) scheme will expire in 2018.

Most importantly, more emphasis may be placed on helping companies improve their top-line growth so as to improve productivity. That is, rather than taking the carrot-and-stick approach of starving companies of foreign workers and subsidising the costs of investment in technology, the focus going forward should be on helping local companies improve their revenues. There are some measures in Budget 2015 along these lines. To achieve this goal, it is important to help companies internationalise. For a small and open economy such as Singapore, regional markets such as Indonesia, Malaysia, the Philippines, Vietnam and Myanmar are key. Internationalisation of local companies is not a new strategy for Singapore although little has been said about it in the restructuring program over the past few years.

Regional expansion may be the best way for SMEs to escape their current predicament

While government-linked companies (GLCs) and larger Singaporean companies have succeeded in regional markets, small- and medium-sized enterprises (SMEs) have found it tougher going. It is true that many SMEs are more concerned about their mere survival in the domestic market than expanding overseas. And, the pressure on wage costs from restructuring has further clipped their wings. Some help with top-line growth might be in order.

Regional expansion may be the best way for SMEs to escape their current predicament. More innovative and efficient companies stand a fair chance of success in the region. The existing ASEAN Free Trade Agreement and the upcoming formation of the ASEAN Economic Community (AEC) could provide the platform for SMEs to expand regionally. More policy measures to incentivise the partnering of SMEs with GLCs or foreign SMEs for regional expansion could benefit Singapore significantly.

For example, many technologically advanced SMEs in Europe are struggling with depressed domestic markets. Asia offers them significant growth prospects. Joint ventures that leverage the technology of European SMEs, with Singapore's regional linkages, could raise growth prospects and local technological capabilities at the same time. More policy measures and initiatives to facilitate this process would not only help SMEs internationalise but would improve productivity too, with clear implications for real income growth.

Budget 2015: Shaping the Future

Deputy Prime Minister and Finance Minister Tharman Shanmugaratnam unveiled the 2015 Budget just as the nation was gearing up for its 50th anniversary celebrations. While the budget builds on a legacy of five decades of nation-building, it is also very much about shaping the future of Singapore [3].

...there are also marked shifts in the approach and depth of some of the measures

Promoting inclusive growth and deepening economic restructuring are key thrusts in the budget. However, there are also marked shifts in the approach and depth of some of the measures. This clearly showcases the resolve to achieve these long-term objectives.

Key areas of focus include skills upgrading and investment in public infrastructure, strengthening the social safety net, and providing more support for companies in the restructuring process.

Investing for the Future

Significant efforts have been made to prepare Singaporeans for challenges ahead. The SkillsFuture scheme will be underpinned by a lifelong SkillsFuture Credit that every Singaporean will receive [4]. The scheme is essentially about investing in Singaporeans.

...a two-pronged approach of upgrading skills and technology

As an economy matures, the types of skills required will become more complex. The scheme is aimed at enhancing industry-specific skill sets. So it should enable Singaporeans to meet challenges in the new economic structure. Plainly, the ongoing productivity drive is now taking a two-pronged approach of upgrading skills and technology.

There will be significant investment in public infrastructure and education in the coming years. Additional funding for public transportation and healthcare facilities will help ease current bottlenecks from capacity-lagging population growth in past years. Furthermore, additional education support for children from lower income families, in particular, is also in line with Singapore's long-held economic principle to ensure social mobility.

Strengthening the Social Safety Net

Special transfers

As part and parcel of the objective to redistribute wealth, there have been significant special transfers to Singaporeans (see Table 3). Apart from cash grants (i.e. the goods and services tax voucher or GSTV), other tax rebates and top-ups to various public assistance schemes, significant ground-breaking measures were also introduced.

The Silver Support scheme will help provide financial support to low-income elderly people with insufficient Central Provident Fund (CPF) savings for retirement and little family support. The aim is to help those who fall through the cracks of the existing social safety net.

3 **Special Transfer Package**

	Revised FY2014 SG$ bn	Estimated FY2015 SG$ bn
Special Transfers	12.83	11.67
Special Transfers Excluding Top-ups to Endowment and Trust Funds	4.33	5.67
GST Voucher Special Payment	0.28	0.32
Service and Conservancy Charges Rebates	0.08	0.08
CPF Medisave Top-ups	0.12	0.1
Pioneer Generation Package	0.3	-
Productivity and Innovation Credit	1.4	1.5
Productivity and Innovation Credit Bonus	0.67	0.45
Temporary Employment Credit	-	0.69
Wage Credit Scheme	1.46	2.31
Other Transfers	0.02	0.22
Top-ups to Endowment and Trust Funds	8.5	6
Top-up to Endowment Funds	0.5	-
Special Employment Credit Fund	-	0.5
National Research Fund	-	1
National Productivity Fund	-	1.5
Pioneer Generation Fund	8	-
Changi Airport Development Fund	-	3

Source: Ministry of Finance

CPF adjustments

Adjustments to the CPF system have also been made. The CPF salary ceiling will be raised from S$5,000 to S$6,000 from 2016 while the contribution cap for the Special Retirement Scheme (SRS) has been lifted to boost CPF savings.

CPF contribution rates for older workers will also be increased [5]. An additional 1% interest rate on the first S$30,000 of CPF balances will be provided for workers from the age of 55. The higher CPF interest return will encourage Singaporeans to be more prudent in their retirement planning. While the increase in the salary ceiling and hikes in employers' CPF contribution rates for older workers may hurt companies, the effect will be partially

...companies must look beyond the physical limitations of older workers and capitalise on their experience...

offset by the enhanced Temporary Employment Credit (TEC), the Special Employment Credit (SEC) and other cost subsidisation measures for companies. It will not be a zero-sum game. The net impact on employability of older workers is expected to be minimal. Most importantly, companies must look beyond the physical limitations of older workers and capitalise on their experience to boost productivity amid a tight labour market.

Deepening Restructuring

Top-line growth

The budget also provided more support to companies in raising productivity. More importantly, there is a shift in the restructuring approach as productivity growth has continued to languish (see page 7). Measures have become more targeted and less painful. Emphasis is now placed on helping companies improve their top-line growth so as to bring about improvements on productivity. As mentioned earlier, instead of taking the carrot-and-stick approach of starving companies of foreign workers and subsidising the costs of investment in technology, the focus is now on promoting innovation and helping local companies improve their revenues via internationalisation [6].

Internationalisation

Significant efforts have been made to promote the innovation and internationalisation of companies. Enhancement of International Enterprise (IE) Singapore overseas investment grants and tax deductions will encourage more companies to venture abroad. Streamlining many of SPRING Singapore's assistance schemes will improve the capabilities of SMEs and catalyse the growth of start-ups. Besides deferring hikes in foreign worker levies to help ease the constraints on companies, the transition support package, which includes the wage credit scheme and corporate income tax rebates, will be extended to 2017, but with a lower level of subsidisation. These will provide interim support for companies by giving them more time to adjust.

Preserving Fiscal Prudence

Sustainability

Budget 2015 demonstrated Singapore's prudent fiscal planning (Table 4). While a deficit of S$6.67 billion has been budgeted for fiscal year 2015 due to a 19.3% increase in expenditure, the overall fiscal position for the current term of government remains balanced as a result of past years' surpluses. Moreover, significant efforts have also been made to ensure longer term fiscal sustainability amid potential increase in social spending as the population ages.

Temasek will now be included in the Net Investment Return framework to further boost the fiscal coffer. Marginal tax rates for the top 5% of income earners will be raised by 2 percentage points to 22% to make the tax regime more progressive and equitable. Additional funds have been set aside from the current budget to finance infrastructure development for future growth. This will lower the fiscal burden in the coming years in terms of developmental expenditure.

Budget priorities

The priorities of this Budget have been clearly expanded beyond just addressing immediate social concerns and the restructuring of the economy. It also sets out to tackle the challenges of an ageing population. Budget 2015 is all about shaping the future of Singapore.

4 **Singapore's overall fiscal position**

	Revised FY2014	Estimated FY2015	Change over Revised FY2014	
	SG$ bn	SG$ bn	SG$ bn	% change
Operating revenue	61.35	64.27	2.92	4.8
Less:				
Total expenditure	57.20	68.22	11.02	19.3
Operating expenditure	43.31	48.71	5.41	12.5
Developmental expenditure	13.89	19.51	5.62	40.5
Primary surplus/deficit	4.15	-3.95		
Less:				
Special transfers	12.83	11.67	-1.16	-9.1
Add:				
Net investment returns contribution	8.55	8.94	0.39	4.6
Overall budget surplus/deficit	-0.13	-6.67		

Source: Ministry of Finance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2Q Outlook for Singapore

- Uncertainties in the external environment and domestic restructuring constraints imply subdued growth ahead
- GDP growth is expected to average 3.2% in 2015 and 3.5% in 2016
- Inflation will remain benign on low energy prices at 0.4% in 2015 and 1.3% in 2016
- Chance of further monetary policy easing by the MAS is rising given low inflation

The economy grew by 2.1% on-year in the December quarter of 2014 (Table 5). On the margin, the economy exceeded market expectations with a healthy expansion of 4.9% (on-quarter, seasonally adjusted). Full-year GDP growth for 2014 now reads 2.9%. This upward revision can be attributed to a better-than-expected showing in the manufacturing and services sectors.

5 **GDP growth by sectors**

	2013	1Q14	2Q14	3Q14	4Q14	2014
Percentage change year-on-year						
Overall GDP	4.4	4.6	2.3	2.8	2.1	2.9
Manufacturing	1.7	9.6	1.3	1.7	-1.3	2.6
Construction	6.3	7.4	3.0	1.1	0.7	3.0
Services producing	6.1	3.7	2.6	3.3	3.1	3.2
Quarter-on-quarter annualised growth rate, seasonally adjusted						
Overall GDP	4.4	1.8	-0.5	2.6	4.9	2.9
Manufacturing	1.7	6.2	-9.3	0.9	-2.5	2.6
Construction	6.3	3.4	-3.0	0.7	2.2	3.0
Services producing	6.1	0.0	1.9	3.2	7.8	3.2

Source: DOS/MTI

Patchy Outlook for Manufacturing Growth Ahead

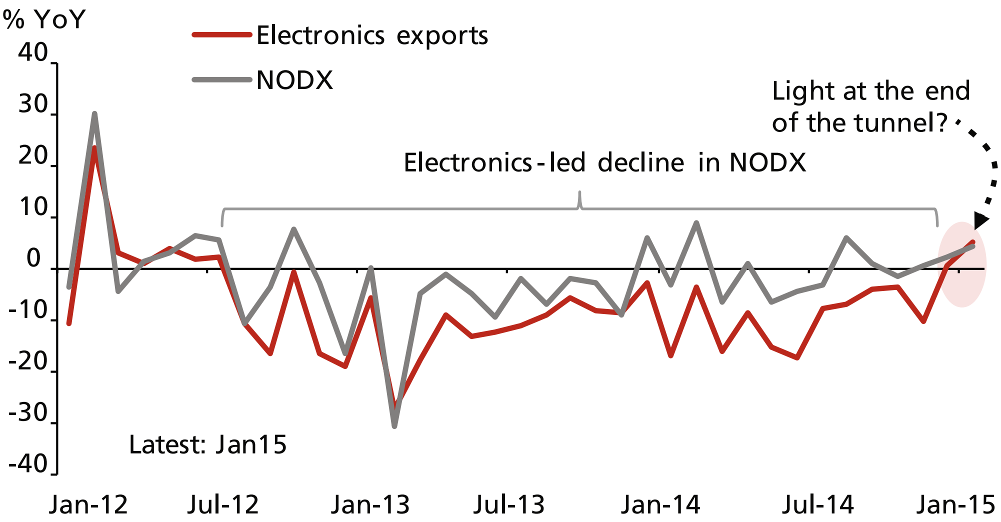
Industrial production output figures for October to December 2014 were revised upward. With the adjustments, December quarter manufacturing growth now reports a contraction of 1.3% on-year, compared with a decline of 2.0% assumed in the advance GDP estimates. This by itself has contributed an additional 0.2 percentage point to the headline number.

Uncertain outlook

The improvement in the manufacturing sector is supported by the turnaround in non-oil domestic exports (NODX). Export sales are finally above water after 28 months of doldrums (Chart 6), dragged down mainly by the weakness in electronics previously.

However, there are risks ahead. The SEMI book-to-bill ratio, the leading indicator for global electronics cycle has fallen back to around parity level again.

6 **End of NODX slump**



Source: IE Singapore/DBS Group Research

Exports to the top three markets ... may have bottomed, but signs of a pick-up remain elusive

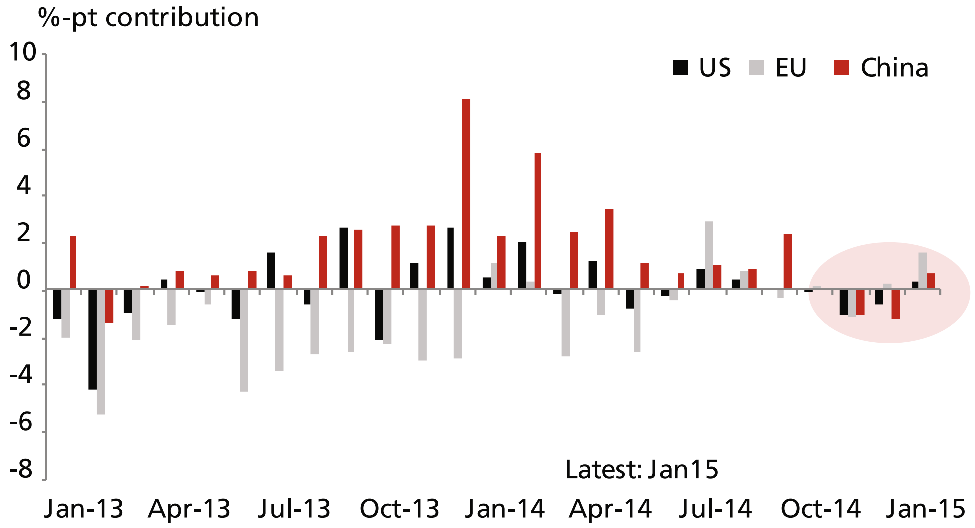
Global semiconductor sales growth had moderated to 9.3% on-year as of December 2014, compared with 10.2% in June 2014. Outlook for the manufacturing sector will remain tepid in the coming months as external headwinds remain strong. Pockets of downside risk in the global economy still exist. Exports to the top three markets – the US, the Eurozone and China – may have bottomed, but signs of a pick-up remain elusive (Chart 7).

Unless the recovery in the US gains momentum, slower growth in China this year and the placid outlook in the Eurozone will continue to weigh down on the prospects for the manufacturing sector in the coming quarters.

Uneven Improvement in Service Growth

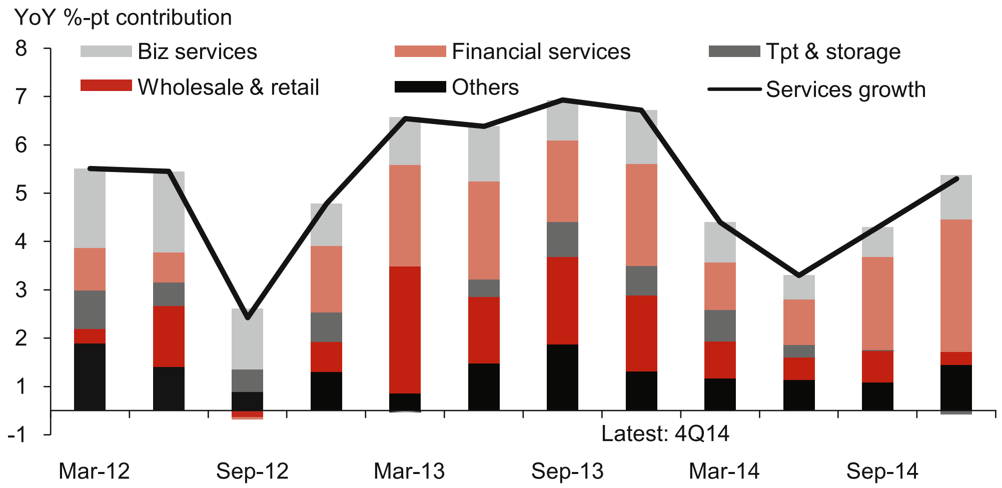
The services sector grew 3.1% on-year in the December quarter of 2014. That was significantly faster than the 2.6% that had been forecast by the advance estimates. Growth was supported mainly by the finance and insurance sector, which recorded a growth pace of 10.3%. That translates into a stunning 36.2% surge on an on-quarter, seasonally adjusted basis. In fact, the financial services industry alone accounted for about 57% of the total growth in the overall services sector.

7 **%-pt contribution to export growth**



Source: IE Singapore

8 **Services growth driven mainly by financial services sector**

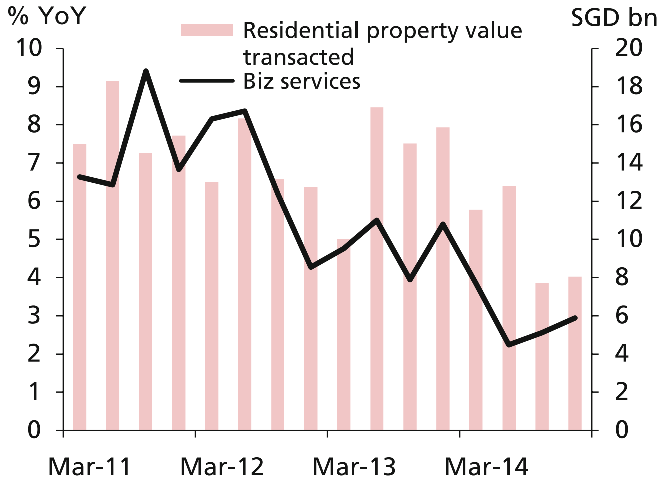


Source: DOS/MTI/DBS Group Research

Performance in other services industries has been less encouraging

Performance in other services industries has been less encouraging. Going forward, externally oriented services sectors such as transportation and trading services will face headwinds from the challenging global economic environment. Business services will be weighed down by a cooling property market (Chart 9). Moreover, the labour market is expected to remain tight through the restructuring process. The unemployment rate will remain low while the vacancy rate will continue to escalate.

9 **Business services growth**



Source: DOS/MAS/DBS Group Research

10 **Labour crunch**

Source: DOS/DBS Group Research

Labour market tightness

The difference between job vacancy and job creation, a reflection of the labour market tightness, has already reached an unprecedented level (Chart 10). The tight labour market will remain the number one challenge for service providers in the quarters to come.

Subdued Growth Outlook Ahead

The outlook for three key trading partners – China, the Eurozone and Japan – are expected to remain dicey while the recovery in the US economy has been slow. Nothing in the external environment suggests an improvement in growth momentum in the near-term.

Dicey and slow

In fact, there have been downward pressures on the GDP growth trajectory in the first quarter of the year, judging from the current global economic conditions. Overall the GDP growth forecast for 2015 remains at 3.2%, but we see downside risks.

For 2016, we expect the growth momentum in the US to pick up while the outlook in the Eurozone, Japan and China should stabilise. But potentially higher interest rates will crimp growth momentum in Asia and Singapore. A cautiously optimistic outlook will emerge and this makes for a subdued growth pace of 3.5%.

Inflation to Remain Benign

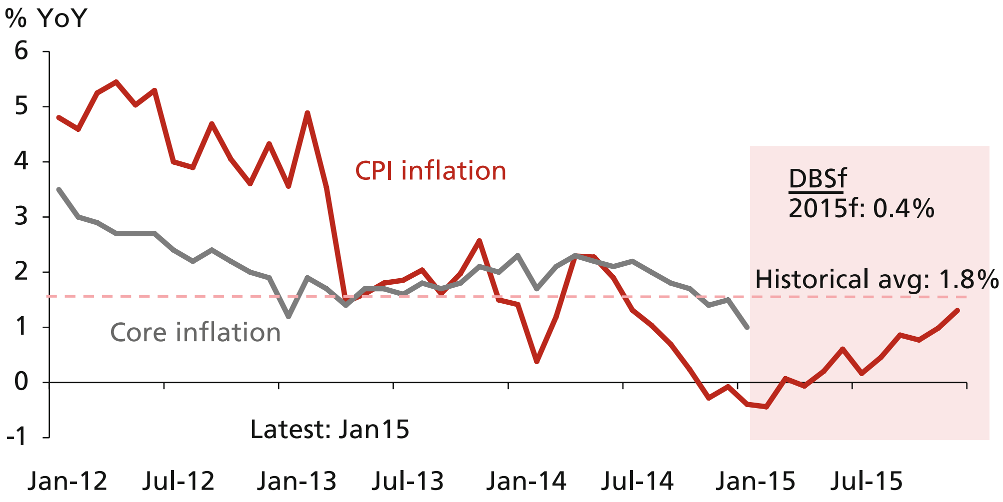
Inflation is expected to average 0.4% in 2015 (Chart 11). Such benign inflation comes on the back of low energy prices, a significantly less-than-expected increase in wage growth, a cooling property market, as well as moderation in healthcare costs due to the introduction of the Pioneer Generation Package.

Oil prices

Oil prices have fallen by about 50% over the past months. Being a net importer of oil, the island state will benefit significantly from a reduction in underlying costs, and henceforth inflation. As long as oil prices stay low, inflationary pressure within the domestic economy should remain muted.

Moreover, while the labour market has been tight, wage growth has not been as strong as anticipated. In fact, average nominal wage growth in 2014 has moderated to 2.6% on-year, compared with 4.2% in 2013. Benign wage growth is expected to persist along with the sub-par growth of 3.2% this year. As a result, the pass-through effects on consumer prices will consequently be modest.

11 **Benign inflation**



Source: DOS/MAS/DBS Group Research

A cooling property market has further weighed down on inflation

A cooling property market has further weighed down on inflation. Rental has been falling and is expected to continue on the downward trend amid risk of higher interest rates and a supply glut in the property market.

Pioneer Generation Package

Lastly, the Pioneer Generation Package, introduced by the government to alleviate the burden of healthcare costs for the elderly, has lowered healthcare inflation. The sub-index has eased from an average increase of 3.5% on-year between January and August 2014 to 1.8% over the past four months.

Inflation is declining on the compounded effects of the mixed bag of factors above. Not only is the base of the inflation trajectory for this year drastically reduced, the slope of this trajectory, in the form of sequential changes to prices, is likely to be significantly less than previously anticipated. Inflationary pressure, be it external or domestic, will stay relatively muted in the coming months.

Headline inflation will likely average minus 0.1% on-year in the first half of 2015 before inching higher to 0.9% in the second half. Overall inflation is expected to rise going forward to print 1.3% in 2016, partly on the back of the low base this year, higher energy prices and potentially stronger global growth.

Risk of Further Easing by MAS

Much depends on the balance of risk between inflation and growth

The Monetary Authority of Singapore (MAS) surprised the market on January 28 this year when it announced it had flattened the slope of its appreciating Singapore dollar nominal effective exchange rate (SGD NEER) policy band. The decision was made in conjunction with a downward revision in its inflation forecasts. The headline consumer price index (CPI) inflation forecast for 2015 was lowered to between minus 0.5% and 0.5%, from 0.5 to 1.5% previously.

Flatten the slope

The outlook for the core inflation was lowered to 0.5-1.5%, from 2-3% previously. This is a rare off-scheduled policy move by the authority. While MAS has brought its exchange rate policy closer to the general monetary easing stance seen in many countries globally, it still has a modest appreciation policy. With the SGD NEER now in the lower quartile of its band and flirting with the lower limit, the chance of further easing is rising.

Further easing

Much depends on the balance of risk between inflation and growth. And, both are facing downside risk amid a sluggish external environment and global deflationary pressure. If inflation continues to remain stuck in a negative level or if growth turns out weaker than expected, MAS could well re-centre the policy band lower or switch to a zero appreciation stance altogether.

12 **Singapore Economic Indicators**

	2014	2015f	2016f	4Q14	1Q15f	2Q15f	3Q15f	4Q15f	1Q16f
Real output and demand									
Real GDP (00P)	2.9	3.2	3.5	2.1	2.4	3.5	3.6	3.4	3.4
Private consumption	2.5	2.2	2.6	2.2	2.0	2.3	2.3	2.0	2.2
Government consumption	1.7	6.4	5.8	3.3	6.0	7.0	5.8	6.7	6.0
Gross fixed investment	-1.9	0.3	2.4	1.2	-1.4	0.0	1.0	1.6	1.7
Exports	2.2	2.1	3.0	0.2	2.0	2.0	1.8	2.5	2.5
Imports	1.5	1.5	2.4	0.5	0.9	1.5	1.3	2.3	2.4
Real supply									
Manufacturing	2.6	1.2	4.3	-1.3	-2.6	-0.6	2.1	5.6	4.5
Construction	3.0	1.1	3.5	0.7	0.3	5.0	0.4	-1.1	3.0
Services	3.2	4.3	3.7	3.1	4.1	4.9	4.8	3.5	3.5
External (nominal)									
Non-oil domestic exports	-0.7	1.5	2.5	0.5	2.2	2.2	0.0	1.7	0.2
Current account balance (USD bn)	59	61	62	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
% of GDP	19	19	19	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Foreign reserves (USD bn)	257	251	260	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Inflation									
CPI inflation	1.0	0.4	1.3	-0.2	-0.2	0.2	0.5	1.0	1.2
Other									
Nominal GDP (USD bn)	308	319	334	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Unemployment rate (%, sa, eop)	2.0	2.1	2.0	1.9	2.0	2.0	2.1	2.1	2.0

- % change, year-on-year, unless otherwise specified
Source: Bloomberg

Notes

[1] "SG: Restructuring on track", 16 Aug 2013. http://go.dbs.com/1AKZmW8

[2] "SG: Restructuring pain", 8 Oct 2014. http://go.dbs.com/1Au1PVu

[3] "SG: Jubilee Budget 2015", 10 Feb 2015. http://go.dbs.com/1Ep9aty

[4] SkillsFuture Credit will be given to all Singaporeans aged 25 years and above. Each eligible Singaporean will have an initial credit of SG$500 for education and training, which will be topped up at regular intervals and will not expire.

[5] CPF contribution for workers aged 50 to 55 years will be raised to the same level as those for younger workers at 37%.

[6] "SG: Old problem, new approaches", 27 Jan 2015. http://go.dbs.com/1AKZYLb

Sources: All data are sourced from CEIC. Forecasts are DBS Group Research.

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