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Singapore: Country Risk Insights

Economic Research Led By:

Nor Zahidi Alias
Chief Economist
+603 2082 2277
zahidi@marc.com.my

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In a nutshell

- Singapore's macroeconomic strength is reflected by its status as the world's third wealthiest country, with gross domestic product (GDP) per capita in purchasing power parity (PPP) terms of USD82,762 in 2014, a stark improvement from a low of USD8,845 in 1980. The relatively stable political environment, progressive economic policies as well as significant attention paid towards structural growth factors have contributed to the acceleration of per capita income. Singapore's high degree of trade openness has helped spur the development of the finance sector, which in turn buoyed the economy through the development of deep capital markets. The services sector formed two-thirds of the country's output, which is common among other developed economies, while the manufacturing sector remains a steady contributor to the economy, averaging close to 20.0% of GDP over the past 10 years.

- The city-state's key strength is further underpinned by its exceptionally strong external position that is characterised by its huge current account (CA) surplus which, to a certain extent, helped it to accumulate substantial external assets. In the five years post-Global Financial Crisis (GFC) through to 2014, its CA surplus stood at a whopping 20.0% of GDP, vis-à-vis advanced countries' average of 1.9% of GDP. Singapore's external position is further strengthened by its status as a large net creditor nation with an average net international investment position (IIP) of 189.3% of GDP over the last five years, one of the highest in the world. With a large foreign reserves stockpile amounting to SGD340.4 billion in 2014, MARC believes that Singapore is in a strong position to guard its economy against ordinary external shocks.

- On the fiscal front, the government continues to maintain prudent fiscal management, as evidenced by persistent fiscal surpluses since 2005 save for the recessionary year of 2009. Its fiscal balance averaged at 0.9% of GDP in five years through to fiscal year 2014 (FY2014), broadly unchanged from the period prior to the GFC. While the government is projecting a fiscal deficit in FY2015, MARC opines that the government's finances will remain in good shape, and will enable the country to utilise past fiscal reserves to respond to the current weak economic momentum. The government has also been proactive, raising its top marginal personal income tax rate for the first time in 30 years during the latest 2015 Budget, in anticipation of larger future spending bills. Risk on the debt profile, meanwhile, is minimal due to its sole reliance on domestic sources. Moreover, public external assets remain ample, suggesting that the government budgetary position will remain sturdy over the medium to longer term.

- Singapore's high global institutional rankings, particularly in terms of governance, competitiveness and business environment, is another positive attribute. It ranked exceptionally well in all but one of the sub-indicators of the World Bank's 2014 Worldwide Governance Indicators, and has consistently ranked second out of 151 countries in the World Economic Forum's (WEF) Global Competitiveness Index (GCI) in the four years through 2014-2015. Singapore is also well-known for its efficiency and for being largely corruption-free, ranking seventh out of 175 countries on Transparency International's 2014 Corruption Perception Index, albeit falling slightly from its previous position. Similarly, the World Bank also continues to rank Singapore as the most attractive place to do business, placing it at the top of its Ease of Doing Business rankings since 2007.

- Notwithstanding the positive factors, we also take into consideration Singapore's high exposure to the external sector given its status as a regional trade and financial hub. The value of total merchandise trade was almost triple the size of its GDP, the world's second highest after Hong Kong. As a result, Singapore's growth record is tied to the path of the global economy. Its growth volatility is the highest among advanced economies at 5.1% in the five years post-GFC (advanced economies average: 0.9%). In the aftermath of the GFC, except for a sharp rebound in 2010, the overall growth momentum continues to moderate, averaging 4.2% during the four years through to 2014 (pre-GFC: 7.4%), undermined by sub-par economic growth in other advanced economies and slower growth in East Asia.

- Going forward, the prospects of long-term growth will continue to be constrained by the rapidly ageing population. However, MARC views positively the government's efforts to nurture a new growth model that focuses on higher productivity. This will help reduce its reliance on foreign workers and set the stage for a more sustainable growth path over the medium to longer term.

Table 1: Selected economic indicators

	2009	2010	2011	2012	2013	2014
Real GDP Growth	-0.6	15.2	6.2	3.4	4.4	2.9
Inflation Rate - CPI (%)	0.6	2.8	5.2	4.6	2.4	1.0
Unemployment Rate (%)	3.0	2.2	2.0	2.0	1.9	2.0
Fiscal Balance - FY end-March (% GDP)	-0.3	0.3	1.1	1.6	1.3	0.0
Government Debt (% GDP)	104.2	99.6	102.2	106.3	103.2	99.3
Current Account (% GDP)	16.8	23.7	22.0	17.2	17.9	19.1
Net International Investment Position (% GDP)	220.6	202.1	185.0	187.9	189.4	182.0
International Reserves (USD bn)	187.8	225.8	237.7	259.3	273.1	256.9
External Debt (% GDP)	451.9	424.5	432.4	419.7	442.7	450.3

Source: MoF, Singstat, CEIC, MARC Economic Research

Key Strengths

High-income economy with well-developed financial centre

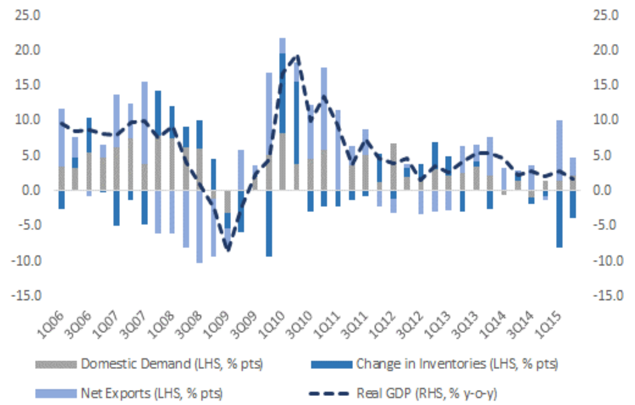
As a small yet very open economy, Singapore’s macroeconomic strength is reflected by its status as the world’s third wealthiest country, with GDP per capita in PPP terms rising almost tenfold from USD8,845 in 1980 to USD82,762 in 2014. With progressive economic policies in place, the relatively stable political environment as well as significant attention paid towards structural growth factors have contributed to the acceleration of per capita income, leading to a rapid improvement in the standard of living. Indeed, Singapore doubled its per capita income almost twice as fast as other advanced economies, including Canada and Sweden.

Singapore’s high degree of trade openness has helped spur the development of the finance sector, which in turn supports the overall economy through the development of deep capital markets and efforts to attract major global banking houses. The services sector formed 66.8% of GDP in 2014, of which two-thirds comprised wholesale and retail trade, business services as well as finance and insurance. The manufacturing sector, meanwhile, remains a steady contributor to the economy, averaging close to 20% of GDP since 2000 (2014: 19.3%).

Recent indicators suggest that the economy has somewhat slowed in 1H2015, particularly during 2Q2015, as the relatively strong expansion during the first three months of the year has been weighed down by weaker external demand as well as the continuous reduction in inventories in the following quarter. Private consumption, however, remained robust, with growth accelerating to 3.8% in 2Q2015 (1Q2014: 3.3%), the strongest since 2Q2013, benefitting from relatively cheap pump prices. Total investment, meanwhile, rebounded strongly during the same period, printing a 4.1% growth, reversing the 1.0% decline in the preceding quarter. On the external front, however, real exports barely grew at 0.6% (1Q2015: 3.9%), while imports shrank at a faster rate of 0.8% (1Q2015: -0.7%). As a consequence, contribution from net exports to GDP growth declined to 2.5 percentage points from a four-year high of 8.7 percentage points in 1Q2015. While the reduction in inventories was relatively smaller than the preceding quarter at 3.9 percentage points (1Q2015: -8.0 percentage points), it still wiped out almost two-thirds of the overall contribution from other growth sources. During the first half of 2015, economic growth moderated to 2.3%, compared with the 2.4% pace in the preceding six-month period.

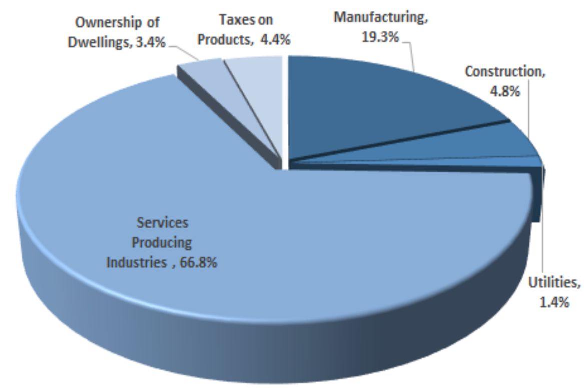
On the supply side, the performance of the economy appears to be mixed, with manufacturing once again leading the downside while the services sector seems unaffected. Output in the manufacturing sector dropped 4.9% from a year earlier in 2Q2015 (4Q2014: -2.4%), attributed to the broad-based declines in the transport engineering and biomedical manufacturing clusters. The only sweet spot is the services sector, which grew by 3.4% during the quarter, albeit slower than the preceding period (1Q2015: 4.2%), as the finance and insurance, wholesale and retail trade and business services collectively added 2.0 percentage points to headline GDP growth.

Chart 1: Real GDP growth and contribution to growth



Source: CEIC, MARC Economic Research

Chart 2: Singapore economic structure (2014)



Source: CEIC, MARC Economic Research

Exceptionally strong external position

Unlike many other advanced economies, Singapore continues to enjoy a huge CA surplus despite the challenging global economic conditions. In terms of percentage of GDP, Singapore's CA surplus stood at a whopping 20% of GDP in the five years post-GFC, a stark contrast to the average of 1.9% of GDP in advanced countries. As such, Singapore's external position is very strong, and in fact is stronger than warranted by fundamentals, according to the International Monetary Fund (IMF). This is partly due to the structural factors such as persistent budget surpluses as well as a huge accumulation of foreign exchange reserves, owing to its status as an important regional trade and financial centre.

The CA balance appears solidly in the black, widening to SGD74.5 billion in 2014 (2013: SGD67.7 billion), largely attributed to the rising goods and services balance despite weak external demand. While goods export growth has remained tepid, rising by only 0.3% in 2014 (2013: 0.7%), the continuous decline in imports (2014: -0.5%, 2013: -1.1%) has resulted in an even larger goods balance, reaching a historical high of SGD96.8 billion in 2014 (2013: SGD93.2 billion). Relative to the size of the economy, the CA surplus stood at 19.1% of GDP in 2014, an increase of 1.2 percentage points from the preceding year, although lower than its cyclical peak of 23.7% of GDP in 2010.

To complement the huge CA surplus, Singapore's capital and financial account (CFA) balance remained in the red and widened further in 2014. That is viewed to be the norm for a highly open economy given Singapore's status as the regional financial hub, as larger deficits reflect stronger global financial activities. The shortfall in the CFA stood at SGD62.9 billion in 2014, the largest since 1993, an increase of 39.3% from the preceding year's SGD45.1 billion deficit. Although net portfolio investment outflows had eased from 2013, the outflows from the other investments account almost doubled, contributing to the widening in the overall CFA deficit. In the first three months of 2015, however, outflows in portfolio investment resumed with SGD10.9 billion leaving the country, compared with an inflow of SGD542 million in the preceding quarter, as the talks on the possibility of United States (US) Federal Reserve (Fed) interest rate hikes intensified.

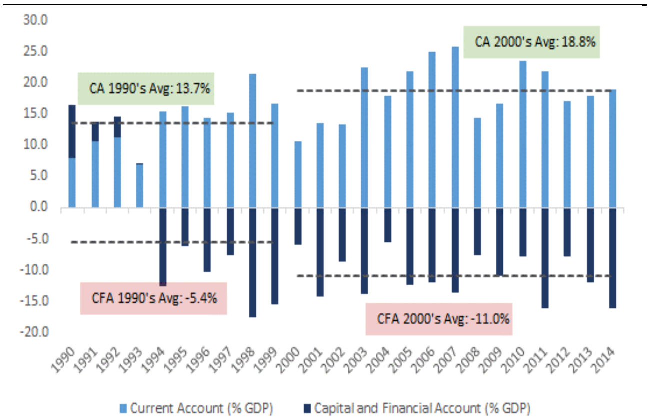
The city-state's external position is further strengthened by its status as a large net creditor nation as evidenced by its strong positive net IIP. As of 2014, its net IIP stood at SGD710.0 billion, or 182% of GDP, one of the highest in the world, although lower than the preceding year's SGD716.1 billion and 189.4% of GDP.

With huge and persistent CA surpluses averaging 18.8% of GDP since the new millennium, MARC believes that Singapore is in a very strong position to guard its economy against any balance of payments crisis. As a consequence, its external assets are very large, averaging 935.2% of GDP in the five years post-GFC, far exceeding its external liabilities which averaged 745.9% of GDP during the same period.

The country's huge surpluses also suggest persistent strong trade performance despite challenging external demand, far exceeding the remittance outflows and the deficit in income balance over the years. Looking ahead, MARC is of the view that the CA balance will continue to remain strong, although it will likely narrow on the back of structural factors such as the ageing population and the move towards a less labour-intensive growth model. In addition, the government is committed to channeling extra resources to support the economy via higher spending on infrastructure, education, and social safety nets.

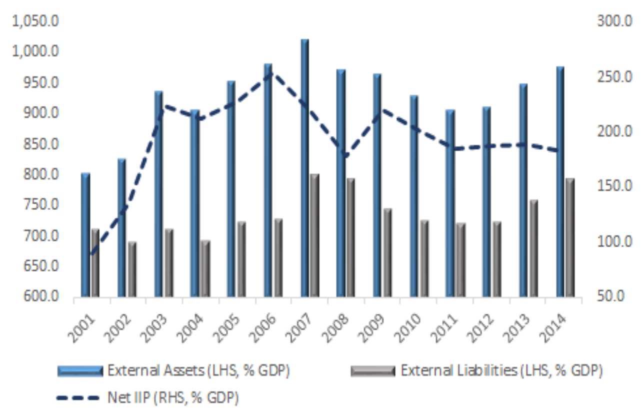
The only minor concern is its gross external debt which amounted to 450.3% of GDP in 2014, of which three-quarters of the borrowings are concentrated in the financial sector. In general, Singapore is relatively vulnerable given its heavy reliance on foreign funding when compared with other advanced countries. However, a large foreign reserve stockpile amounting to SGD340.4 billion as of end-2014 (equivalent to 8.9 months of merchandise imports) provides an adequate buffer to cover the debt servicing costs. More importantly, the government is not liable to foreigners, which is a rarity for advanced economies.

Chart 3: CA and CFA as % GDP



Source: CEIC, MARC Economic Research

Chart 4: IIP as % GDP



Source: CEIC, MARC Economic Research

Prudent fiscal management

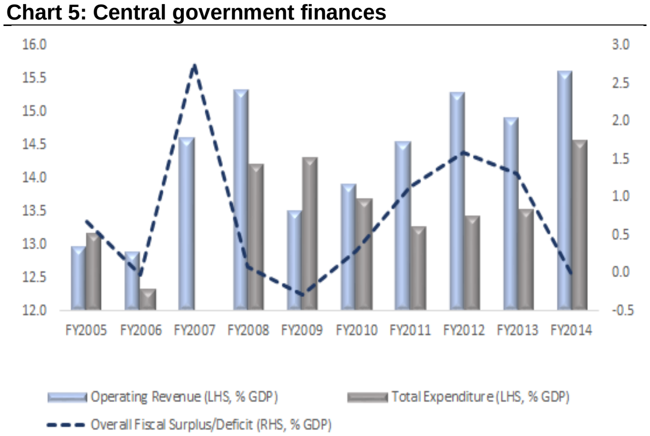
The government of Singapore continues to maintain prudent fiscal management as evidenced by sustained fiscal surpluses since 2005, save for the recessionary year of 2009. Its fiscal balance averaged at 0.9% of GDP in the five fiscal years through FY2014, relatively unchanged from the period prior to the GFC. The government continues to adopt a low-expenditure policy to offset its relatively low revenue receipts, in view of its status as a tax haven country. Relative to the size of the economy, both revenue and expenditure are well below the regional standard, averaging 14.9% of GDP and 13.7% of GDP respectively in the five years post-GFC.

In FY2014, however, the government registered a small deficit of SGD0.1 billion, resulting in a balanced budget in terms of its ratio to the economy (0.0% of GDP) compared with the preceding year's SGD5.0 billion surplus (1.3% of GDP). Although the fiscal balance deteriorated, we are not overly concerned on the overall fiscal situation given that there are large fiscal reserves that the government can utilise to increase its social outlays, especially for the elderly. In fact, the actual fiscal balance was even better than the budgeted amount, despite higher-than-expected actual spending. Total operating revenue climbed 7.6% during FY2014, faster than the 2.2% increase in the preceding year and exceeding the budgeted 4.4% rise, thanks to the overall improvement in all revenue sources. On the expenditure side, development expenditure rebounded strongly by 15.7% to SGD13.9 billion from a 4.6% drop in the prior period, and close to its budgeted amount of SGD13.8 billion. Growth in operating expenditure, on the other hand, was broadly unchanged in FY2014, rising 9.0% (FY2013: 9.1%), resulting in an increase in total expenditure of 10.6% compared with the same period last year (FY2013: 5.6%).

Although the government is expecting a larger fiscal deficit of SGD6.7 billion (-1.7% of GDP) in the current fiscal year, we expect government finances to remain in good shape, enabling the country to utilise past fiscal reserves to respond to the currently weak economic momentum. Going forward, the government is expected to incur higher spending bills over the medium term largely due to structural factors such as an ageing population as well as the commitment to support higher productivity. As such, the government has been taking proactive measures to offset rising future outlays by revising upwards its top marginal personal income tax rate to 22% from 20%, the first increase in the last 30 years, as part of its efforts to avoid a sustained annual budget deficit as required under the Constitution.

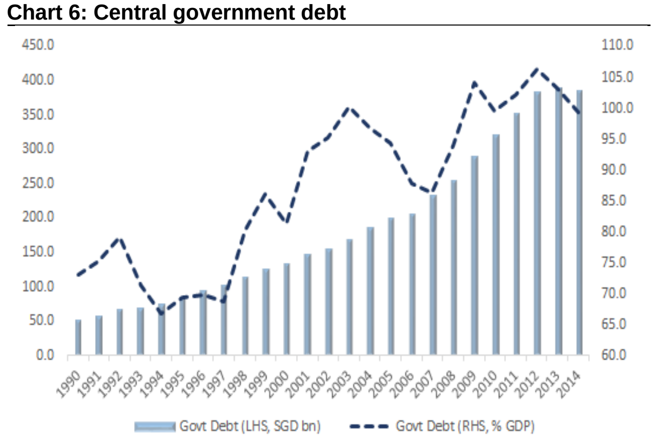
While Singapore's government debt is relatively high, it was purposely created with an intention to provide a risk-free benchmark of its debt capital market and to supply a guaranteed income flow to its pension fund, rather than to finance the government's expenditure. MARC believes that Singapore's government debt will not be a major concern over the medium to longer term, given its sole reliance on domestic sources. In fact, it provides an additional income stream for the government through investments made with the proceeds of the issuance of the debt, which is more than sufficient to cover the debt servicing costs. On average, the return from these investments (which includes reinvested earnings of other government assets) is estimated to have grown by at least 19.0% per annum (p.a.) on a compound annual growth rate (CAGR) basis in the nine years through to 2014, of which up to 50% were accounted for under the budget account and the rest must be protected as past reserves. Looking ahead, MARC opines that the government's budgetary position will remain strong, although a fiscal deficit is projected in the current fiscal year resulting from its efforts to rebalance the economy.

Chart 5: Central government finances



Source: MoF, MARC Economic Research

Chart 6: Central government debt



Source: CEIC, MARC Economic Research

Very high global institutional ranking

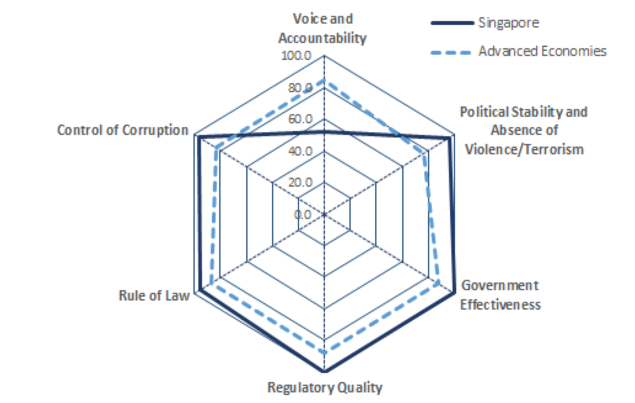
Singapore's high global institutional rankings, particularly in terms of governance, competitiveness and business environment, is another positive attribute. In the latest 2014 World Bank's Worldwide Governance Indicator, Singapore scores above the 95th percentile rank in all but one of the major indicators, namely the 'voice and accountability' where it ranked at 52nd partly due to the control of domestic media by government-linked companies.

The city-state also stands out in terms of competitiveness, consistently ranking second out of 151 countries in the WEF's GCI in the four years through 2014-2015, while affirming its lead among Asian countries. This stellar performance is attributed to its exceptionally strong position across all spectrums of the GCI. Similarly, the World Bank also continues to place Singapore as the most attractive place to do business, ranking it at the top of the Ease of Doing Business rankings since 2007 and leading in the enforcing contracts and cross-border trading sub-indices.

Although the government has been in power over the past five decades, it remains in the top spot of Transparency International's Corruption Perception Index, reflecting its efficiency and largely corruption-free image. It has been consistently ranked within the top five spots since 2001, although the latest index indicated a mild deterioration which saw its position unexpectedly declining to seventh place in 2014.

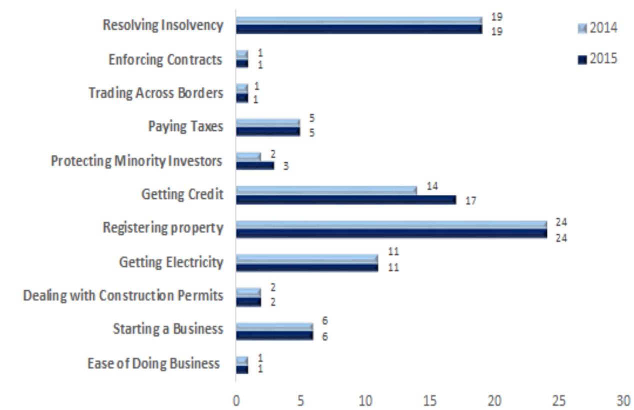
MARC is of the view that Singapore's institutional strength is exceptional, and expects it to remain in the top league of most global rankings and indicators, reflecting its ability to provide a business-friendly environment combined with a high level of competitiveness. Its first-class infrastructure as well as highly efficient labour and goods markets will likely preserve Singapore's status as one of the most attractive locations for businesses, confirming its status as a regional trade and financial hub.

Chart 7: World Bank Worldwide Governance Indicators 2014 (percentile ranking, higher is better)



Source: World Bank, MARC Economic Research

Chart 8: World Bank Ease of Doing Business 2015 and 2014 (ranking, lower is better)



Source: World Bank, MARC Economic Research

Major Challenges

High exposure to the external sector

Singapore's success story, however, has not been without speed bumps along the way. The value of total merchandise trade was almost triple the size of its GDP, the world's second highest after Hong Kong. As a result, Singapore's growth record is tied to the path of the global economy. Its growth volatility is the highest among advanced economies at 5.1% in the five years post-GFC (advanced economies average: 0.9%). In the five years through to 2008, the economy has grown by a steady average pace of 7.4% p.a., before the GFC interrupted and caused the economy to contract by 0.6% in 2009. Since then, the overall growth momentum has continued to moderate, averaging at 4.2% between 2011-2014, undermined by sub-par economic growth in other advanced economies and slower growth in East Asia.

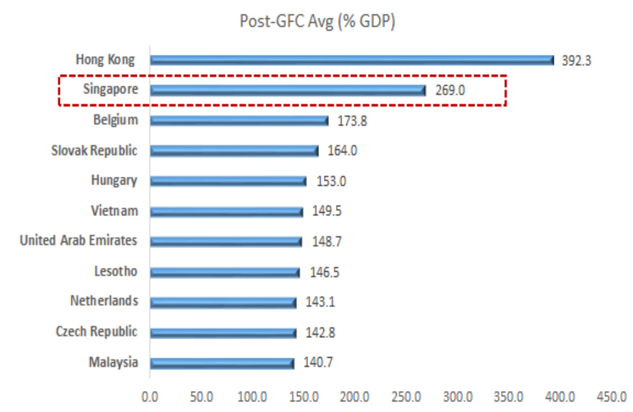
Singapore's economic growth decelerated further to just 2.9% in 2014 (2013: 4.4%), the weakest since 2009, as it was impacted by a confluence of factors, including a weak global growth momentum, as well as the turnaround in housing and credit cycles resulting from macro prudential measures imposed by the Monetary Authority of Singapore (MAS). Real exports growth more than halved from 4.5% in 2013 to just 2.1% in 2014, although the overall contribution from net exports remained substantial at 58.5% of the incremental growth (2013: 51.8%). Domestic demand growth, on the other hand, moderated for a third consecutive year in 2014, with private consumption rising by only 2.5% (2013: 3.6%), and adding 0.9 percentage points to headline growth, the least since 2009.

Although Singapore is a net oil importer, the impact of the rout in the global oil market since late 2014 should not be taken lightly given the country's status as a major regional oil trading hub and Asia's oil and oil product pricing centre. The oil industry as a whole is estimated to account for 5.0% of Singapore's GDP.

Over the last ten years, oil exports constituted an average 21.5% of total overseas shipments while refined petroleum products accounted for 18.8% of total manufacturing output.

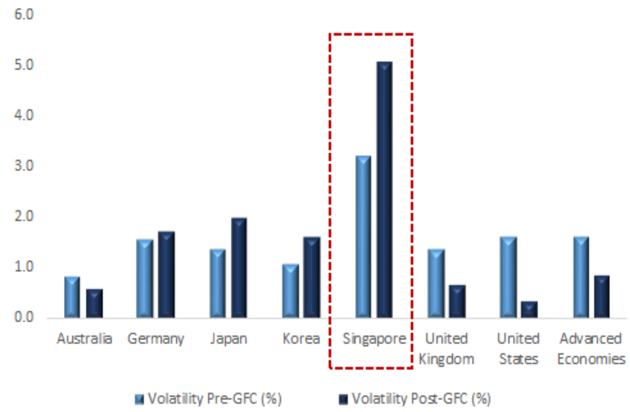
Going forward, while we foresee the economy picking up in tandem with the gradual recovery of the Group of 3 (G3) economies, i.e. US, Japan and euro zone, the near-term outlook for the city-state is weighed down by the slowdown in other emerging economies, particularly China. Although the US is expected to post the fastest growth among G3 economies, a slower-than-expected economic growth in China would have a significant spill-over effect on the Singaporean economy given the high degree of interconnectedness.

Chart 9: Merchandise trade as % of GDP



Source: World Bank, MARC Economic Research

Chart 10: GDP growth volatility of selected advanced economies



Source: IMF WEO Database, MARC Economic Research

Rapidly ageing population

Singapore's prospects of long-term growth will continue to be constrained by the rapidly ageing population. Over the medium term, however, it will hinge on the pace of domestic restructuring activities towards productivity-led growth that is characterised by a knowledge and skill-based economy. MARC views positively the government's efforts to increase social outlays, especially on healthcare and education, while nurturing the new growth model that will reduce its reliance on foreign workers. While the domestic restructuring activities have caused the economy to slow temporarily in recent times due to a tight labour market and downward margin pressures, it will set the stage for a more sustainable growth path over the medium to longer term to overcome supply-side constraints and an ageing population.

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MALAYSIAN RATING CORPORATION BERHAD (Company No.: 364803-V)
5th Floor, Bangunan Malaysian Re, No. 17, Lorong Dungun, Damansara Heights, 50490 KUALA LUMPUR
Tel.: +603 2082 2200 Fax: +603 2094 9397 E-mail: marc@marc.com.my
Homepage: www.marc.com.my