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Singapore: Country Risk Insights

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In a nutshell

- Singapore's macroeconomic strength is depicted by its status as the third wealthiest country in the world, supported by credible macroeconomic management and a consistently stable political environment. Since the 1970s, the economy has grown rapidly, with real gross domestic product (GDP) growth averaging 6% to 7% per annum. As a result, its per capita income jumped by almost tenfold to USD83,733 on a purchasing power parity (PPP) basis in 2014, from a low of USD8,845 in 1980, contributing to a significant improvement in the standard of living. In 2015, Singapore continued to record a still healthy non-inflationary economic growth of 2.0% (2014: 3.3%), against a backdrop of weakening global trade momentum and depressed commodity prices. This is commendable given the fact that Singapore is a small and highly open economy.

- The city-state's exceptionally strong external balance sheet complements its key strength. Several years of huge current account (CA) surpluses have, to a large extent, led to the accumulation of sizeable external assets. In the six-year period post-Global Financial Crisis (GFC), its CA surplus averaged a whopping 19.7% of GDP, significantly larger than its advanced countries peers' of just 0.2% of GDP. We foresee the CA surplus to remain exceptionally strong over the medium term although it is expected to moderate due to the drawdown of domestic savings to address its structural challenges. Singapore's status as a large net creditor nation has further strengthened its external position. Its net positive international investment position (IIP) stood at an average of 202.2% of GDP over the last six years, one of the highest in the world, suggesting that Singapore is in a very strong position to guard against exogenous shocks.

- On the fiscal front, the government continued to maintain high fiscal discipline, in that the strong fiscal balance in the past years has led to the build-up of large fiscal reserves which the government can utilise during hard times. Its fiscal surpluses averaged at 0.5% of GDP in the six years through the fiscal year ended March 2016 (FY2015), a tad lower than the 0.9% of GDP in the pre-GFC period (2005-2008). The public sector essentially has zero direct liabilities as the relatively high government debt stock was issued primarily to provide a risk-free benchmark for the country's domestic capital market and to supply a guaranteed income stream to its obligatory central pension fund. In fact, proceeds from the issuances of the securities are fully invested, providing an additional income stream for the government which is more than sufficient to cover the debt servicing costs.

- Singapore's key strength is further underpinned by its solid institutional framework. The policymaking is effective and highly ranked in most global rankings and indicators. The city-state is well-known for its efficiency and for being largely corruption free, ranking eighth in Transparency International's 2015 Corruption Perception Index. It ranked exceptionally well in all but one of the sub-indicators of the World Bank's 2015 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 five years through 2015-2016. Similarly, its top-notch ranking on the World Bank's Ease of Doing Business Index since 2007 confirmed its business-friendly environment.

- Notwithstanding its positive attributes, as a trading nation, Singapore is indeed vulnerable to external shocks. Its growth volatility was significantly higher at 4.8% in the six-year period through 2015, compared with other advanced countries (0.7%). Nevertheless, the fact that Singapore continues to demonstrate resilient economic performance in the face of uneven global growth momentum reflects its economic strength. This can be attributed to the significant diversification of its economy as evidenced by the service sector's share of the economy which has risen steadily to a new high of 67.9% in 2015 (2014: 67.0%). The manufacturing sector's share, on the other hand, declined to 17.8% (2014: 19.1%).

- Another concern on the prospects of long-term growth is Singapore's rapidly ageing demographic profile. Singapore's median age stood at 39.6 years in 2015, up from just 34 years in 2000, while about 50% of total residents are aged 40 years and above. In this regard, MARC views positively the authorities' persistent efforts to restructure its growth model towards a productivity- and knowledge-based economy which will reduce its reliance on foreign workers. This would set the stage for a more sustainable growth path over the medium to longer term, although economic growth, in general, will remain modest over the transitionary period.

Table 1: Selected economic indicators

	2010	2011	2012	2013	2014	2015
Real GDP Growth	15.2	6.2	3.7	4.7	3.3	2.0
Inflation Rate - CPI (%)	2.8	5.2	4.6	2.4	1.0	-0.5
Unemployment Rate (%)	2.2	2.0	2.0	1.9	2.0	1.9
Fiscal Balance - FY end-March (% GDP)	0.3	1.1	1.6	1.3	0.1	-1.2
Government Debt (% GDP)	99.6	102.3	106.5	103.9	99.8	104.7
Current Account (% GDP)	23.7	22.0	17.2	18.0	17.4	19.7
Net International Investment Position (% GDP)	204.6	200.3	198.4	203.7	196.6	209.7
International Reserves (USD bn)	225.8	237.7	259.3	273.1	256.9	247.7
External Debt (% GDP)	424.5	432.1	421.0	448.1	456.4	441.8

Source: MoF, Singstat, CEIC, MARC Economic Research

Key Strengths

An advanced economy with credible macroeconomic management

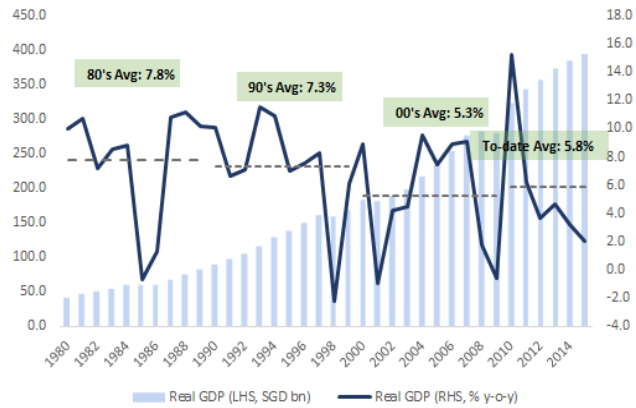
Being an important regional trade and financial hub, Singapore has become the third wealthiest country in the world, thanks to its credible macroeconomic policies and stable political environment. The economy has grown rapidly since the 1970s, with an average growth of 6% to 7% per annum that contributed significantly to its per capita income. From a low of USD8,845 in 1980, GDP per capita in PPP terms surged almost tenfold to USD83,733 in 2014, the third highest in the world, leading to a rapid improvement in the standard of living.

In spite of depressed global commodity prices and weak global growth momentum, Singapore continued to portray a still healthy non-inflationary economic growth of 2.0% year-on-year (y-o-y) in 2015, although moderating from 3.3% in the preceding year. This is commendable, given the fact that Singapore's economy is highly dependent on global trade performance which has weakened significantly since late 2014. It is also worth noting that the slowdown in the overall growth momentum was partly due to Singapore's transition towards a new growth model based on a productivity- and knowledge-based economy, as well as the turnaround in the credit cycle on the back of macroprudential measures introduced earlier.

The domestic demand growth rebounded in 2015, rising 2.5% y-o-y after being flat in the preceding year, supported by an expansionary fiscal stance and the easing in the monetary policy since early 2015. Both government and private consumption registered strong growth, rising 6.6% and 4.5% respectively in 2015 (2014: -0.1% and 2.2% respectively), offsetting the continued weakness in total investment (2015: -1.0%, 2014: -2.6%). All in all domestic demand added 1.9 percentage points to the headline growth in 2015. Meanwhile, net exports appear unabated despite the challenging external environment, growing steadily at 4.6%, albeit slower than the 6.5% expansion in 2014. It contributed 1.3 percentage points to the growth while inventories subtracted 1.5 percentage points.

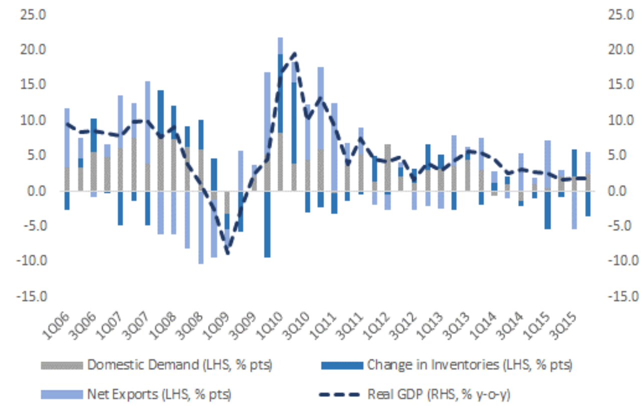
On the supply side, however, weakness was broad-based, with manufacturing contracting by 5.2% (2014: +2.7%), undermined by a 13.0% slump in the transport engineering cluster due mainly to persistently low international oil prices. Services sector growth, meanwhile, eased slightly to 3.4% from 3.6% in the preceding year, supported by a pick-up in wholesale and retail trade growth (2015: 6.1%, 2014: 2.1%), offsetting the slowdown in the finance and insurance (2015: 5.3%, 2014: 9.1%) as well as transportation and storage segments (2015: 0.0%, 2014: 2.6%). Similarly, the construction and utilities sectors recorded slower growth of 2.5% and 1.2% respectively in 2015 (2014: 3.5% and 2.2% respectively).

Chart 1: Real GDP and GDP growth



Source: CEIC, MARC Economic Research

Chart 2: Quarterly real GDP growth and contributions to headline growth



Source: CEIC, MARC Economic Research

Exceptionally strong external balance sheet

Singapore's exceptionally strong external balance sheet as reflected by its consistently huge CA surpluses for nearly three decades is a major economic strength. As compared with its advanced countries peers, Singapore's CA surpluses averaged a whopping 19.7% of GDP in the six-year period post-GFC, a stark contrast to the average 0.2% of GDP in other advanced countries. This reflects Singapore's structural factors such as persistent fiscal surpluses as well as a huge accumulation of foreign exchange reserves, owing to its status as an important regional financial and trade hub.

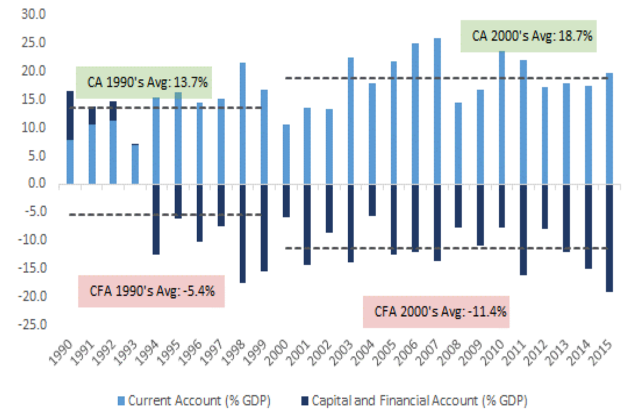
In spite of the challenging external environment, the CA balance remains solidly in the black, widening by 17.5% to a record high of SGD79.1 billion in 2015 (2014: SGD67.4 billion) and equivalent to 19.7% of GDP (2014: 17.4%). A combination of cheap energy imports and higher income from investments abroad have helped offset the lacklustre performance of the export sector. The capital and financial account (CFA), on the other hand, saw larger deficits due to higher investment outflows. The shortfall in the CFA widened further in 2015, amounting to SGD77.0 billion (2014: -SGD58.6 billion), due mainly to higher outflows of portfolio investments and other investments. Nevertheless, it is important to note that the outflows experienced by Singapore are largely due to the increase in net purchases of overseas securities by domestic entities rather than the withdrawal of funds by foreign investors as commonly seen regionally.

Singapore's status as a large net creditor nation as evidenced by its strong positive net IIP complements its remarkably solid external position. As of 2015, its net IIP stood at an all-time high of SGD844.0 billion (2014: SGD763.2 billion) and equivalent to 209.7% of GDP (2014: 196.6%), which was the highest since 2009. This can be attributed to the prominent slowdown in external liabilities growth which has helped to contribute to the rise in net asset position. With net IIP consistently double the size of the national output over the past decade, Singapore is indeed in a very strong position to guard against exogenous shocks.

In general, Singapore's ability to accumulate persistently huge CA surpluses reflects large domestic savings from both the public and private sectors. It also suggests persistent strong trade performance which more than offset the remittance outflows and the deficit in income balance over the years. On the other hand, persistent CA surpluses also point to a lack of domestic investments relative to savings. Going forward, we are of the view that while the CA position will likely moderate over the medium term due to some structural factors, it will remain exceptionally strong. The structural factors such as the rapidly ageing population suggests that the drawdown of pension saving funds will likely contribute to the moderation of the CA surpluses. In addition, the reduced reliance on foreign workers in a bid to restructure the economy to be based on productivity-led growth would also help to narrow the CA balance in the near future.

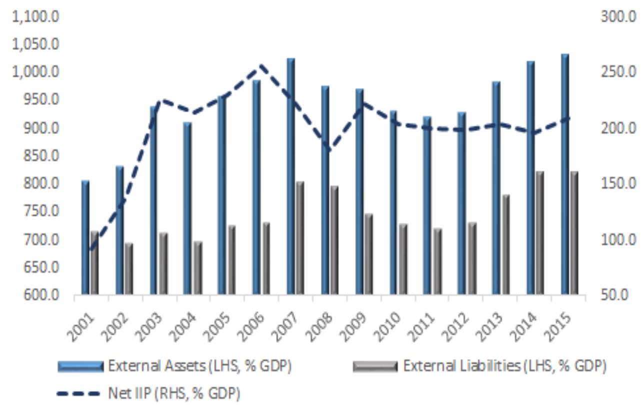
While Singapore's gross external debt has remained large at over 400% of GDP for more than a decade, its external assets are also very large and more than adequate to cover its short-term liabilities. Indeed, its sizeable short-term external debt, particularly in the banking sector, is backed by equally large short-term financial external assets, although official reserves coverage remained relatively low at just 26% of total short-term external borrowings. Notwithstanding this, Singapore's official reserve assets which stood at 87.2% of GDP in 2015 is one of the largest in the world and in fact is larger than any other financial centres. In addition, taking into account the size of assets managed by its sovereign wealth funds, namely Government of Singapore Investment Corporation (GIC) and Temasek, Singapore's total financial reserves would amount to at least 187% of GDP in 2015.

Chart 3: CA and CFA balances as % GDP



Source: CEIC, MARC Economic Research

Chart 4: External assets, liabilities and net IIP as % GDP



Source: CEIC, MARC Economic Research

Strong fiscal discipline

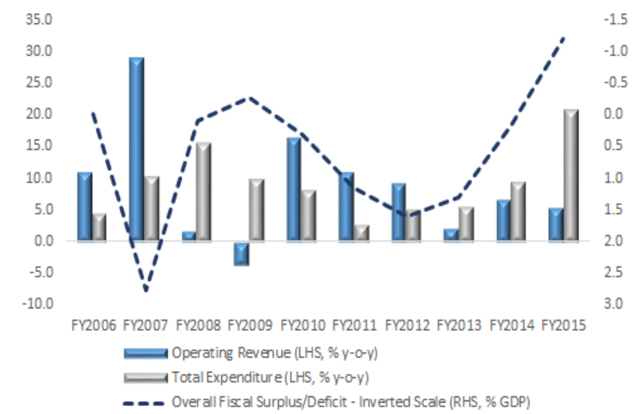
The government of Singapore continued to maintain strong fiscal discipline, consistently registering positive fiscal balances over the years, due mainly to its conservative fiscal rules that require a balanced budget over the political term of the government. Its fiscal balance averaged 0.5% of GDP in the six fiscal years through FY2015, a tad lower than 0.9% of GDP in the pre-GFC period (2005-2008). Generally perceived as a tax haven country, the government continues to adopt a low-expenditure policy to offset its relatively low revenue receipts. Both revenue and expenditure averages of 15.0% and 14.2% of GDP respectively in the six-year period post-GFC are well below the regional and advanced countries' average.

Notwithstanding this, amid the downside risks to the economy in recent years, the government has adopted an expansionary fiscal stance in FY2015. Consequently, its overall balance slipped to deficit territory to the tune of 1.2% of GDP in FY2015 (FY2014: 0.1% of GDP), larger than the 0.3% shortfall registered during the GFC. While the deterioration in fiscal balance was rather steep as compared to during the GFC, we are not overly concerned on the overall fiscal situation given the large fiscal reserves generated from past fiscal surpluses. In fact, the actual fiscal balance in 2015 was better than the 1.7% of GDP shortfall initially projected, largely due to the 13.3% jump in net investment returns contribution, 10.7% more than the amount estimated during the Budget 2015.

The public sector essentially has zero direct liabilities as the relatively high government debt stock was issued primarily to provide a risk-free benchmark for the country's domestic capital market and to supply a guaranteed income stream to its obligatory central pension fund. More importantly, the issuances of debt were predominantly in domestic currency, safeguarding it from foreign currency risks. As of end-2015, Singapore's government debt stood at 104.7% of GDP in 2015, an increase by 4.9 percentage points from the preceding year, but below the historical high of 106.5% of GDP in 2012. We are of the view that Singapore's relatively high government debt level is not a concern over the medium to longer term, given its role and sole reliance on domestic sources. In fact, proceeds from the issuances of the securities are fully invested, providing an additional income stream for the government which is more than sufficient to cover the debt servicing costs.

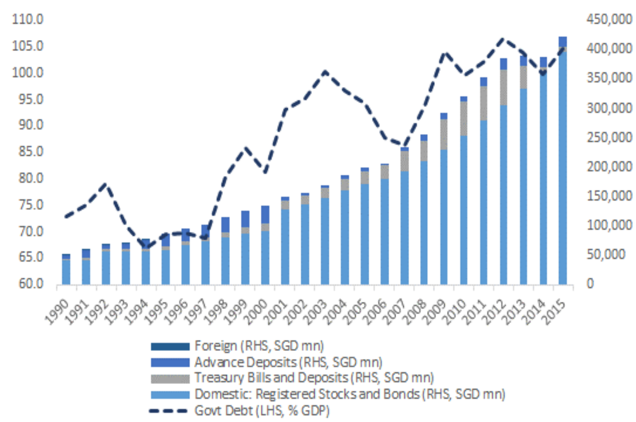
On the whole, MARC believes that the government balance sheet will remain remarkably healthy in the foreseeable future, underpinned by large fiscal buffers to respond to the currently weak economic momentum. The measures proposed in the recent Budget 2016 underscore the government's commitment to rejuvenate the economy through an expansionary fiscal policy which will increase the deficits in the primary balance to 1.2% of GDP from 1.1% in FY2015. Nevertheless, the shortfall in primary balance is expected to be offset by a 48.6% jump in income from investment following the inclusion of Temasek in the net investment returns framework. This would bring the overall fiscal balance back to a surplus, amounting to SGD3.4 billion or equivalent to 0.8% of GDP in FY2016, according to the government estimates.

Chart 5: Central government finances



Source: MoF, MARC Economic Research

Chart 6: Central government debt



Source: CEIC, MARC Economic Research

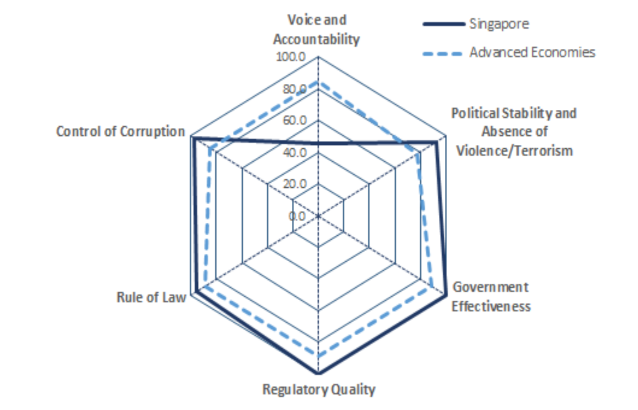
Solid institutional framework

Singapore's exceptionally solid institutional framework supports its overall key strength. Policymaking is effective and highly ranked in most global rankings and indicators. Singapore is well-known for its competitive advantage, affirming its lead among Asian peers and maintaining its second highest position out of 151 countries in the WEF's GCI for a fifth consecutive year in 2015-2016. This can be attributed to its stellar performance across all spectrums of the GCI, particularly in terms of its overall market efficiency, having ranked in the top three in goods, labour and financial market efficiency for a ninth consecutive year since 2007-2008. Similarly, its business-friendly environment resulted in its top-notch rankings in the World Bank's Ease of Doing Business Report, consistently ranking first place out of 189 economies in the ten years since 2007.

Despite being in power over the past 50 years, the government is perceived as one of the cleanest in the world, consistently scoring the top spot on Transparency International's Corruption Perception Index. Out of 168 countries in the world, Singapore ranked eighth place in 2015, one notch lower than the preceding year's ranking, and second place among 27 Asia Pacific countries. Separately, the 2015 World Bank Worldwide Governance Indicators confirmed Singapore's institutional strength, with the rank remaining above the 95th percentile in all sub-indicators and outperforming its advanced countries peers, save for voice and accountability due mainly to government influence in much of the domestic media.

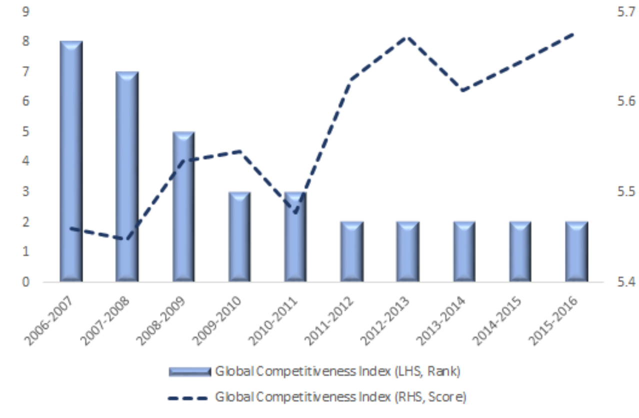
Going forward, MARC believes Singapore to remain in the top league of most global rankings and indicators over the medium to longer term. Its first-class infrastructure and highly efficient labour and goods markets will likely preserve Singapore's status as one of the most attractive locations for businesses and affirm its status as an important regional trade and financial hub. Meanwhile, the relatively stable political environment following a landslide victory of the ruling party in the latest general election suggests that the continuity and effectiveness of the policymaking will likely be preserved over the near to medium term.

Chart 7: World Bank Worldwide Governance Indicators 2015 (percentile ranking, higher is better)



Source: World Bank, MARC Economic Research

Chart 8: WEF GCI score and rank



Source: WEF, MARC Economic Research

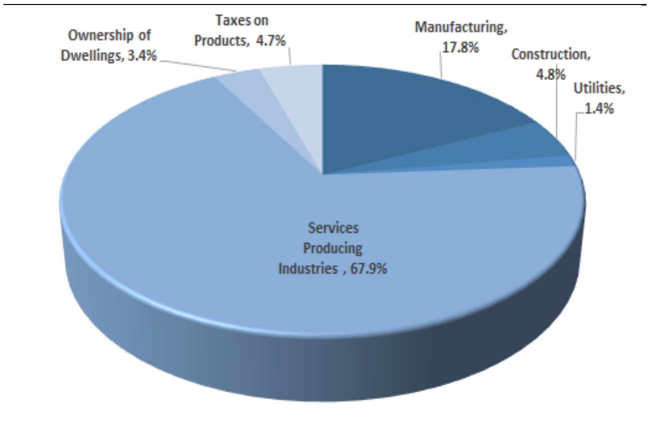
Major Challenges

Susceptible to external sector risks

As a trading nation, Singapore is indeed vulnerable to external shocks. It is well-known for its highly open economy, with the value of total trade worth more than triple the national income, the world's second highest after Hong Kong. The dependency on trade means that Singapore's growth momentum is inevitably tied to the global growth trajectory. Among the advanced countries, Singapore's growth volatility was significantly higher at 4.8% in the six-year period through 2015 (advanced countries: 0.7%). Notwithstanding this, the fact that Singapore continues to demonstrate resilient economic performance in the face of uneven global growth momentum reflects its key economic strength. This can be attributed to the significant diversification of its economy as evidenced by the service sector's share of the economy which has risen steadily to a new high of 67.9% in 2015 (2014: 67.0%). The manufacturing sector's share, on the other hand, declined to 17.8% (2014: 19.1%). Of other sectors, only construction is significant, accounting for 4.8% of total GDP during the same period (2014: 4.7%).

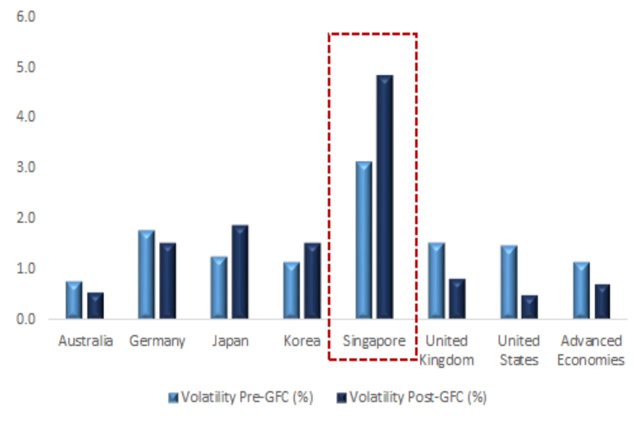
Going forward, the prospects over the near term largely hinge on the pace of global economic recovery and stability of global commodity prices. The protracted period of low global crude oil prices, unsynchronised monetary policy direction of other major central banks, and China's sputtering growth engine as well as financial risks are among Singapore's short-term risks. A substantial pickup in regional trade and financial flows will be required over the near term for economic growth to accelerate meaningfully, something which is highly unlikely at this juncture. Indeed, the recent sell-off in the global stock market early this year amid ongoing concerns over the direction of oil prices and China's growth momentum resulted in Singapore's Straits Times Index tumbling by 24.6% in January 2016 from its post-GFC peak in April 2015. With global trade momentum remaining weak, the outlook for Singapore's manufacturing and trade-related sectors are not inspiring either. While real GDP growth stood at 1.8% y-o-y for a third consecutive quarter in the first three months of 2016, the manufacturing sector extended its contraction for a sixth straight quarter, though at a lesser pace during the same period (1Q2016: -2.0%, 4Q2015: -6.7%).

Chart 9: Singapore's economic structure (2015)



Source: CEIC, MARC Economic Research

Chart 10: GDP growth volatility of selected advanced economies (measured by standard deviation)



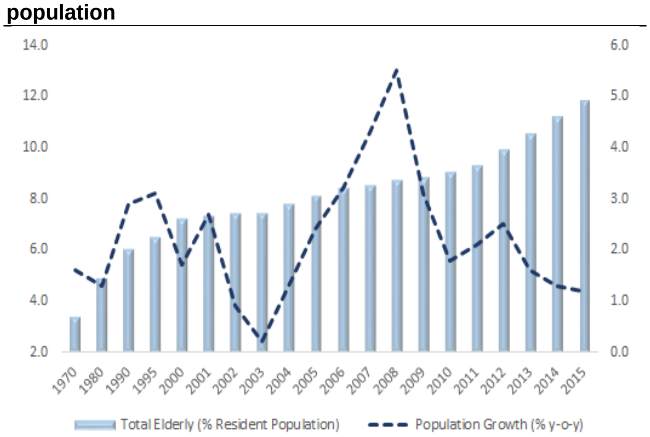
Source: IMF WEO Database, MARC Economic Research

Rapidly ageing population

The prospects of long-term growth will continue to be constrained by the rapidly ageing demographic profile. Singapore's median age stood at 39.6 years in 2015, up from just 34 years in 2000, while about 50% of total residents are aged 40 years and above. Total population growth, meanwhile, eased further to just 1.2% in 2015, from its long-term average of 2.3% pace. This reflects Singapore's structural challenges that the authorities need to address as it would have a severe implication on the economy over the medium to longer term due to lower labour productivity, which could in turn affect the overall competitiveness of the economy. Moreover, the rapidly ageing society would result in a drawdown of domestic savings due to higher spending commitment particularly on healthcare and social services, on top of the declining government revenue amid the fall in working age population.

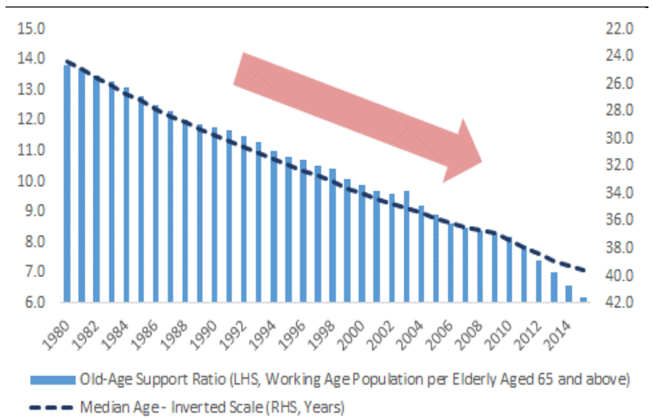
In this regard, MARC views positively the authorities' persistent efforts to restructure its growth model towards a productivity- and knowledge-based economy which will reduce its reliance on foreign workers. This would set the stage for a more sustainable growth path over the medium to longer term, although economic growth, in general, will remain modest over the transitionary period.

Chart 11 : Population growth and total elderly as % resident population



Source: Singstat, CEIC, MARC Economic Research

Chart 12: Median age and old-age support ratio



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