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Country Risk Monitor

SINGAPORE

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In a nutshell

- As a country with very limited natural resources, Singapore has built its strength on credible and proactive macroeconomic policies. That successfully transformed the nation to become an important global trade and financial hub, contributing to a rapid improvement in the standard of living. Its gross domestic product (GDP) per capita in purchasing power parity (PPP) terms which stood at USD85,382 in 2015 was the fourth highest globally. While economic growth remained below the pre-crisis level amid cyclical and structural factors, it also reflects an economy that is maturing, as commonly experienced by other advanced economies. In fact, it grew twice as fast as other advanced economies, at 3.3% per annum in the five years since 2012 (advanced economies: 1.5%).

- The city-state's external balance sheet has also remained extremely robust, as reflected by sizeable and sustained current account (CA) surpluses as well as a strong net external creditor position. Peer comparison suggests that Singapore's CA surpluses outperformed its advanced nations' peers by a whopping 16.0 percentage points of GDP in the seven-year period post-Global Financial Crisis (GFC). Meanwhile, its positive net international investment position (IIP) which stood at an average of 204% of GDP over the past ten years is substantially stronger than any other country in the world. While we expect CA surpluses to moderate on the back of its structural challenges, it will remain exceptionally strong. In addition, with net IIP consistently double the size of the total output over the past decade, we opine that Singapore will continue to be in a very strong position to guard against exogenous shocks.

- The government of Singapore has continued to maintain high fiscal discipline. Thanks to its conservative fiscal rules, the fiscal balance remained in the black in all but two years in the past decade. While the government continued its expansionary fiscal stance since fiscal year ended March 2016 (FY2015), the overall government balance sheet remained exceptionally strong, backed by large fiscal reserves. The public sector has virtually zero direct liabilities as the relatively large stock of government debt (112.9% of GDP) was meant to provide a benchmark for its domestic capital market and to provide a guaranteed income stream to its mandatory central pension fund. In fact, the proceeds raised are fully invested, with returns of these investments more than offsetting the debt servicing costs.

- Singapore's extremely solid institutional settings supplement its strong economic fundamentals. The policymaking is effective and highly recognised in most global rankings and indicators. The government is well known for its efficiency and for being largely corruption free, ranking seventh in Transparency International's 2016 Corruption Perception Index. Singapore's strong governance standard is reflected in its exceptionally good ranking in all but one of the World Bank's 2016 Worldwide Governance Indicators. Meanwhile, its high level of economic competitiveness and business-friendly environment are being affirmed by its top-notch ranking in both the World Economic Forum's (WEF) Global Competitiveness Index (2016/17: 2nd) and World Bank's Ease of Doing Business Index (2017: 2nd) over the years.

- As a small and highly open economy, Singapore is undeniably vulnerable to external developments. Its growth volatility of 4.6% in the seven-year period through to 2016 was broadly higher than its advanced economies peers' rate of 0.8%. Nevertheless, the fact that the city-state continues to demonstrate resilient economic performance amid uneven external development reflects its strong economic fundamentals. Notably, the economy grew at a healthy pace of 2.0% in 2016 (2015: 1.9%). In addition, Singapore's significant economic diversification provides ample immunity in the face of uneven global growth momentum. About two-thirds of its total output were contributed by the services sector over the past decade, while the manufacturing sector accounted for an average 19.0% of GDP during the same period.

- Singapore's long-term prospects, however, will be challenged by its structural issues that include, among other things, a rapidly ageing population and tepid productivity growth. Singapore's median age stood at 40 years in 2016, while its fertility rate of 1.2 births per woman was the world's lowest. Its productivity growth, meanwhile, shrank to 0.9% per annum since 2012, broadly lower than the average 3.7% pace registered in the pre-GFC period. In this regard, MARC views positively the government's continuous efforts to restructure its growth model towards a productivity- and knowledge-based economy. This would translate to a more sustainable growth path over the medium to longer term, although economic growth will remain modest over the transitional period.

Key Strengths

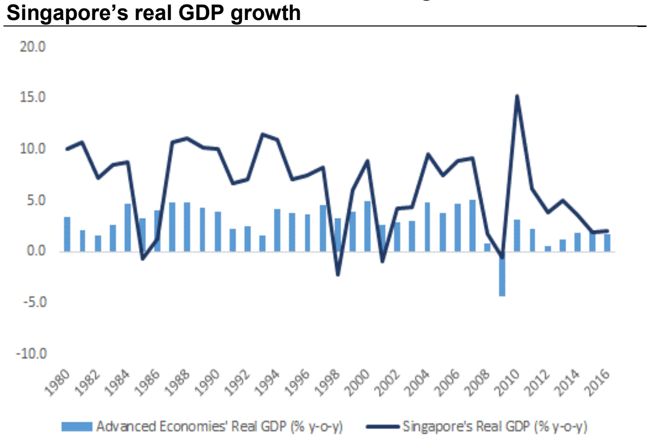
An advanced economy with credible macroeconomic policies

As a country with very limited natural resources, Singapore has built its strength on credible and proactive macroeconomic policies. That successfully transformed the nation into a developed economy with trade and financial services activities being the mainstay of the economy. Continuous and successful economic reforms have also shaped the economy to become an important global trade and financial hub, contributing to a rapid improvement in living standards. Its GDP per capita in PPP terms which stood at USD85,382 in 2015 was the fourth highest globally, trailing only Luxembourg (USD99,505), Macao (USD101,292) and Qatar (USD132,870). While economic growth remained below the pre-crisis level amid cyclical and structural factors, it also reflects an economy that is maturing, as commonly experienced by other advanced economies. In fact, it grew twice as fast as other advanced economies, at 3.3% per annum in the five years since 2012 (advanced economies: 1.5%).

Notably, Singapore's economy continued to remain resilient, growing at a respectable pace of 2.0% in 2016 (2015: 1.9%). This is commendable, considering its heavy reliance on global trade momentum and deep financial linkages with China and other advanced economies, such as the United States (US) and United Kingdom (UK). Surprisingly, the growth was driven by larger contributions from net exports, following depressed commodity prices which helped ease the overall growth in import bills (2016: +0.3%, 2015: +2.9%). Net exports added 2.7 percentage points to headline growth in 2016 (2015: 0.3 percentage points). Domestic demand, on the other hand, was rather muted during the year, growing merely 0.2% in 2016 (2015: 3.7%), due mainly to the sharp slowdown in private consumption growth (2016: 0.6%, 2015: 4.6%), alongside a deep contraction in total investment (2016: -2.5%, 2015: +1.1%).

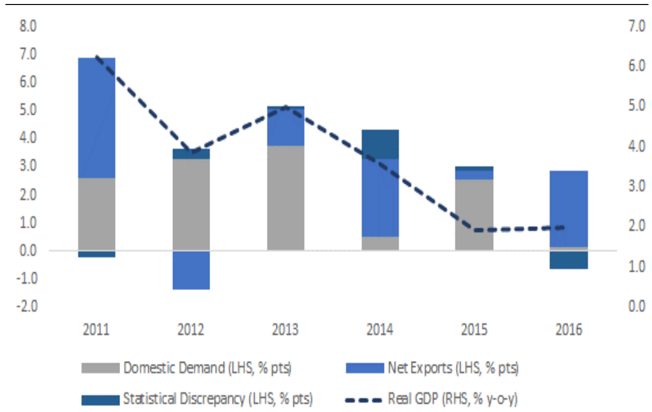
On the supply side, the manufacturing sector had recovered somewhat, expanding 3.6% in 2016 (2015: -5.1%), mainly attributed to the rebound in the electronics (2016: 16.0%, 2015: -6.8%) and biomedical manufacturing clusters (2016: 14.0%, 2015: -2.6%). That helped to offset the continuous drag from the transport engineering segment (2016: -18.0%, 2015: -13.0%), which was weighed down by the prolonged weakness in the crude oil market. Services sector growth, meanwhile, eased for a third consecutive year, growing merely 1.0% (2015: 3.2%). This was due to a broad-based slowdown in the wholesale and retail trade (2016: 0.6%, 2015: 3.7%) and finance and insurance (2016: 0.7%, 2015: 5.7%) subsectors, as well as a contraction in the business services segment (2016: -0.9%, 2015: 3.9%), which collectively accounted for around two-thirds of total services.

Chart 1: Advanced economies' real GDP growth versus Singapore's real GDP growth



Source: IMF, CEIC, MARC Economic Research

Chart 2: Real GDP growth and contribution to growth – demand side



Source: CEIC, MARC Economic Research

Extremely robust external balance sheet

Singapore's external balance sheet is extremely robust, as reflected by sizeable and sustained CA surpluses for nearly three decades. Peer comparison suggests that Singapore's CA surpluses outperformed its advanced nations' peers by a whopping 16.0 percentage points of GDP in the seven-year period post-GFC. This can be partly attributed to 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 global financial and trade hub.

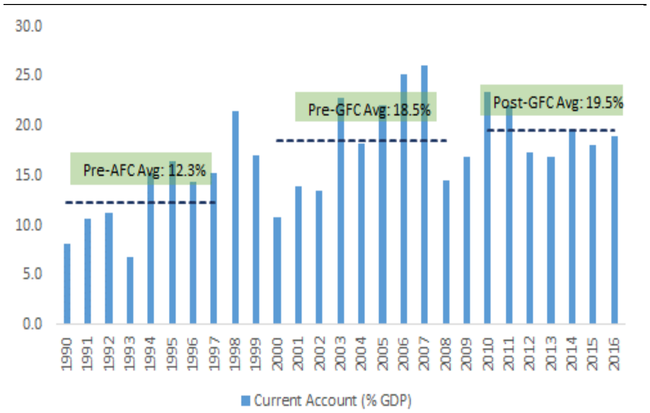
In spite of a difficult external environment, the CA balance swelled to 19.0% of GDP in 2016, or a record high of SGD78.1 billion (2015: 18.1% of GDP). The capital and financial account, on the other hand, recorded larger shortfalls amounting to SGD81.9 billion or 20.0% of GDP, due to higher outflows of capital from Singapore's shore. It is important to note that the outflow actually reflects higher domestic investment abroad, rather than withdrawal of funds by foreign investors. In fact, despite the recent shift in global sentiment towards USD-denominated assets, there were net inflows of capital by foreigners (excluding foreign direct investments) amounting to USD24.4 billion in 2016 (2015: -USD15.0 billion).

Singapore's status as a strong net external creditor reinforced its solid external position. This reflects its huge domestic savings and intensive amounts of investment abroad by domestic entities. As of 2016, the city-state's net IIP stood at 224.0% of GDP, an increase by a whopping 30.3 percentage points from the preceding year. Over the past ten years, its positive net IIP position stood at an average of 204.0% of GDP, substantially stronger than any other country in the world.

While Singapore's large stockpiles of external debt (2016: 452.5% of GDP) warrant a high reserves buffer, we foresee Singapore's official reserves asset at 26% of total short-term external debt as adequate. It is important to note that its high level of gross external debt reflects cross-border financial intermediation of its large international banking system. Most importantly, its sizeable short-term external debt, particularly in the banking sector, is backed by even larger short-term financial external assets. In addition, Singapore's foreign exchange reserves of 86.8% of GDP is one of the largest in the world and in fact is larger than any other global financial centre.

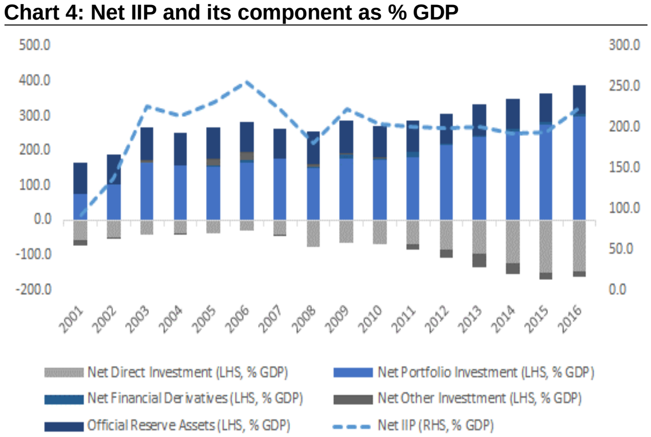
In general, Singapore's persistently large CA surpluses reflect its huge domestic savings from both the public and private sector. It also reflects a strong trade performance which more than offset the remittance outflows and the deficit in income balance over the years. In contrast, persistent CA surpluses also suggest a lack of domestic investments relative to savings. Looking ahead, MARC is of the view that while CA surpluses will likely moderate in the medium to longer term on the back of rising age-related spending and the drive to restructure the economy, the overall external balance sheet will remain exceptionally robust. In addition, with net IIP consistently double the size of the total output over the past decade, we opine that Singapore will remain in a very strong position to guard against exogenous shocks.

Chart 3: CA as % GDP



Source: CEIC, MARC Economic Research

Chart 4: Net IIP and its component as % GDP



Source: CEIC, MARC Economic Research

High fiscal discipline

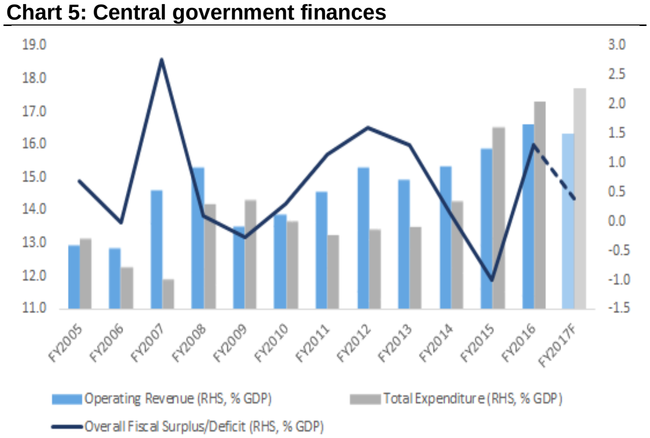
Singapore's fiscal management has been commendable as the government continued to maintain high fiscal discipline, due in part to its conservative fiscal rules. Accordingly, the fiscal balance remained in the black in all but two of the last ten years. It averaged at 0.7% of GDP in the five fiscal years through to FY2016, a shade lower than the 0.8% of GDP registered in the five years preceding that.

In spite of the expansionary fiscal stance it adopted since FY2015, the overall fiscal balance swung into a surplus of 1.3% of GDP in FY2016, a broad improvement from a deficit of 1.0% of GDP in the preceding fiscal year. This can be attributed mainly to the inclusion of Temasek, its sovereign wealth fund, into the net investment return framework, offsetting a slower gain in revenue (FY2016: 5.9%, FY2015: 6.6%). In addition, a prudent expenditure policy also helped restore its budgetary performance. For instance, the 5.8% increase in expenditure in FY2016 (FY2015: 19.1%) was in fact 2.8% below its budgeted spending. Accordingly, its overall fiscal surplus improved by 0.5 percentage points of GDP than initially envisaged during the Budget 2016.

The public sector has virtually zero direct liabilities, despite its relatively large stock of government debt (2016: 112.9% of GDP). The debt was created for the purpose of providing a benchmark of its domestic capital market. The issuances also supply a guaranteed income stream to its mandatory central pension fund, rather than financing government expenditure as the latter is prohibited under Singapore's Constitution. In fact, all proceeds raised from the issuance of the debt were fully invested and provide an additional income stream for the government that is more than sufficient to cover the debt servicing costs. Most importantly, the issuance of debt was long term in nature and in domestic currency, alleviating foreign currency risk. Moreover, ample public sector assets, combined with persistent fiscal surpluses, will continue to support its liabilities over the medium to longer term.

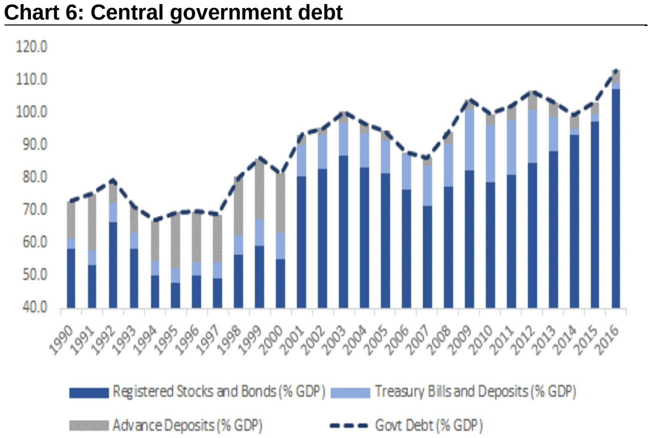
All in all, MARC is of the view that the overall fiscal situation will remain exceptionally robust in the foreseeable future, backed by large fiscal buffers. The recent Budget 2017 showed that the government would maintain its fiscal expansionary stance, as evidenced by a larger primary deficit of 1.3% of GDP (FY2016: -0.7%). This, however, reflects the government's pre-emptive approach to restructuring the economy in view of its structural challenges. Nevertheless, a history of fiscal surpluses along with consistent investment returns made via its sovereign wealth funds have contributed to the build-up of its large fiscal reserves, and hence supplemented its budgetary account on a sustainable basis under the net investment return framework. Accordingly, the overall fiscal balance is expected to remain in surplus of 0.4% of GDP in FY2017.

Chart 5: Central government finances



Source: MoF, MARC Economic Research

Chart 6: Central government debt



Source: CEIC, MARC Economic Research

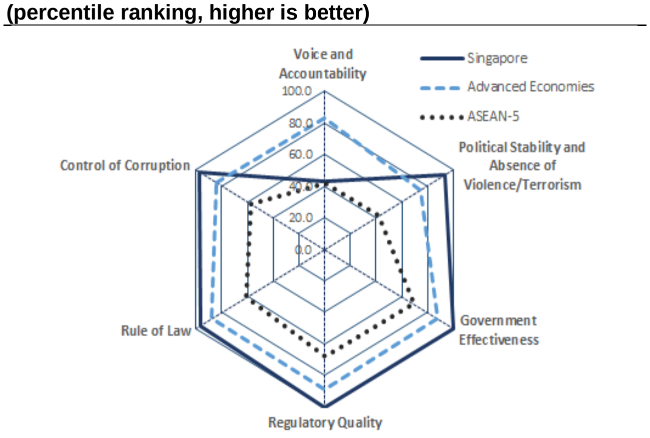
Solid institutional settings

Singapore's extremely solid institutional settings supplement its strong economic fundamentals. The policymaking is effective and highly recognised in most global rankings and indicators. The government is well known for its efficiency and for being largely corruption free, despite being in power since the country's independence in 1965. The Transparency International Corruption Perception Index ranked Singapore at 7th place globally in 2016, (2015: 8th), and placed it in the second spot among 30 Asia Pacific nations. Meanwhile, the World Bank 2016 Worldwide Governance Indicators reaffirmed Singapore's solid governance metrics, with the rank consistently above the 95th percentile in all but one of the sub-indicators, outperforming its regional and advanced countries peers.

As an important global financial and trade hub, Singapore's strong degree of competitiveness continued to be assured. The country maintained second position out of 152 countries globally in the WEF's GCI for a sixth year running through 2016-2017, above its Asian peers. Similarly, its business-friendly environment is reflected in its top-notch rankings in the World Bank's Ease of Doing Business report, securing second place out of 190 nations in the 2017 survey.

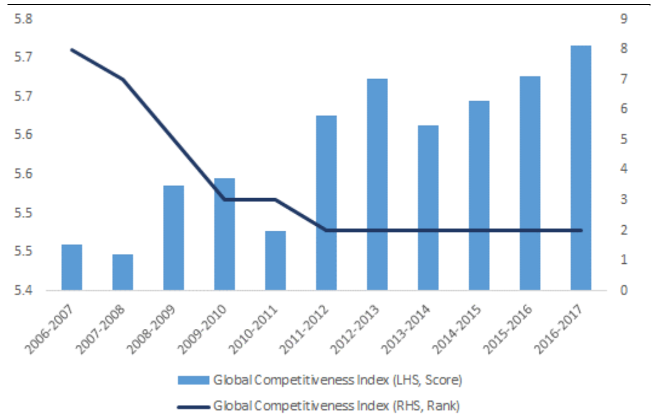
MARC is of the view that Singapore's political landscape is likely to remain stable over the foreseeable future. The solid institutional framework will ensure that the effectiveness of policymaking processes will be preserved over the near to medium term. We also believe that Singapore's favourable position in most global rankings and indicators will remain relatively unscathed against the backdrop of rising global geopolitical and protectionism risks. In addition, its first-class infrastructure and highly efficient goods and labour markets will likely preserve Singapore's status as an important global trade and financial centre.

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

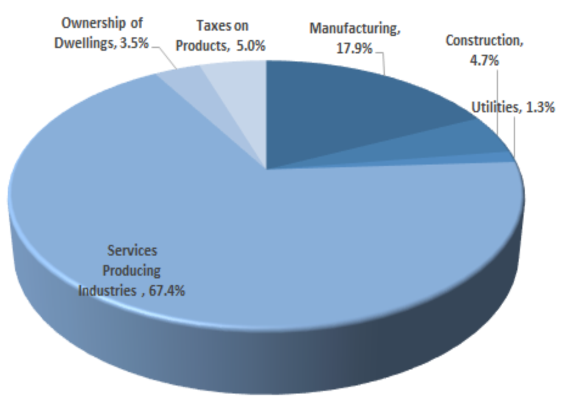
Susceptible to external developments

As a small country that relies heavily on global trade and financial activities, Singapore is undoubtedly susceptible to external developments. In particular, the total trade value is triple the size of its national income, the world's second highest after Hong Kong. The dependency on trade also means that Singapore's growth momentum is inevitably tied to the global growth trajectory. Accordingly, its growth volatility of 4.6% in the seven-year period through to 2016 was much higher than its advanced economies peers' rate of 0.8%.

Indeed, the slowdown of China's economy, combined with greater financial volatility amid heightening global geopolitical risks, have raised some concerns over Singapore's growth trajectory. Still, the economy weathered these challenges effectively, thanks to the authorities' proactive and effective countercyclical measures to support the economy. Singapore's significant economic diversification also provides ample immunity in the face of uneven global growth momentum. About two-thirds of its total output were contributed by the services sector over the past decade. The manufacturing sector, meanwhile, accounted for an average of 19.0% of GDP during the same period. Of the other sectors, only the construction sector saw an increase share of total GDP, rising to nearly 5.0% of the total output over the five years through to 2016, partly attributed to the real estate market boom post-GFC, from 3.2% of GDP in the five years since 2004.

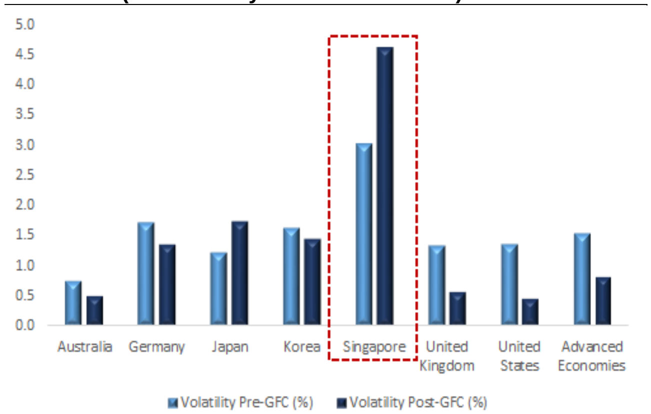
Looking ahead, the prospects in the near term depend largely on the pace of global economic recovery and further stability in key commodity prices. As a highly open economy, external factors such as slower global trade, China's economic rebalancing and spillover effect from renewed global financial volatility remain Singapore's short-term downside risks. Notwithstanding this, stronger growth in advanced economies, particularly in the US, Europe and Japan, should provide some support to export-oriented sectors over the near term.

Chart 9: Singapore's economic structure (2016)



Source: CEIC, MARC Economic Research

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



Source: IMF, CEIC, MARC Economic Research

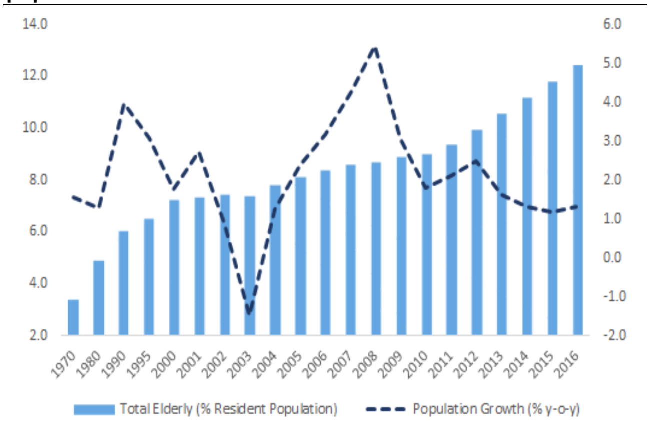
Structural issues that limit potential growth

Singapore's long-term prospects, however, will be constrained by its structural issues, arising from a rapidly ageing population and tepid productivity growth. Singapore's median age stood at 40 years in 2016, up from just 34 years in 2000, while about 50% of total residents are 40 years and above. In addition, its total fertility rate of 1.2 births per woman in 2016 was the word's lowest, on par with South Korea. According to the International Monetary Fund (IMF), rising life expectancy combined with a persistently low fertility rate as well as currently tight immigration policies are among the factors contributing to Singapore's rapidly ageing society. Citing a United Nations (UN) projection, the IMF foresees that Singapore's old age dependency ratio will climb by a whopping 30 percentage points to 47% in the next two decades from 17.1% in 2016, mirroring Japan's experience.

Meanwhile, its productivity growth has been lacking, averaging at 0.9% in the five years since 2012, broadly lower than the average 3.7% pace registered in the pre-GFC period. Indeed, slower productivity gains in recent years proved to be a drag on real GDP expansion, with total multifactor productivity growth subtracting an average 0.8 percentage points from headline economic growth in the five years through to 2016. In comparison, total multifactor productivity growth added 3.9 percentage points to headline growth in the five years between 2003 and 2007. These, along with tight control on low-skilled foreign workers, will further constrain labour supply growth and could have an impact on domestic demand over the medium to longer term.

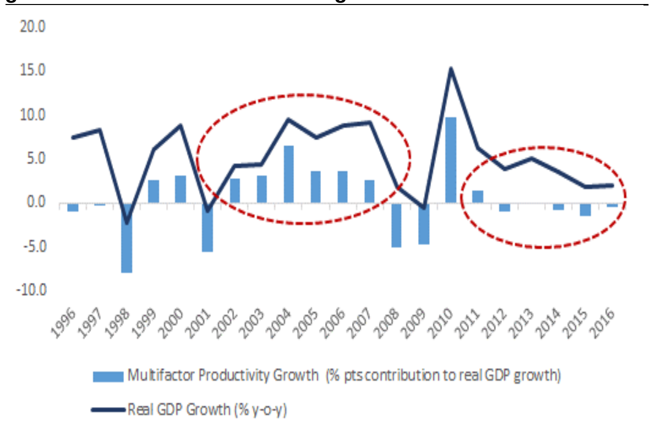
In this regard, MARC views positively the government's persistent efforts to restructure its growth model towards a productivity and knowledge-based economy. The authorities recently enhanced its restructuring measures during Budget 2017 by further strengthening its commitment to rejuvenate the economy. This is done with the hope of generating a more sustainable growth path over the medium to longer term. Indeed, we concur with the authorities' view that economic growth will likely average between 2.0% to 3.0% over the next decade, compared with initial expectations of a 3.0% to 5.0% rate.

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



Source: Singstat, CEIC, MARC Economic Research

Chart 12: Real GDP growth and multifactor productivity growth contribution to real GDP growth



Source: CEIC, MARC Economic Research

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