QNB Economics
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Singapore announces expansionary budget as growth slows

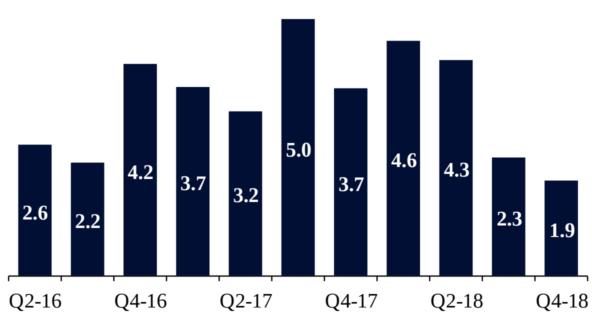
The Singaporean economy is slowing down. The trend comes after growth hovered around three-year highs on the back of external tailwinds associated with the synchronized global expansion and booming demand for electronics in Q4 2016-Q2 2018. Headwinds are currently dominating as the global scenario has deteriorated. With demand weakening in large advanced and emerging economies (US, EU, Japan, and China), Singaporean exports are suffering and sentiment is affecting domestic activity. A small open economy with external trade in goods and services equivalent to 234% of GDP, Singapore is very sensitive to trends in global demand. Last quarter, Singaporean real exports have contracted for the first time in more than two years. This has contributed to the negative surprise in headline GDP growth. In fact, the Singaporean Ministry of Trade and Industry (MTI) has recently released the final print for GDP growth in Q4 2018, revising the reading of the advanced print down to 1.9% from 2.2%.

Within this backdrop, the Singaporean government has launched an expansionary 2019 budget. The central government surplus will turn into a deficit. The short-term fiscal impulse is expected to come mostly from a slight increase in private consumption due to higher special transfers to lower income groups. A significant part of the increase in spending is expected to create an impulse over the long-term. This is because the additional allocation to endowment and trust funds is expected to be disbursed as healthcare support for Singaporeans over time horizons that go much beyond the fiscal year.

Despite the prudence over the expansionary stance, the fiscal policy is set to become the main line of defence to cushion growth moving forward. Our analysis delves into the three main reasons for the expected reliance on more expansionary fiscal policy, both in the short-term and over longer time horizons.

First, the monetary policy framework limits the potential for policy stimuli in Singapore. Singapore's monetary policy is based on a basket, band, and crawl (BBC) exchange rate system in which price stability is achieved through exchange rate management rather than changes in a policy interest rate. As per the operational framework of the Monetary Authority of Singapore (MAS), the value of the Singapore dollar (SGD) is allowed to fluctuate within a band (currently estimated to be +/- 2%) against an undisclosed basket of currencies – also known as the nominal effective exchange rate (NEER). Monetary policy is thus adjusted by changing the slope of SGD NEER or the "crawl." Typically, the crawl is set on an upward (appreciating) or flat path (slope of 0%). After two years in a flat path because of disinflationary pressures, the MAS has started a gradual normalization process last year. While the MAS does not explicitly announce the slope of the SGD NEER policy band, the market consensus is that the appreciation slope is currently set at 1.0% per year, which is still considered accommodative. If growth slows further, the MAS can stand pat and decide not to further increase the SGD NEER slope. However, the bar is high for the reversal of the policy normalization process, especially as inflation expectations are still firm and the labor market has tighten significantly in recent years.

Real GDP growth in Singapore
(quarterly, seasonally adjusted, y/y, %)



Sources: Haver Analytics, QNB Economics analysis

Second, with a healthy fiscal position and large fiscal reserves, the fiscal space is rather vast for Singapore. Over the last few years, the budget has positively deviated from targets on the back of over-performance of revenues, project savings and cash flow delays for development expenditure. Overall budget surpluses were significant. According to the Singaporean Constitution, the government has to deliver balanced budgets over each term, which means that the current administration can be even more aggressive in 2020 and disburse the accumulated surplus of about SGD 14-15 Bn. If the surpluses are not spent, the amount has to be locked up in Singapore's long-term financial reserves. The Singaporean government is estimated to hold nearly USD 1 Tn or 200% of GDP in financial assets, including USD 294 Bn in official FX reserves and more than USD 700 Bn as assets under management in two sovereign wealth funds (GIC and Temasek) as estimated by the Sovereign Wealth Fund Institute.

Third, a more supportive fiscal stance is important to ease medium-term supply constraints, support external rebalancing and tackle key demographic challenges. Public funds are essential to promote economic restructuring and broad productivity boosting incentives for businesses, including tax benefits for research & development and resources for labor training and re-training. As the population ages and healthcare bills rise, significant expenditure growth becomes necessary. Moreover, an older population and a build up of more robust social insurance and safety nets are likely going to favour a gradual moderation of net savings. This should boost private domestic consumption and narrow the persistently large current account surpluses.

All in all, fiscal policy remains supportive and is expected to loosen more over the coming years. More expansive policies are expected to offset external headwinds as well as facilitate the city state's new rounds of structural economic transformation.

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