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SINGAPORE

SINGAPORE'S FY16 PRE-BUDGET THOUGHTS

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Sluggish growth but no full-blown or technical recession yet.

Let's get the facts right – the global and Singapore economies are still in disappointing shape this year but not quite staring at a full-fledged recession. While downside risks abound, namely weaker China growth, elevated financial and commodity market volatility, the prognosis is sluggish but still positive growth for the Singapore economy at this juncture. That said, the recent January-February economic indicators have been mostly undershooting market expectations and the risk of a technical recession in 1H 16 is growing, albeit it is not quite our baseline scenario yet. Our 2% yoy growth forecast for 2016 is within the official growth forecast of 1-3% yoy. It would be safe to say that better to keep the powder dry for now so as to have extra ammunition if things go downhill from here.

Back to economics amid structural restructuring challenges.

The FY15 Budget theme was "building our future, strengthening social security", but the FY16 budgetary focus will clearly shift back to strengthening the economy by helping the companies overcome challenges. Global and regional demand conditions continue to handicap business sentiments, especially for manufacturing and the externally-oriented sectors. From the monetary policy front, the MAS had already eased the SGD NEER policy twice in 2015. A further monetary policy easing at the upcoming April policy review could be less likely but not impossible. Nevertheless, companies have made it clear any short-term relief and/or government aid from the fiscal front may be timely, if not necessary. The business wish lists seem to suggest that foreign manpower constraints have overtaken cost complaints?

Domestic fiscal considerations – real or theoretical constraint?

Finance minister Heng had said that the FY16 Budget aim "is to help companies to navigate through this very difficult period" but as the Budget is the government's first year in its new term, it will have to be "particularly prudent" this year so as to have the resources when it needs to act later. Looking back in history, the Singapore government had run budget deficits in FY2001, FY2003-2004, as well as FY2006 (due to $1.4b of Growth Dividends) and FY2008-2009, of which 2001 and 2009 were clearly recession years. One plausible scenario in our view then is that the FY16 Budget could be "prudent" in that it does not run an outright deficit position, but allow room for off-budget measures at a later stage should the economy require it.

Prospects for off-budget measures down the road assuming the need arises.

Note the Singapore government previously introduced two stimulus packages worth a total of $13.5b, comprising of $2.2b in July and $11.3b in October 2001, when it was obvious the economy had already sunk into a recession and MAS noted that the introduction of off-budget measures without any change in MAS monetary policy stance would lift GDP growth by a full percentage point. These

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measures included corporate and personal income tax rebates, rental rebates by government landlords, removal of anti-speculative property measures (including the reduction in stamp duty), enhancement of existing finance schemes (eg. the Local Enterprise Finance Scheme) etc, but was also coupled with a tightening of the foreign worker policy criteria. Therefore, it would not be inconceivable that should the need arise, off-budget measures, albeit clearly still speculative at this juncture as our 2016 GDP growth forecast is still standing at 2% yoy, could materialize along similar lines.

Expected FY15 budgetary out-turn is likely to remain a significant deficit.
FY14-FY15 Budgets were unusual in that there were significant accumulated surpluses to spend towards the tail end of the previous term of government and milestones like the Pioneer Generation Scheme and the Silver Support scheme were introduced in order to strengthen the social safety nets for an ageing population. Given that operating revenue, especially the corporate and personal income taxes, as well as other fees and charges, are running ahead of plan for the first three quarters of FY15, notwithstanding the tepid 2015 GDP growth of 2% yoy, the likely FY15 budgetary out-turn is likely to remain a significant deficit of $6.5b (equivalent to 1.6% of GDP) based on our estimates.

A modest FY16 budget surplus/deficit in spite of larger NII contributions?
Given the official rhetorical stress on a fiscally prudent budget, we have penciled in a return to a marginal overall FY16 budget surplus of $0.37b (equivalent to 0.1% of GDP), which is very close to a balanced position. Depending on how the Singapore economy eventually fares, given the growing downside headwinds from the external front, the growth picture may settle closer to the lower half of the official 1-3% growth forecast. Recall that that higher Net Investment Returns contributions (NIRC), from including Temasek Holdings in the full NIR Framework, together with the adjustments to top personal tax rates, will add yearly revenues of about 1% of GDP, and the FY16 NIRC could be close to $13b (about 3% of GDP).

Fiscal prudence on the expenditure side?
Following the big-ticket items like the Pioneer Generation Scheme (PGS) in recent Budgets, there may not be any blockbuster goodies in this coming Budget. That said, there is still likely to be continued government focus on strengthening social safety nets, especially for the vulnerable groups like the youth in the disadvantaged/low-income households (particularly in the areas of leveling up such as education and housing) and the elderly (beyond the PGS to potentially beefing up of the Silver Support scheme and the livelihood means, whether through the likes of GST vouchers and/or MediSave top-ups). Given sustained high cost of living concerns with Singapore ranked as the most expensive city globally, a further enhancement of Workfare Income Supplement may be on the cards given the last enhancement was in 2013. In particular, the government could further incentivize the employment of elderly Singaporean workers given the demographic ageing . Other sweeteners could also be more targeted tax relief to support healthcare and childcare costs to promote child-bearing and strengthen family bonds.

Need to broaden the tax revenue base going forward?
On the flip side, the expenditure needs are likely to continue to grow over time, with $36b required over five years to achieve a car-lite society for Singapore according to MOT's Addendum. As such, there will be a need to shore up the revenue base. Whilst a hike in the 7% GST rate is unlikely for now, there have been suggestions

to cut the current registration threshold from $1m annual turnover to $500k as well as look at new ways of imposing GST on the digital economy, especially online services even though enforcement may be tricky. In addition, there could be other tax tweaks such as relooking at the partial tax exemption and subject smaller companies to income tax at a separate concessionary rate (eg 8%) while the remaining companies continue to be taxed at 17%. However, given the sluggish economy and soft business sentiments currently, these are probably more medium-term considerations.

Fundamental foreign labour policy principles are unlikely to change.
Businesses have called for a reassessment of the foreign manpower policy stance in view of tepid growth and protracted weak productivity data. Last year's Budget had a 1-year standstill on foreign worker levy hikes and companies have been requesting for a further deferral, however, we see a less than 50% probability that it will be deferred for another year, but there may be some tweaks to allow for more breathing space for selected industries.

Similarly, property cooling measures are unlikely to be immediately lifted. Barring a recession or an unsustainable correction in private property prices, we think that the likelihood of an immediate lifting of the ABSD or SSD is low at this juncture. The property market is still softening but at an acceptable pace for now. Any tweaks to the cooling measures may come only in 2017 or later?

Supportive measures for SMEs should be on tap.
While a near-term rollback on foreign manpower policies may be out of the question, there is likely to be additional measures to aid SMEs through this current challenging period. While the Committee for Future Economy (CFE) will only make its recommendations at the year-end, the FY16 Budget will likely unveil plans to boost innovation and facilitate SMEs to create value through industry collaboration, internationalization and capability building, especially through investing in technology and R&D. Given the tapering off of bank credit growth and slightly elevated interest rate volatility, one pressing area of need could be some form of SME financing. Last but not least, one low-hanging fruit would be to continue to simplify and streamline some of the grant and incentive application processes and criteria to expedite and benefit SMEs.

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