SINGAPORE: PRE-2018 BUDGET

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SPORE: PRE-2018 BUDGET THOUGHTS

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After a stellar 2017 GDP growth, watch 2018 Budget on 19 Feb.

Singapore's 4Q17 GDP growth was revised up to 3.6% yoy (2.1% qoq saar) in 4Q17, bringing full-year 2017 GDP growth from 3.5% to 3.6% yoy (highest annual pace since 2014's 3.9% yoy). The broadening engines of growth beyond manufacturing, particularly electronics, with services picking up speed (namely in finance & insurance, transportation & storage, wholesale trade, and even domestically-oriented services like retail and food services given the improving labour market and consumer sentiment) should bode well for the 2018 outlook. While MTI retained its official 2018 growth forecast at 1.5-3.5%, it now expects to come in slightly above the mid-range, The risks remain that the external demand outlook is slightly weaker versus 2017, and potential headwinds are trade protectionism, upside US' inflation risks and elevated financial market volatility potentially impacting regional economies.

2017 fiscal position is likely to reflect the robust economic growth.

The healthy Singapore economy has lifted many boats, including benefiting tax collections. Based on the healthy collections in the first three quarters of FY17, total tax revenue receipts could exceed the FY17 Budget by some 5%. However, with budgeted total expenditure at $75 billion, the primary balance is still likely to come in around -$2.1 billion. After factoring in the planned Special Transfers of $6.6 billion and the Net Investment Income Contribution of $14.1 billion, the overall budget surplus is likely to reach $5.41 billion (or 1.3% of GDP).

What is in store for 2018 Budget?

Budget 2018 is expected to continue efforts to help firms and Singaporeans transform to be future-ready. Come 19 February, we should expect to see a renewed but targeted push to promote innovation, digitalisation, and R&D investments, while investing in key economic infrastructure and caring for the ageing population. Our estimated FY2018 budget surplus of $5.4 billion (or 1.3% of GDP), predicted on sustained 2018 GDP growth of 2-4% and business confidence and consumer sentiment holding up. Given the ageing demographics, increased social policy spending remains necessary, even though expenditures have exceeded operating revenues since FY2015. In addition, upgrading the economic infrastructure framework for Singapore remains critical to maintain Singapore's pole ranking in many global competitiveness surveys, attract foreign direct investments and sustain a dynamic economy that creates jobs and wealth.

Potential tax changes in store?

Finance Minister Heng had earlier suggested the need for "less goodies" and more government revenue. Since the US has just slashed its corporate income tax from 35% to 22%, and adjustments to our top personal income tax brackets kicked in from YA 2017, it may seem prudent to look for other tax revenue alternatives at this juncture to at least maintain Singapore's global tax competitiveness and remain business-friendly. The net investment income contribution had also risen sharply from around $2.4 billion in FY2007 to over $14 billion by FY2016-17, and given the currently challenging low-yield environment, it remains an open question if more can be tapped on a longer-term sustainable basis.

Weighing the odds for an E-commerce tax and GST.

Senior Minister of State for Law and Finance Indranee Rajah also commented on the possibility of an e-commerce tax, saying "it's certainly something we would like to do, but we have to be careful about how we do it". As such, an e-commerce tax looks potentially likely, especially with some industry estimates tipping Singapore's e-commerce sales reaching $10 billion by 2020. For GST, the debate is not so straight forward as it is seen as a regressive tax. That said, our 7% GST rate is relatively low compared to 8% in Japan and 10% in South Korea and Australia, and the rate has not been hiked since 2007.

A 1% point hike in the GST could contribute around $1.7 billion in tax revenue, and 2% could potentially lift GST contribution to around 20% of total tax receipts compared to 16% in FY2017. If GST hikes materialize, this would be likely be accompanied by an enhancement of GST Vouchers (regular and cash special payments) and U-Save rebate quantum to help lower-income households with expenses and alleviate the regressive nature of a higher GST.

Enabling business to take advantage of the digital economy

On the business side, the Industry Transformation Maps (ITMs) remain the main strategy to transforming the Spore economy industry by industry, and will take time to execute. In addition, the merger of Spring Singapore and IESingapore should provide a more synergistic approach to helping businesses adapt, create value and venture to new markets. However, gross fixed asset formation declined 1.8% yoy in 2017, extending the 0.6% contraction in 2016, and subtracted 0.2% points from GDP growth in 2017. The main drags came from construction & works in the private sector (-17.9% yoy) and public transport equipment (-41.0% yoy). This suggested that capex investments remained sluggish despite the improvement in headline GDP growth and domestic business confidence. With the expiry of the PIC in YA2018, there are some industry concerns about sustaining the pace of digital transformation in the Singapore economy, especially when it comes to SMEs. For instance, some industry players have suggested it will be timely to enhance tax incentive measures, especially for digital adoption, digital skills training and other R&D investments.

Moving the needle further on skills training and upgrading.

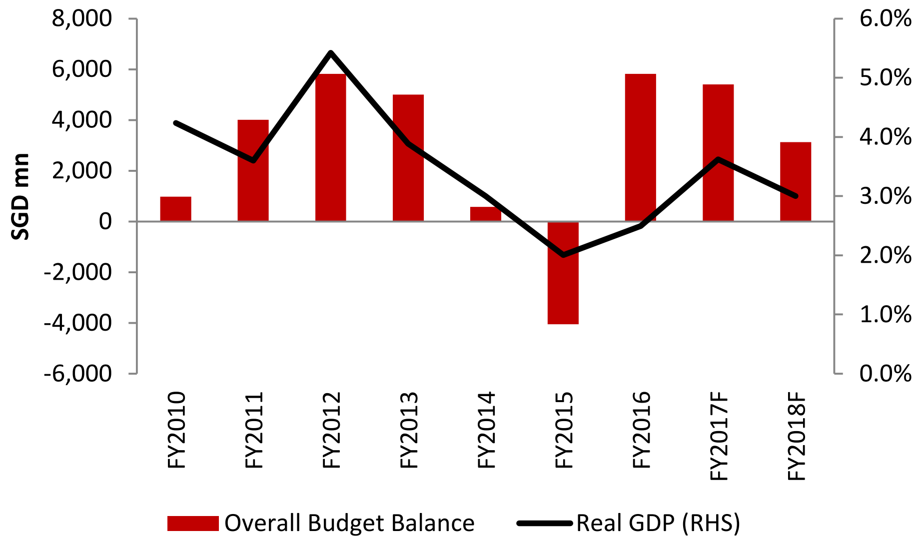
The unemployment rate remained relatively low at 2.2% last year, but there are signs of 2H17 stabilization in the labour market after a somewhat soft patch in 1H17. Nevertheless, unit labour cost fell 0.3% in 2017, partly reversing the 2.0% increase in 2016. With 2018 GDP growth likely to sustain around the 2-4% range, the domestic labour market may see a modest improvement in terms of hiring and wage intentions, but the upside is likely limited amid the push for a more productive labour force and intact foreign manpower policy constraints.

Therefore, it may timely to enhance current funding and resources, including a top-up of the SkillsFuture accounts for Singaporean workers, among the suite of measures to motivate older workers to go for training while they are employed, especially the PMETs.

2018 Budget is likely to set a "give and take" tone.

The Finance minister had previously articulated the need to keep the tax system fair and progressive across income groups, a sustainable tax system is one that rewards effort by individuals and enterprise, and fiscal sustainability is about striking the right balance between current and future generations. The policy perspective remains one of planning for the long term ie. beyond 5-10 years. We have estimated three scenarios: (1) no change in GST, (2) 1% hike in GST, and (3) 2% hike and the impact on the overall budget balance can vary from $3.1 billion to $4.8 billion for FY18, equivalent to 0.7% - 1.1% of GDP.

Singapore's fiscal position (assuming a 1% GST hike for FY2018)



Source: CEIC, OCBC

Summary Tables

SGD mn	FY2016	FY17 Budgeted	FY1H17	FY2017F
Total Operating Revenue	68,964.4	69,450.0	38,345.4	72,884.2
Total Expenditure	71,045.0	75,070.0	30,671.4	75,003.9
Primary Balance	-2,080.6	-5,620.0	7,674.0	-2,119.7
Special Transfers	6,467.0	6,582.0	3,290.0	6,582.0
NIRC	14,368.0	14,110.0	7,055.0	14,110.0
Overall Budget Balance	5,820.4	1,908.0	11,439.0	5,408.3

Note: Special transfers and NIRC FY1H17 prints are assuming 50% of FY17 budget

SGD mn	FY17 Budgeted	FY18 (No GST Hike)	FY18 (1% GST hike)	FY18 (2% GST Hike)
Total Operating Revenue	69,450.0	77,089.7	77,895.6	78,713.7
Tax: Goods and Services	11,250.0	11,353.9	12,985.8	13,803.9
Total Expenditure	75,070.0	79,714.5	79,714.5	79,714.5
Primary Balance	-5,620.0	-2,624.8	-1,818.9	-1,000.8
Special Transfers	6,582.0	8,356.2	8,356.2	8,356.2
NIRC	14,110.0	14,110.0	14,800.0	14,110.0
Overall Budget Balance	1,908.0	3,129.0	4,624.9	4,753.0

Source: Singapore Budget, MOF, OCBC Bank