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Curtain Raiser for Budget 2020

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Highlights

- **The global and domestic economic environment remains lacklustre, and the recent coronavirus outbreak has cast a dark cloud over regional growth prospects in the near-term**. Singapore's 2020 GDP growth could potentially be shaved off by up to 0.5-1% point from the baseline depending if the current epidemic is mild or severe. Hence we had widened our 2020 growth forecast to 0-2% from 1-2% on 30 January to factor in the downside risks from the coronavirus.
- **Budget 2020 comes at an opportune time for a more expansionary fiscal stance to provide a much needed lift to buffer the downside growth risks. We have pencilled in an $8 billion overall budget deficit, equivalent to 1.5% of GDP for Budget 2020, which will be a record per se.** In addition to a potential GST offset package (that is likely to outweigh the $4b package over 5 years announced in 2007), there will also be targeted assistance for coronavirus-affected firms, especially SMEs, and workers (which again can be larger than the $230m provided in the SARS relief package back in 2003). This is in addition to continued efforts to invest in infrastructure, sustain R&D and build local capabilities and upskill the workforce, as well as combat climate change, given the substantial accumulated fiscal surplus position.
- **A further monetary policy response is also possible if the coronavirus outbreak prolongs into 2Q20.** Back in October 2019, MAS had already flattened the S$NEER slope slightly. On 5 February 2020, MAS clarified that there is sufficient room within the policy band to accommodate the easing of S$NEER in line with the weakening economic conditions due to the coronavirus outbreak and the next review will be in April 2020 as scheduled. Market interpreted this as green light to push the S$NEER from +1.7% on the stronger side of its parity band to -0.2% on the weaker side. The odds of an easing action by the MAS in the upcoming April MPS has risen to non-negligible levels - while it may still be too early to conclude that the MAS will make such a move, the needle is probably moving in that direction. We do not rule out the possibility of the MAS reverting to a zero appreciation path for the SGD NEER, and regard a re-centering lower as the lower-probability event.

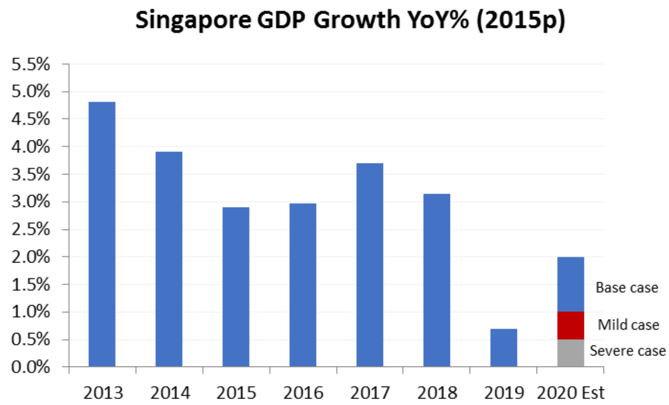
The coronavirus outbreak is posing a clear downside risk to 2020 growth prospects.

The global and domestic economic environment remains lacklustre, and the recent coronavirus outbreak has cast a dark cloud over regional growth prospects in the near-term. Our earlier estimate is that Singapore's GDP growth could potentially be shaved off by up to 0.5-1% point from the baseline depending if the current epidemic is mild or severe. Consequently, our 2020 GDP growth forecast range has been widened from the earlier 1-2% to 0-2% to accommodate for spillover effects from three fronts: (a) the likely slump on tourism and hospitality-related industries due to travel restrictions, fear of air travel and cruises due to reported cases and quarantine orders; (b) possible disruptions to manufacturing and even the construction sectors due to potential shortages of raw materials and components arising from China's city quarantines and travel curbs; and (c) the fear factor contributing to weak consumer sentiments and a cut back in F&B, discretionary spending and entertainment in the near-term as people avoid crowded places.

Will 1Q20 or even 2Q20 GDP growth sink in the wake of the coronavirus outbreak?

The Singapore economy may contract in 1Q20 given the sombre mood prevailing after the government raised the DORSCON alert level from yellow to orange on 7 February. The Singapore Tourism Board has warned that tourist arrivals and spending could fall by 25-30% this year due to the coronavirus outbreak and the impact is likely to be worse than the 2003 SARS pandemic. China accounts for about 20% of international visitor arrivals (compared to just 9% in 2003) amounting to about 3.6 million visitors in 2019 and also is Singapore's top revenue market in the first three quarters of 2019 accounting for $3.2 billion in tourism receipts excluding sightseeing, gaming and entertainment segments. According to STB, Singapore is losing an average of 18,000-20,000 international visitors a day due to travel restrictions. There is still substantial uncertainty about when the coronavirus outbreak will peak and subside, but the risk of a protracted slump cannot be fully discounted at this juncture.

GDP growth (% yoy)	Baseline (pre COVID-19)	Mild scenario	Severe scenario
1Q20 GDP	1.1%	-0.6% yoy	-1.2% yoy
Full-year 2020	1.5%	0.7%	0%



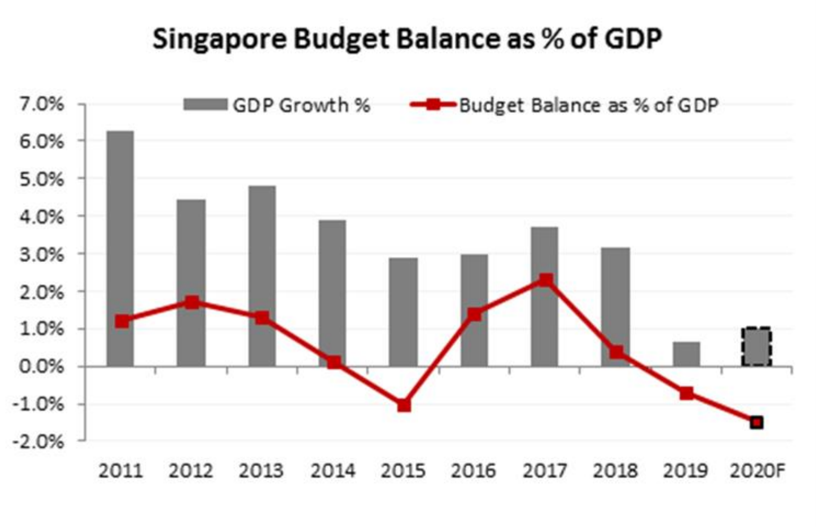
Source: CEIC, OCBC

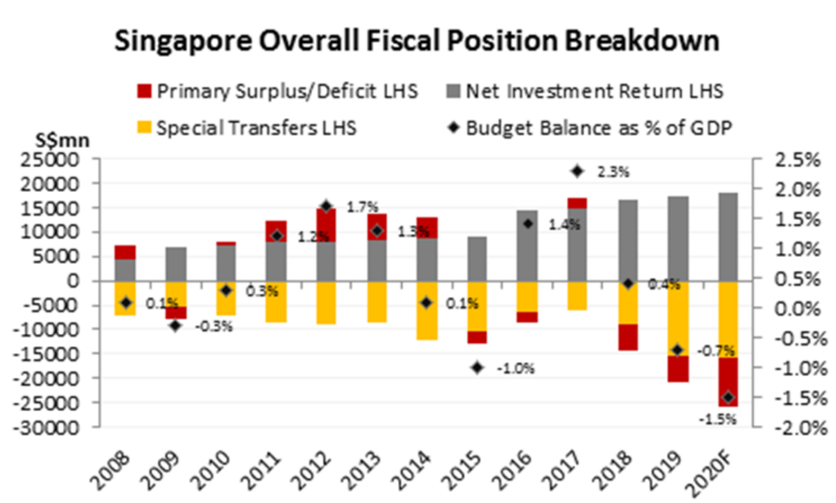
However, the snapback in financial market sentiments could lead growth.

That said, the turnaround in market sentiments could also be quick given the SARS experience where a sharp rebound in 2H 2003 was seen. If there are signs that infections have peaked, the recovery rate is improving and the death toll is under control, or a vaccine is on the horizon, then it is plausible that financial markets, being more forward looking, may see risk appetite bouncing back. That said, economic indicators like unemployment rate may be slower to react – during SARS in 2003, domestic GDP growth had tanked to -0.3% yoy in 2Q 2003, but the unemployment rate only surged from 3.6% in 2Q2003 to 4.8% in 3Q 2003 and subsequently eased back to 3.9% by 4Q 2003. As such, the overall unemployment rate could creep slightly higher to around 2.5% by end of the year if business confidence remains depressed by the coronavirus outbreak and other uncertainties.

Budget 2020 comes at an opportune time to provide a more expansionary fiscal stance.

Given the potential growth dip in 1Q20, the Budget 2019 outturn may not differ significantly from plan. While operating revenue was only largely in line with plan up to November 2019, the last quarter of fiscal year 2019 (which coincides with 1Q of calendar year 2020) could disappoint. However, a suitably expansionary Budget 2020 will provide a much needed lift to buffer the downside growth risks this year. We have pencilled in an overall budget deficit of up to $8b which is equivalent to 1.5% of GDP for the 2020 Budget, which is significantly higher than the $4b deficit (equivalent to 1% of GDP) seen in 2015 which coincided with the last general election.





Source: CEIC, OCBC

Look for a GST offset package and also a coronavirus relief package in Budget 2020.

The key highlights of the 2020 Budget is likely to include a potential GST offset package in view of the highly anticipated 2% point GST hike (that could outweigh the last $4b GST offset package over 5 years announced in 2007), and also a Coronavirus relief package to provide targeted assistance to affected industries, firms and workers (which again can be larger than the $230m provided in the SARS relief package back in 2003). These will be in addition to the multi-year ongoing efforts to continually invest in infrastructure, encourage digital transformation and productivity, sustain R&D, innovate and build local capability and upskill the workforce, as well as combat climate change. Thankfully, there is a substantial accumulated fiscal surplus amounting in excess of $15 billion for the past four years, so

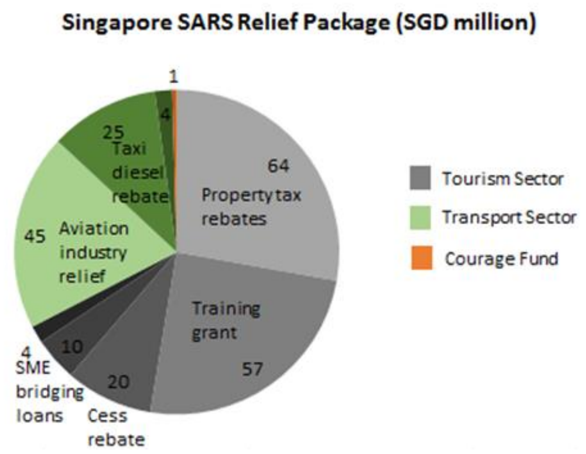
Singapore is in the fortunate position of having sufficient dry powder to strike a balance between buffering against short-term downside risks and implementing the medium-term strategy to meet structural challenges like an ageing population and digital disruption.

The GST offset package back in 2007 included GST credits (of up to $1,250 over four years), Senior Citizens' Bonus (of $250-$1250 over four years), U-Save rebates (with those staying smaller HDB flats to get more rebates over five years), S&CC rebates (between 0.5 to 4 months over five years), rental rebates (between 1 to 4 months), top-ups to Post-Secondary Education Account schemes, property tax rebate, assistance for pensioners and low-income households with children, top-ups to Public Transport Fund for lower-income households, assistance through Citizens' Consultative Committees, self-help groups and VWOs for lower-income households, and additional subsidies etc.

Recall in Budget 2018, the GST was announced to increase from 7% to 9% sometime between 2021-2025. Hence Budget 2020 may be timely to fix the actual timing of the GST hike, which is likely to be a two-step hike in view of the tepid growth environment, and possibly starting later rather than earlier. To assist Singaporeans, especially lower-income households, cope with the upcoming round of GST hikes, a more generous GST offset package could be in the offing, but is likely to comprise of the usual assistance methods as highlighted above. A clear redistributive principle is also likely to make the GST hike more palatable to the masses.

A coronavirus relief package will also be forthcoming. In 2003, the $230 million SARS relief package was meant to provide immediate relief for the most affected sectors, namely the tourism and transport-related sectors, rather than a general stimulus package for the whole economy. Adjusting $230 million for inflation alone, the coronavirus relief package is likely to exceed at least $300 million. But given the greater importance of the China market for visitor arrivals and spending, and in view that visitor arrivals from other key source markets are also expected to fall due to the hit to travel confidence, the coronavirus package may at least double that amount ie around $500 million. The coronavirus relief package is likely the 2003 SARS relief package and target three key areas, namely (a) the tourism-related industries through additional property tax rebates for commercial properties and gazetted tourist hotels, reduction of Foreign Worker Levy for unskilled workers and TV license fee rebates for gazetted tourism hotels, bridging loans for tourism-related SMEs and enhanced training grants, (b) the transport sector, including diesel tax rebate and taxi operator license fees waivers, relief measures for the aviation industry such as aircraft landing fees, rental rebates for Changi and Seletar airports, port dues for cruise ships etc, and (c) the setting up of a Courage Fund where the government made a $1m upfront contribution with a matching grant.

In addition, a potential tweak or delay to the further tightening of the dependency ratio ceilings (DRCs) for foreign workers employed in the services sectors from January 2021 would be welcomed. Beleaguered SMEs will also welcome any policy assistance provided by Enterprise Singapore to address liquidity and cashflow challenges, as well as enhanced training grants to send workers for skills upgrading during this period when global and domestic demand may remain soft.



Source: CEIC, OCBC

Social and economic development priorities remain key in Budget 2020.

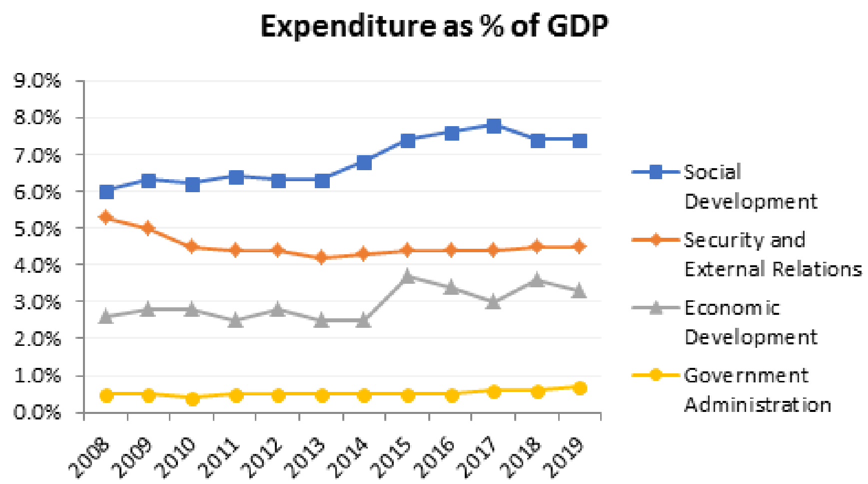
The bulk of expenditure for Budget 2020 will still likely be focused on social and economic development priorities. Social development expenditure has accounted for a lion's share of 47% of total expenditure allocation in Budget 2019, dominated largely by education (16.4%) and health (14.6%). Since 2011, education's share of total expenditure has actually declined from 20.8% to 16.4% in 2019, whilst that for health has actually increased from 9.7% to 14.6% over the same period. This is probably in line with the ageing population and greater focus on stepping up healthcare support especially for the elderly, including the Pioneer and Merdeka Generation Packages and the Community Health Assist Scheme (CHAS).

While another healthcare package for the post-Merdeka Generation is not expected for now, nevertheless, the ageing population is likely to ensure that healthcare costs may continue to increase over time. It is also not inconceivable that in time to come, the healthcare component may supersede education in terms of allocation given the low total fertility rate.

A more community-based and holistic approach to encourage older Singaporeans to live a fulfilling life at every stage could also include expanding the Community Network for Seniors and a top-up to the Silver Volunteer Fund.

The second biggest expenditure allocation after social development is security and external relations with 28.3%, albeit this is lower than the 31.8% seen in 2011, whereas the allocation to economic development has risen from 18.4% to 20.6% over the same period (see chart below). With the need to continue to support businesses to raise productivity and help workers to retrain, acquire new skills, find jobs and stay employable, the allocation to economic development remains important. Moreover, there is a currently a stronger case to argue for assistance to help displaced workers and SMEs to ride out the current challenging economic environment, with efforts led by Enterprise Singapore.

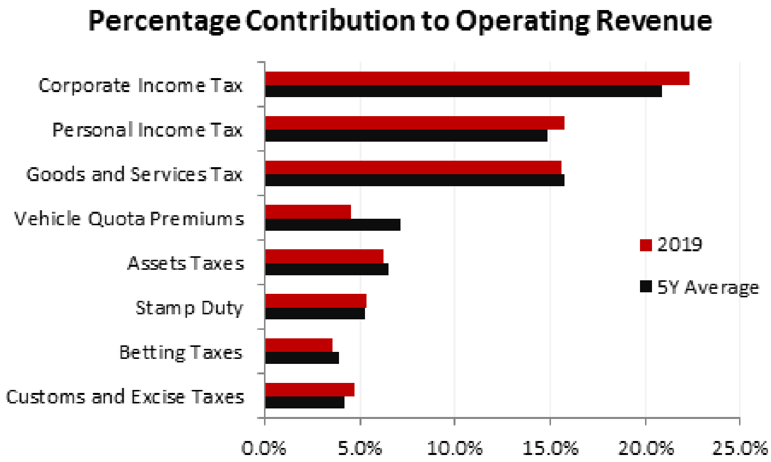
On special transfers, there may be special allocations to fund R&D for the next five years from 2021-2025, combat climate change (in view of the $100 billion needed for climate change initiatives over the next 100 years), and promoting sustainable and green investments. It may also be timely for another top-up to the SkillsFuture scheme to encourage Singaporean workers to adopt lifelong learning as fundamental to their careers especially as the retirement age is being raised.



Source: CEIC, OCBC

From the revenue perspective, the three key pillars include corporate income tax (22.3% of total revenue receipts), personal income tax (15.8% of total revenue receipts) and GST (15.6% of total revenue receipts). We do not expect this trend to change structurally in the near-term. In fact, with the upcoming GST hike of 2% points, the contribution of GST could potentially overtake that of personal income taxes in coming years.

With the shadow of the coronavirus overhanging in the near-term, income tax revenue, whether from corporate or personal taxes, may be somewhat dented in the first half of 2020. Moreover, 2019 was already a sluggish year in terms of GDP growth due to the US-China trade war, China slowdown, and Brexit and other geopolitical uncertainties. Some tax relief may be forthcoming to help assist firms and workers tide over this challenging period. GST collections for the first half of 2020 could also be impacted by the coronavirus outbreak if consumers avoid crowded places and trim their discretionary expenditures, on top of the significant declines in tourist arrivals during this period.



Source: CEIC, OCBC

Post-Budget, the question remains if there may be a further monetary policy response in April 2020 if growth momentum does not improve but potentially remain in the doldrums. Back in October 2019, MAS had already flattened the S$NEER slope slightly. On 5 February 2020, MAS clarified that there is sufficient room within the policy band to accommodate the easing of S$NEER in line with the weakening economic conditions due to the coronavirus outbreak and the next review will be in April 2020 as scheduled. Still, the S$NEER has eased from +1.7% from the stronger side of its parity band to 0.2% on the weaker side.

While the MAS has called the current monetary policy stance “appropriate”, the odds of an easing action by the MAS in the upcoming April MPS has risen to non-negligible levels. While it may still be too early to conclude that the MAS *will* make such a move, the needle is probably moving in that direction. We do not rule out the possibility of the MAS reverting to a zero appreciation path for the SGD NEER, and regard a re-centering lower as the lower-probability event.

Conclusions

Budget 2020 has potential to surprise to the upside of expectations given the substantial accumulated fiscal surpluses, the back-to-back lacklustre GDP growth environment, the double-whammy from the coronavirus following the US-China trade war concerns from 2019, and of course the expectation that it is an election year budget. We have pencilled in an $8 billion overall budget deficit, accounting for 1.5% of GDP for Budget 2020, which will be a record per se. A significant GST offset package and a coronavirus relief package will likely feature prominently, in addition to step-up assistance to beleaguered SMEs and lower-income households.

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