

# Singapore

## Economic Assessment

Singapore continued its strong growth momentum in the first half of 2004, reflecting the overall pickup in global economic activity and recovery from the impact of SARS a year earlier. GDP expanded by 7.5% in the first quarter and 12.5% in the second, supported by stronger external and domestic demand (Figure 2.10).

The nascent recovery in domestic demand seen in late 2003 has become stronger and broader in 2004. Higher spending on machinery and equipment pushed up fixed investment, which increased in real terms by 12.7% in the first half, compared with a 3.8% decline over the whole of 2003. After several quarters of significant inventory reductions, stocks began to build and contributed to growth in manufacturing output in the first half. Private consumption accelerated to 11.6% in the second quarter, from 7.9% in the first, as consumer confidence improved.

A turnaround in labor market conditions helped boost consumption expenditures. Total employment strengthened by 24,100 in the first half of 2004 to the highest level in nearly 2 years. Most of the new jobs were created in services, with some also in manufacturing, but construction continued to shed numbers. The seasonally adjusted unemployment rate has been steady at around 4.5% since December 2003.

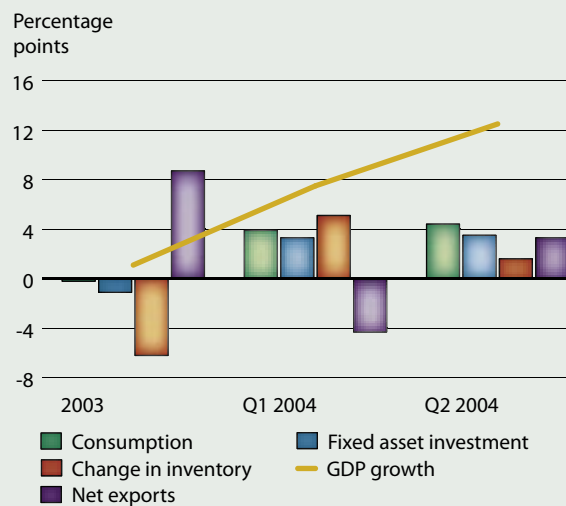
All major manufacturing industries posted growth, lifting manufacturing value added to 11.0% in the first quarter and 20.6% in the second. Output of electronics rose by 12.9% and 25.4% in the first and second quarters, respectively, driven by an impressive rise in semiconductor and consumer electronics production. The biomedical industry grew by 20.5% in the first quarter and by a vigorous 51.2% in the second, with much of the impetus coming from pharmaceuticals, due in part to a higher-value product mix than a year

earlier and to strong exports to the EU and US. Transportation engineering also performed well in the first half, largely on the back of increased demand for ship repairs, ship building, and oil rigs. Construction, which has been depressed in the past 5 years, revived a little, by 1% in the first quarter, but then resumed its decline in the second when value added fell by 5.1%, dragged down by weaker construction activity in both the public and private sectors. Continued oversupply in the property market remains a major reason for the sector's poor performance.

Services posted strong growth of 9.0% in the first half, spurred by continued strength in entrepôt trade, a rise in motor-vehicle sales, and a rebound in global travel. The low base of 2003 contributed to the upswing in tourism-related industries such as hotels, restaurants, and transportation.

Financial services expanded by 8.6% in the first half of the year. The Straits Times Index gained 4.2% from end-2003, and the value of

Figure 2.10 GDP Growth and Contribution by Expenditure Account, Singapore, 2003–Q2 2004



Source: Ministry of Trade and Industry.

**Table 2.10 Selected Economic Indicators, Singapore, 2004–2005, %**

Item	2004		2005	
	ADO 2004 Update	ADO 2004 Update	ADO 2004 Update	ADO 2004 Update
GDP growth	5.6	8.1	4.8	4.2
Inflation (CPI)	1.2	1.8	1.7	1.6
Current account/GDP	34.5	27.0	32.7	25.0

Source: Staff estimates.

stock trading increased by 21.3% in the period. Total commercial bank lending to nonbank customers rose by 5.8%, while housing loan growth remained strong. However, after a tentative recovery in the first quarter, credit to the corporate sector contracted for most segments in the second.

On a year-on-year basis, the CPI rose by 1.4% in the first quarter and 1.9% in the second, compared with an increase of just 0.5% for all of 2003. Structural factors, such as a 1 percentage point rise in the goods and services tax from January 2004, the low SARS-induced base of 2003, and the impact of higher global commodity prices contributed to the uptrend in prices.

Bolstered by the upturn in the global electronics industry and booming demand from regional economies such as the PRC, merchandise exports measured in nominal US dollars jumped by 28.3% in the second quarter after a gain of 15.3% in the first. The key products contributing to this included electronics, petrochemicals, pharmaceuticals, and specialized machinery. Merchandise imports surged by 23.5% in the first 6 months to meet the need for rising inputs for the export industries and as a consequence of the recovery in domestic demand. The current account surplus as a share of GDP fell to 26.8% in the first half of 2004, from 30.9% a year earlier, mainly due to the rapid growth in imports.

The strong economic pickup was reflected in a rapid improvement in fiscal revenues. Government operating revenues, which exclude investment income, interest income, and capital receipts, improved by 12.4% in the first half, while government expenditures (operating plus development expenditures) grew by 3.4%. As a result, the primary operating deficit shrunk to 2.6% of GDP in the first half of 2004 from 4.1% in the year-earlier period.

## Policy Developments

Against the backdrop of a more favorable external environment and a sustained recovery in domestic demand, the authorities switched from an accommodative macroeconomic policy stance to a moderate tightening. The budget for FY2004 (beginning 1 April) aims at maintaining a prudent fiscal position and at continuing to use tax policy in an effort to improve competitiveness and so attract FDI. It includes a reduction in corporate income tax from 22% to 20% and tax exemption for newly incorporated companies, foreign-sourced income, and Singapore-sourced investment income. Overall, budget expenditures will increase by 5.6% in FY2004, mainly in defense, education, and transportation infrastructure. The budget deficit is estimated to narrow to S\$1.4 billion in FY2004 (0.8% of GDP), and the Government intends to balance the budget by FY2005.

A well-functioning social safety net is key to the country's structural adjustment to capital- and skill-intensive industries. Some principles on this issue were set out in the FY2004 budget, which calls for careful targeting of assistance, as well as a balance between assisting those in need and avoiding the erosion of the work ethic.

To contain inflationary pressure, the Monetary Authority of Singapore in April shifted its monetary policy from zero appreciation of the trade-weighted nominal effective exchange rate to a modest and gradual appreciation. In line with the global low interest rate environment and easy domestic liquidity conditions, interest rates remained low. The 3-month domestic interbank rate stayed at 0.75% in the first half, then rose to 1.13% in August in response to US rate increases.

Related to the change in exchange rate policy, the Government emphasized that Singapore companies should secure their competitiveness through improvements in productivity and innovation, rather than attempting to rely on currency depreciation. The strength of the Singapore dollar is helping expand Singapore's overseas investments, which include foreign assets owned by government-linked companies and the private sector, enabled by the country's significant current account surpluses. Recent official statistics put the cumulative value of overseas invest-

ments at US\$159 billion in 2002. Investments by government-linked companies have risen sharply since then, so their present level is much higher. Government-linked companies increased strategic investments at home and abroad during the first half of the year. Given its substantial domestic savings, and diminishing returns on those savings, the Government is likely to continue investing overseas, especially in other Asian economies.

However, to tackle the problems of an aging population and in response to a prolonged decline in the birth rate, the Government announced a number of pro-fertility measures, including an extension of paid maternity leave and higher child care subsidies, in an effort to raise the birth rate to the level needed to keep the population stable.

#### Outlook for 2004–2005

Robust expansion in the first half of the year has brightened the cyclical outlook. Given the improved global demand and domestic momentum, GDP growth in 2004 is now forecast at 8.1%, significantly higher than the 5.6% projected in *ADO 2004*. The forecast for 2005 has been revised down by 0.6 percentage points to 4.2% to reflect the impact of the anticipated slowdown in the PRC and global monetary tightening.

Private consumption is forecast to rise by 6.0% in 2004 and 5.0% in 2005, underpinned by continuing improvement in consumer sentiment. Employment will continue to improve gradually as the recovery spreads across more industries. However, the unemployment rate is unlikely to fall sharply because of the ongoing structural transition, and is forecast at 4.0–4.5% in 2004–2005. A slight increase in real wages is expected as the economy continues to recover. However, the rise in wages is likely to lag productivity gains, exerting little cost pressure on domestic inflation.

Export growth will remain strong over the

rest of 2004, supported by the global corporate personal computer replacement cycle, but will moderate in 2005 due to the anticipated slowdown in the PRC and US. Merchandise exports measured in US dollars are forecast to rise by 15.0% in 2004 and 7.5% in 2005. In line with the strength of domestic demand, the rise in imports will outpace that in exports in 2004–2005. Overall, the current account surplus is projected to fall to 27.0% of GDP in 2004 and 25.0% in 2005.

Investment growth is expected to be strong, bolstered by greater confidence in manufacturing as a result of expanding exports. Fixed asset investment is forecast to strengthen by 6.7% and 4.5% in 2004 and 2005, respectively. Investment in machinery and equipment will continue to be the major driver. The rebuilding of inventories will also help lift output in this period.

Domestic prices are projected to rise slightly, though they will be restrained by the anticipated strengthening of the Singapore dollar and weak domestic cost pressures in terms of unit labor costs and profit margins. The CPI is forecast to edge up by 1.8% in 2004 and 1.6% in 2005. Given the benign domestic inflation and interest rate environment, the monetary authority is likely to continue its current policy stance for much of 2004. Fiscal conditions will improve as the economic rebound continues. The operating fiscal deficit is expected to shrink in 2004 and the operating budget is likely to be in balance in 2005.

The main downside risk to these forecasts comes from the uncertainty in global demand conditions, and in particular the extent of the upturn in the global electronics cycle, given Singapore's high exposure to swings in global demand. A possible further slowdown in the PRC's demand for imports would also hurt export-oriented manufacturing. In addition, the potential for reduced liquidity in global financial markets following US rate increases as well as continued high oil prices could pose threats to the recovery of domestic demand.