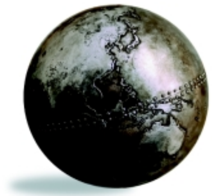


Singapore

Singapore's institutional strengths and flexible economic management enabled it to rebound strongly in 1999 from economic stagnation in the previous year. However, adjustments to the realities of the postcrisis environment will be more challenging and will require further changes in institutional and production structures to retain competitiveness. Long-term prospects for the economy remain bright.

RECENT TRENDS AND PROSPECTS

The economy of Singapore rebounded strongly from a near-stagnant level in 1998 to register GDP growth of 5.4 percent in 1999. The manufacturing sector accounted for much of the growth, reflecting strong external demand for telecommunications equipment, semiconductors, computer peripherals, and computers. The nonelectronic segment of manufacturing also performed well, and chemical output rose sharply, reflecting increased regional demand for industrial chemicals and pharmaceuticals. The construction sector, however, continued to decline, mainly because of a sharp drop in private construction activity. Developers remained cautious because of excess capacity in both residential and nonresidential markets. The service sector also staged a recovery, with increased regional trade flows. Tourist arrivals boosted growth in the transportation and communications sectors, while increased domestic demand led to a sharp rise in the retail and wholesale sectors. The financial services sector also benefited from improved investor sentiment toward regional equity markets and improved regional demand for insurance and investment advice.

Despite the strong rebound in economic activity and increased investment commitments in the second half of the year, overall growth in fixed investment by both private and public sectors remained below its historical rate before the crisis (see figure 2.1). This was due to insufficient credit expansion and industrial overcapacity. Bank lending, other than for housing, remained weak and lagged behind the recovery in industrial production. Lending for housing rose and property transactions increased, however, as prices remained low and banks offered attractive mortgage financing packages. Fiscal policy provided less of a stimulus to the economy than originally envisaged. The original budget for fiscal year 1999 ending 31 March had predicted a budget deficit of S$5.1 billion (3.4 percent of GDP). However, considerably faster-than-expected revenue growth, combined with lower operating and development expenditure, led to a budget surplus. Although a rise in interbank rates reflected the rise in US interest rates that began in mid-1999, domestic retail rates remained relatively stable throughout the year. Banks did not increase borrowing rates because deposits continued to rise even as lending remained weak.

With the recovery in the domestic economy, labor demand strengthened, and greater employment in the service and manufacturing sectors more than compensated for declines in the construction sector. Job vacancy and recruitment rates increased as well. However, retrenchments remained high, with more than half resulting from relocation of lower-end manufacturing operations to cheaper sites in the region. The rate of unemployment nevertheless decreased to 2.9 percent by the end of 1999, its lowest level since mid-1998.

In response to the sharp depreciation of the region's currencies, in 1998 the government introduced temporary measures to reduce unit business and labor costs and maintain price competitiveness. These included a 10 percent cut in employers' contributions to the Central Provident Fund, a mandatory pension fund; cuts in wages; reductions in government-controlled rentals for commercial and industrial properties; and reductions in government-imposed utility charges for electricity and telecommunications. Because of improved recovery prospects, the government planned to increase employer contributions to the Central Provident Fund to 12 percent in April 2000, and if conditions remain favorable, to 20 percent by 2004. Some smaller companies, however, are not performing well enough to bear the additional costs, and have protested the planned increases. Some observers also are concerned that a tighter labor market will lead to a rise in wage costs.

The Singapore dollar remained broadly stable against the US dollar. It appreciated relative to the currencies of its trading partners in the region, with the exception of Indonesia and Malaysia. While this may adversely affect external competitiveness in the short term, authorities expect that in the long term, developing higher-quality, value-added, and knowledge-based products will improve Singapore's competitiveness.

After declining 0.3 percent in 1998 and another 0.6 percent in the first quarter of 1999, consumer price inflation increased in the second quarter because of higher costs of food, transportation, and communication. Inflation in 1999 was subdued, however, averaging 0.5 percent because of relatively low domestic demand and wage inflation. Reflecting increased activity in the private residential market, residential property prices rose 26 percent from their levels at

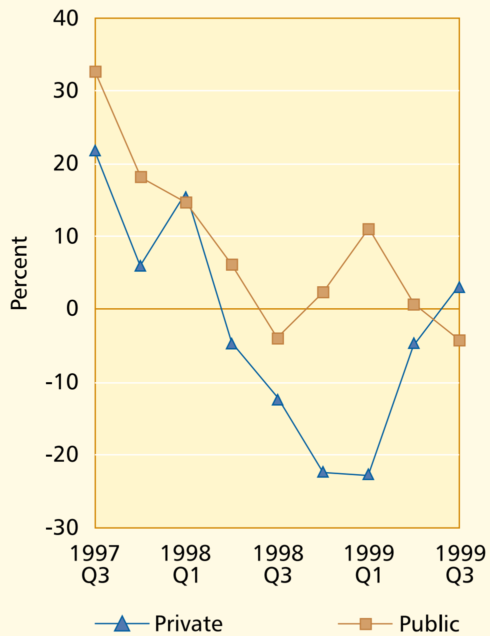
Table 2.3 Major Economic Indicators, Singapore, 1997-2001
(percent)

Item	1997	1998	1999	2000	2001
GDP growth	8.0	1.5	5.4	5.9	6.2
Gross domestic investment/GDP	38.7	33.5	32.7	34.2	36.0
Gross domestic savings/GDP	50.4	49.9	51.2	52.0	52.0
Inflation rate (consumer price index)	2.0	-0.3	0.5	1.5	1.5
Money supply (M2) growth	10.3	30.2	8.5	11.6	11.8
Fiscal balance/GDP[a]	9.6	1.6	2.5	3.0	3.3
Merchandise exports growth	-0.2	-12.2	2.6	3.5	5.3
Merchandise imports growth	0.7	-23.2	6.8	7.9	8.8
Current account balance/GDP	15.8	20.9	18.5	17.8	16.0

a. Excludes grants.

Sources: Singapore Department of Statistics (1999); Monetary Authority of Singapore (1999a); IMF (2000); staff estimates.

Figure 2.1 Growth of Public and Private Fixed Investments, Singapore, 1997 Q3-1999 Q3



Source: Monetary Authority of Singapore (1999b).

the end of December 1998. However, they remained about 31 percent lower than their peak levels in the second quarter of 1996. Prices of commercial property, however, continued to decline, as oversupply dampened the market. Boosted by growing optimism about the region's growth prospects, equity prices rose sharply in the first half of 1999, and then leveled off because of trading curbs by brokering houses and interest rate hikes by the US Federal Reserve. Overall equity prices, as measured by the Stock Exchange of Singapore all-share index, rose 74.8 percent in 1999.

The trade surplus narrowed from its record level of 1998. Although strong growth in the region and in the United States increased demand for Singapore's electronic goods, a higher rate of import growth, which resulted from renewed consumer confidence and diminished inventories, more than offset this demand. The service sector surplus, however, increased as tourist arrivals rose, and expanded intraregional trade led to a greater demand for Singapore's shipping services. In addition, financial service exports increased as the recovery in the stock market resulted in more broker services for nonresident investors. Thus, the current account surplus declined only slightly from its 1998 level. However, a smaller deficit on the capital and financial account occurred because of lower net outflows in portfolio investment and higher net inflows of direct investment. Singapore therefore maintained a healthy level of reserves.

GDP growth is expected to accelerate in 2000 as consumption improves. This should reduce excess industrial capacity and provide greater incentives for investment. Increased asset values and the government's decision to partially restore wage cuts imposed in early 1999 will boost private consumption, while fixed investment will increase along with bank lending. This will be facilitated by a decrease in nonperforming loans to the crisis countries as these economies recover. Higher private consumption and fixed investment will allow continued economic expansion and employment generation in 2000-2001. Inflation is likely to increase to 1-2 percent in 2000 because of increased oil prices, wage inflation, and domestic demand, and will remain around this level during 2001. The trade surplus will likely contract further during the next two years as imports will increase more rapidly than exports. Although exports will increase due to stronger trade growth, imports will increase faster because of the import-dependent nature of exports and a higher demand for capital goods. An improvement in the services and income account will partially offset the narrower trade surplus, however, and steady inflows of foreign direct investment will ensure that overall reserves remain at healthy levels. Foreign debt will pose no problems for Singapore during the forecast period.

ISSUES IN ECONOMIC MANAGEMENT

Although restrictions on the use of the Singapore dollar by nonresidents were considerably eased, the government remained cautious toward the internationalization of the Singapore dollar. For instance, despite the removal of the ceiling on foreign ownership of local banks, these banks must retain at least

50 percent of residents' deposits so that the Monetary Authority of Singapore can control Singapore dollar transactions. These restrictions were based on concern that a large offshore market in Singapore dollars could destabilize domestic exchange and interest rates. If, however, Singapore is to become a major international financial center, the authorities will likely have to contend with the inevitable internationalization of the Singapore dollar.

POLICY AND DEVELOPMENT ISSUES

Singapore's strong institutions and flexible approach to macroeconomic management have allowed it to emerge quickly from the Asian crisis with few social disruptions. However, adjusting to the realities of the postcrisis environment will be more challenging and will require further changes to institutional and production structures to remain competitive.

The Committee on Singapore's Competitiveness has called for a knowledge-based economy to help improve long-term competitiveness. To this end, the government has been developing an institutional structure that will provide appropriate support. The Ministry of Communications and Information Technology was created, and the existing National Computer Board and the Telecommunications Board of Singapore were merged into the Info-Communications Development Authority. This group was given the task of preparing a master plan to develop the information and communications industry. The government has also initiated measures to provide incentives for entrepreneurs entering high-tech industries, and to train people in skills related to information technology. For example, the government has increased the skills development levy paid by employers to fund approved training courses for lower-paid workers. However, there is no certainty that retraining will enable workers with limited skills and education to qualify for jobs being created in the semiconductor and chemical industries. Although the government's past interventions in industrial development have been beneficial, there is some concern that continued interventions on this scale could impede necessary corporate restructuring as market conditions change.

A sound and well-regulated banking sector helped Singapore weather the Asian crisis. However, many other challenges remain. The domestic banking sector, which is overregulated and characterized by high cost and low liquidity, needs to be improved. To help develop the economy as a regional financial center, the Monetary Authority of Singapore (the de facto central bank) introduced a series of wide-ranging measures in 1998 and 1999 aimed at liberalizing financial markets. These include the merger of the Stock Exchange of Singapore and the Singapore International Monetary Exchange into the Singapore Exchange in December 1999, the first fully integrated financial market in Asia.

The government also liberalized entry into the Singapore Exchange by gradually lifting the restrictions on the number of foreign brokers who can participate and on the value of their trades. In addition, the government is developing a risk-based method of calculating capital requirements for brokers and will allow more Singapore dollar-denominated interest rate derivatives to be traded on the exchange. Beginning in 2001, freely negotiated broker commissions will replace the system of fixed commissions, which authorities expect will lower transaction costs. Bank disclosure rules were strengthened by measures recommended by the Committee on Banking Disclosure in May 1998. The Monetary Authority of Singapore also scrapped the 40 percent ceiling on foreign ownership of local banks and granted licenses to four foreign banking groups, which will allow them to open additional branches and run automatic teller machines off-premises.

These liberalization measures have led to a fundamental change in emphasis from regulation to risk-focused supervision and increased disclosure. The authorities expect this to help reduce risks of contagion, broaden and deepen the capital market, decrease costs, and improve efficiency. This change will also boost Singapore's standing as a regional financial center and its competitiveness in relation to Hong Kong, China.