

Singapore

Growth in 2006 remained well above the economy's trend rate for the third year running. External demand was the main driver, although domestic demand, especially investment, also picked up. The pace of growth is expected to decelerate in 2007 to a still-strong but more sustainable rate. Closer links with global economic networks and structural reforms have contributed to the healthy performance, but also led to widening income gaps, posing challenges for the longer term.

Economic performance

Supported by a favorable international economic environment and accommodative domestic policies, the economy expanded by a robust 7.9% in 2006, well above its trend rate of 4–6%, for the third year in a row. Growth of manufacturing moderated on a quarter-on-quarter basis in the first and second quarters, reflecting a cyclical softening in global information technology markets, a contraction in the computer hard-disk industry, and a dip in production of pharmaceuticals. In the second half, manufacturing growth rates picked up to double-digit levels, lifted by a strong performance in semiconductors, transportation engineering, and pharmaceuticals.

Services maintained robust growth over most of the year, providing a buffer against cyclical swings in manufacturing. Overall, quarterly growth in 2006 was less volatile than in previous years, which suggests that the economy has indeed become more diversified (Figure 2.27.1).

For all of 2006, manufacturing grew by 11.5%, led by the transport engineering and biomedical subsectors. The marine and offshore engineering industry expanded by 40.7% in 2006, boosted by strength in global shipbuilding, ship repair, and oil-rig building. Biomedical manufacturing output rose by 22.5% in the year, double the rate of 2005, driven by rapid growth in pharmaceutical exports to Europe. Electronics recorded a modest rise of 3.2%, well down from 2005, as expansion in semiconductors was largely offset by declines in production of hard disks, consumer electronics, and computer peripherals.

In line with a rebound in property market activity, construction accelerated a little to 2.7% from 0.7% growth in 2005. A vibrant economy, robust demand for high-end housing, as well as major planned projects—including two casino-resorts, the renovation of a major shopping district, and the building of a new business district—have lifted confidence among property investors and developers. Services expanded by 6.7% in 2006, underpinned by continued robust growth of wholesale and retail trade and of financial services.

On the demand side, the external arena was again the key driver of growth. Merchandise exports increased by 18.3%, with pharmaceuticals and petrochemicals particularly buoyant. However, exports of domestically made electronic products rose more modestly, by 9.3%,

2.27.1 Quarterly GDP growth

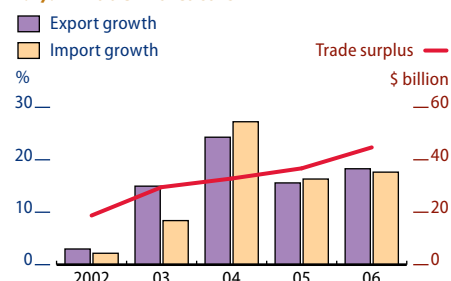


saar = seasonally adjusted annualized rate.

Source: Singapore Department of Statistics, available: www.singstat.gov.sg, downloaded 1 March 2007.

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2.27.2 Trade indicators



Source: Singapore Department of Statistics, available: www.singstat.gov.sg, downloaded 1 March 2007.

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weighed down by the secular contraction in hard-disk drives. Led by growth in reexports of semiconductors, Singapore's entrepôt exports rose rapidly by 22.2%, supported by the trend toward regional production networks and booming regional demand (particularly from the People's Republic of China).

Merchandise imports expanded by 17.6%, largely matching exports (Figure 2.27.2), and reflecting domestic investment in machinery and equipment. Net exports of goods and services in national account terms rose by 10.4% and contributed 3.1 percentage points to total GDP growth (Figure 2.27.3).

Private fixed investment jumped by 16.3%, underpinned by a cyclical rebound in machinery and equipment investment and a pickup in construction (spurred by the recovering property market and strong foreign investment). However, public investment fell by 11.8%, trimming total fixed investment growth to 11.5%. Despite stronger economic expansion last year, growth in private consumption moderated to 2.5%, partly a result of sluggish wages growth. Also, a reduction in the employers' mandated contributions to the national pension fund in 2003 has likely encouraged employees to increase their own retirement savings.

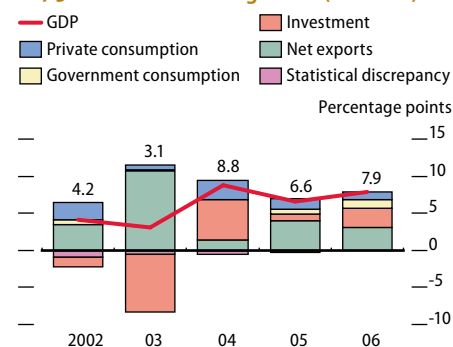
Overall, domestic demand accounted for 4.7 percentage points of total GDP growth in 2006, with a contribution of 2.5 percentage points from total investment (including inventory investment), 1.0 percentage point from private consumption, and 1.2 percentage points from public consumption.

Labor market conditions continued to improve on the back of vigorous economic activity: total employment expanded by 7.6% over the year. Accordingly, unemployment fell from an annual average rate of 3.1% in 2005 to a 5-year low of 2.7% (Figure 2.27.4). Nominal wages rose by just 3.2%, slightly below the pace of 2005 (Figure 2.27.5), even as the labor market tightened. An increase in the number of foreign workers (accounting for 49% of employment growth in 2006) alleviated some of the tightness. Domestic cost pressures were well contained, but the pass-through of higher oil prices intensified. Moreover, prices of imported food rose. As a result, inflation edged up to a year-average 1.0% from 0.5% in 2005.

Against the backdrop of sustained economic growth and rising inflation, the Monetary Authority of Singapore maintained its policy, in place since April 2004, of a modest and gradual appreciation of the trade-weighted nominal effective exchange rate to maintain price stability. Over the year, the Singapore dollar appreciated by 8.5% and 10.1% against the US and Japanese currencies, respectively, but weakened slightly against the euro.

In tandem with US rate hikes in the first half of 2006, Singapore's 3-month interbank interest rate rose by 31 basis points to 3.56% by June, before ending the year at 3.44% (Figure 2.27.6). However, overall liquidity conditions remained loose. Domestic credit creation turned up after a long period of sluggishness, supported by lending to corporations, particularly those in the construction, and the transportation and communications, industries. Partly pushed by the increased credit activity, money supply growth (M2) surged to 19.4% in December 2006, its fastest pace in 8 years (Figure 2.27.7).

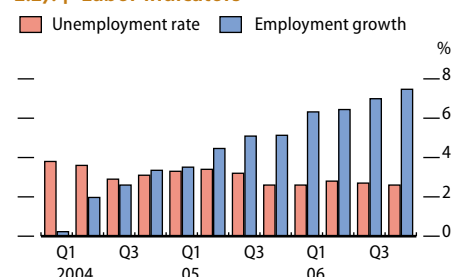
2.27.3 Contributions to growth (demand)



Source: Singapore Department of Statistics, available: www.singstat.gov.sg, downloaded 1 March 2007.

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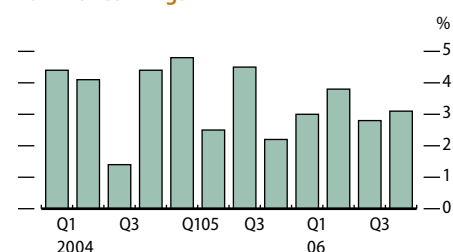
2.27.4 Labor indicators



Source: Ministry of Manpower, available: www.mom.gov.sg, downloaded 7 March 2007.

[Click here for figure data](#)

2.27.5 Growth in average monthly nominal earnings



Sources: Ministry of Manpower, available: www.mom.gov.sg; Ministry of Trade and Industry, available: www.mti.gov.sg; both downloaded 7 March 2007.

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The primary operating fiscal balance, boosted by 2 years of strong economic growth, swung into surplus by S\$1.2 billion (0.6% of GDP) from a S\$665 million deficit (0.3% of GDP) in 2005. Government operating revenues, which exclude investment income, interest income, and capital receipts, rose by 10.5%, driven by higher corporate income tax collections (which reflected stronger corporate profits). Total government expenditures increased modestly by 3.8%, mainly on a reduction in development spending with the completion of transport infrastructure projects.

In the external account, the surplus of trade in goods rose to US\$44.7 billion in 2006, and the current account surplus advanced to US\$36.3 billion, equivalent to 27.5% of GDP. The net outflow in the financial and capital accounts was slightly higher than that in 2005, yet gross international reserves still rose to US\$136.8 billion by end-2006.

Economic prospects

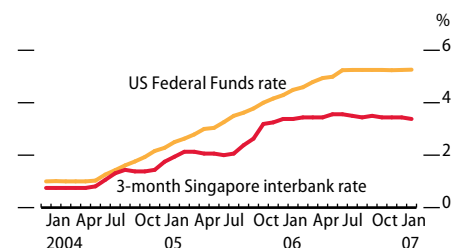
Global growth, after an above-trend period, is expected to moderate, but remain robust, in 2007 and 2008. The global electronics market is projected to grow at a slower pace this year than last. In domestic policies, Singapore's budget for FY2007 (starting 1 April 2007) targets a small deficit of 0.3% of GDP. The corporate tax rate will be lowered from 20% to 18% in an effort to attract more foreign investment. Partly as a means to offset this revenue loss, the Government will raise the goods and services tax (GST) by 2 percentage points to 7.0% from 1 July this year. To compensate for an expected rise in costs for consumers induced by the GST hike, the budget for FY2007 includes a S\$4.0 billion offset package over 5 years.

On the monetary side, domestic inflationary pressures will likely pick up in 2007, though the risks from imported inflation are tempered somewhat by lower international oil prices. The labor market is at its tightest in 5 years and, with the increase in foreign workers unlikely to continue at 2006's rate, this will eventually feed into wages growth. Moreover, the recent liquidity surge, strong asset prices, and the GST hike will also generate pressures, lifting inflation to 1.6% in 2007. The monetary authorities are likely to maintain the current moderately tight stance (Figure 2.27.8).

On the basis of these assumptions, economic growth is expected to ease to 6.0% in 2007 and 5.5% in 2008 (Figure 2.27.9). Domestic demand is likely to play an augmented role in supporting growth. Consumer sentiment will continue to improve because of employment growth, gains in real wages, planned assistance for low-income groups, and the positive wealth effects from the recovering property market. Private consumption growth is forecast to accelerate modestly to 3.5% in 2007. The growth of fixed asset investment is set to continue at a rapid clip, driven by both the public and private sides.

Momentum in manufacturing investment will moderate, slowed by decelerating global economic growth and softening electronics demand. However, construction investment is likely to accelerate in 2007–2008, underpinned by the two major resorts, some public infrastructure projects, and the strong residential property market. Import growth, spurred by solid domestic demand, will outpace the forecast deceleration

2.27.6 Interest rates



Sources: Monetary Authority of Singapore, available: www.mas.gov.sg; US Federal Reserve, available: www.federalreserve.gov; both downloaded 2 March 2007.

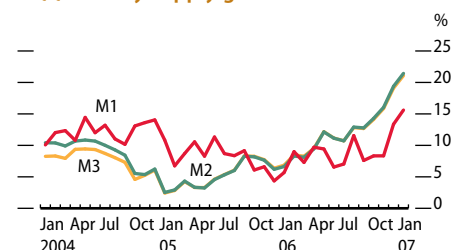
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2.27.1 Selected economic indicators

	2007	2008
GDP growth	6.0	5.5
Inflation	1.6	1.0
Current account balance (% of GDP)	27.0	27.0

Source: Staff estimates.

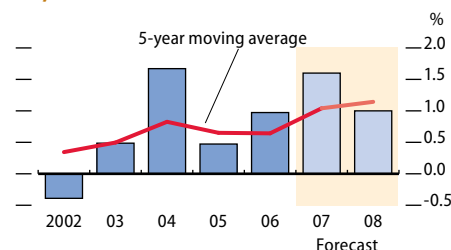
2.27.7 Money supply growth



Source: Monetary Authority of Singapore, available: www.mas.gov.sg, downloaded 2 March 2007.

[Click here for figure data](#)

2.27.8 Inflation



Sources: Singapore Department of Statistics, available: www.singstat.gov.sg, downloaded 1 March 2007; staff estimates.

[Click here for figure data](#)

in exports. The current account surplus as a share of GDP is seen falling slightly to 27.0% in 2007–2008 (Figure 2.27.10).

This outlook would be undercut by a harder than expected landing of the US economy and, to a smaller extent, by a sharp inventory adjustment in global electronics. Conversely, a broadening of the domestic property market rebound could burnish it. There are signs that the rise in prices of high-end housing could spill over to other categories of the private residential market. A broader property rebound could provide additional impetus to investment and consumption growth.

Development challenges

Over the past decade, Singapore has undertaken a range of structural reforms in response to challenges posed by accelerated globalization and increased competition from other Asian economies. The Government has reduced corporate and personal income tax rates, lowered the employer's contribution to the national pension fund, adopted more flexible policies on employment of foreign labor, and stimulated the private sector by divestment of government-linked companies.

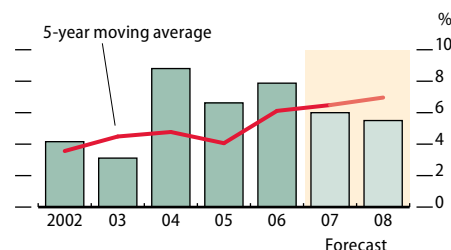
These supply-side reforms have helped make the city-state one of the world's winners in globalization, with a rising share of world trade, increased inflows of foreign capital and talent, and sustained, above-trend growth. The more flexible labor supply response and increased foreign investment have lifted the growth potential above the 3–5% range previously regarded as a longer-term limit.

But not all Singaporeans benefit from linking the economy into global networks. Many older and less educated workers have been left behind as manufacturing and services move up the value-added ladder. Consequently, some structural unemployment has persisted, and wages for low-skill jobs have stagnated. The Government is trying to balance a need for structural reforms with concerns over income inequalities that may undermine social cohesion and the political support for further policy changes. Support for low-income households through retraining and targeted social programs is likely to be a priority of fiscal policy.

The authorities also face challenges in maximizing the effectiveness of future structural reforms. Given both the significant cuts to corporate and personal income tax rates since 2001 (Figure 2.27.11) and the diminishing returns to lowering tax rates further, against a background of needing to support low-income groups and an aging population, additional aggressive tax cuts are unlikely. Instead, supply-side reforms should put more emphasis on investment in education, research and development, and public services.

Tapping into regional and global manufacturing, trade, and financial networks has helped boost growth, diversify its sources, and reduce vulnerability to downswings in the global electronics market. But closer links with the rest of the region, amplified by Singapore's growth as a regional financial center, have increased its exposure to some other risks. These include interruptions in the regional production chain, financial weaknesses in regional economies, and economic or political instability in countries where Singapore has made significant investments.

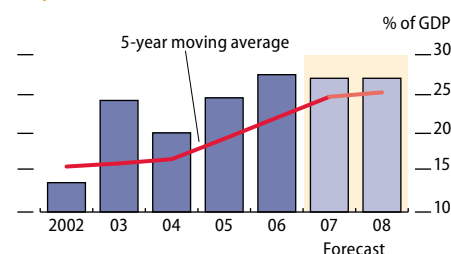
2.27.9 GDP growth



Sources: Singapore Department of Statistics, available: www.singstat.gov.sg, downloaded 1 March 2007; staff estimates.

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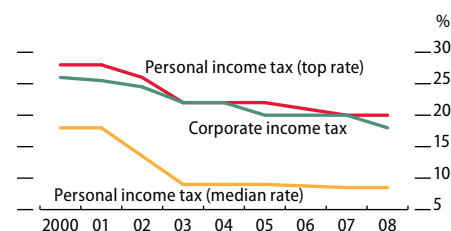
2.27.10 Current account balance



Sources: Singapore Department of Statistics, available: www.singstat.gov.sg, downloaded 1 March 2007; staff estimates.

[Click here for figure data](#)

2.27.11 Tax rates



Source: Inland Revenue Authority of Singapore, available: www.iras.gov.sg, downloaded 7 March 2007.

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