

Singapore

Strong external demand lifted economic growth to 6.4% in 2005. Domestic demand showed signs of recovery, especially consumption, which was bolstered by strengthening employment and a recovering property market. Structural reforms are helping diversify the economy and contributed to the above-trend performance. Growth is expected to continue its rapid pace for most of 2006, and begin to revert to trend late in the year.

Economic performance

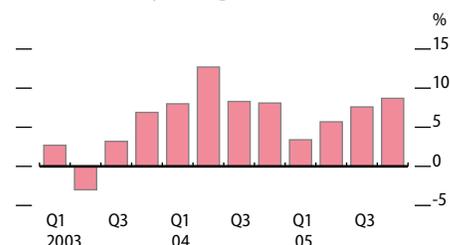
The economy grew by 4.1% in the first half of 2005, against the backdrop of the cyclical downturn in the global electronics industry and a decline in output from the domestic pharmaceuticals industry. In the second half, the rate of expansion nearly doubled from the first 6 months, supported by a boost in pharmaceutical output in the third quarter and a broad-based manufacturing expansion in the fourth (Figure 2.27.1). Full-year growth was 6.4%, significantly higher than the 4–5% trend rate. The growth rate had been even stronger in 2004, when the economy rebounded from a slump induced by the regional outbreak of severe acute respiratory syndrome (SARS).

Manufacturing expanded by 9.3% in 2005, led by the transport engineering, biomedical manufacturing, and electronics subsectors. High global shipping freight rates, increased oil exploration inspired by high oil prices, and the damage caused by Hurricane Katrina to oil rigs in the Gulf of Mexico in August boosted orders for Singapore's offshore and marine engineering industry, which is a major player in ship conversion and oil-rig building. Electronics benefited in the fourth quarter from the end of the global electronics inventory correction around midyear, as orders for electronics products picked up. Construction declined in 2005 for the seventh consecutive year, but at a slower pace (1.1%) than in 2004. A gradual diminishing of oversupply in the property market, as well as government approval for development of two large casino-resorts, lifted market sentiment.

The services sector grew by 5.8%, underpinned by the strong performance of wholesale and retail trade and of financial services. The former was supported by buoyant regional trade and the recovery in domestic consumption, the latter by expansion of asset management and capital market activities. These activities in turn were fueled by increased international investment in Asian equities, greater volatility in the foreign exchange market, and higher turnover in the domestic stock market.

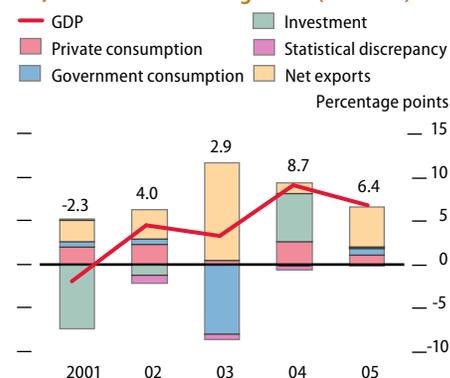
On the demand side, economic growth was generated primarily by external demand (Figure 2.27.2). Merchandise exports measured in Singapore dollars increased by 14.0% in 2005, moderating from a 20.5% surge a year earlier. Much of the growth came from exports of information technology and telecommunications products, spurred by

2.27.1 Quarterly GDP growth



Source: Singapore Department of Statistics, available: <http://www.singstat.gov.sg/keystats/economy.html#gdp>, downloaded 17 February 2006.

2.27.2 Contributions to growth (demand)



Source: Singapore Department of Statistics, available: <http://www.singstat.gov.sg/keystats/economy.html#gdp>, downloaded 17 February 2006.

the recovery in global growth in the second half. Merchandise imports, driven largely by exports, expanded by 13.6%. Imports would have been higher but for weak domestic investment in machinery and equipment. In 2005, net exports in national accounts terms rose by 16.5% and contributed 4.6 percentage points of the 6.4% gross domestic product (GDP) growth.

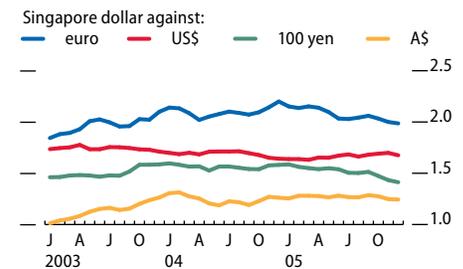
Private consumption continued to recover, but fixed investment contracted by 1.9%, in contrast to a 10.2% rise in 2004. A continued slide in the construction of residential buildings and a dip in aircraft purchases accounted for most of the investment decline. The downswing of the global electronics cycle in the first quarter of 2005 damped investment in machinery and equipment. However, quarterly data show a 15% year-on-year rebound in gross fixed asset formation in the fourth quarter, suggesting greater business confidence in the improving external economic environment. Overall, domestic demand accounted for 2.0 percentage points of the GDP expansion in 2005, with a contribution of 0.2 percentage points from total investment (including inventory investment) and 1.8 percentage points from consumption. (A 0.2 percentage point statistical discrepancy is subtracted to arrive at 6.4% GDP growth.)

Employment expanded by a robust 110,800 jobs, and employment generation was broad-based. Government efforts to enhance labor market flexibility in recent years, aided by job redesign and retraining, have also played a role in reducing slack in the labor market. The unemployment rate fell from an annual average of 3.4% in 2004 to 3.2% in 2005, and would have declined further but for an increase in the labor force participation rate. A tightening job market fed into wages, which rose by 3.5%, similar to the pace of 2004. Despite high international energy prices, consumer inflation slowed to 0.4% from 1.7% a year earlier, due mainly to a fall in car prices that resulted from a decline in the premium paid in Singapore for vehicle permits. The direct effect of high global oil prices has been largely muted so far because of the relatively small share of energy in total costs and contracting gross margins in downstream oil sectors.

In the context of the strengthening domestic recovery and with risks of imported inflation, the Monetary Authority of Singapore maintained its monetary policy target of a modest and gradual appreciation of the trade-weighted nominal effective exchange rate in 2005. Over the year, the Singapore dollar weakened against the United States (US) dollar and currencies pegged to it, but strengthened against other major currencies (Figure 2.27.3). In tandem with US interest rate rises, domestic monetary conditions continued to tighten. The 3-month interbank interest rate rose to 3.25% in December 2005, up 181 basis points from a year earlier (Figure 2.27.4). The strengthening US dollar in 2005 may have contributed to the rise in the Singapore interbank rate. However, the average prime lending rate remained at 5.3%, reflecting weak demand for bank lending.

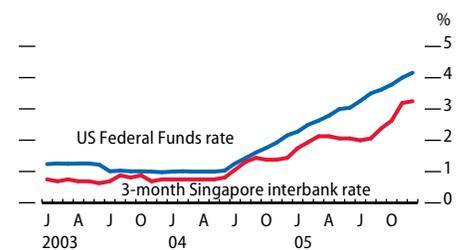
The Government's fiscal position strengthened. Operating revenue, which excludes investment income, interest income, and capital receipts, rose by 6.7% in 2005. Total government expenditure increased by just 1.3%, mainly due to a fall in development spending. As a result, the primary operating deficit fell to S\$0.7 billion (0.3% of GDP) from

2.27.3 Exchange rates



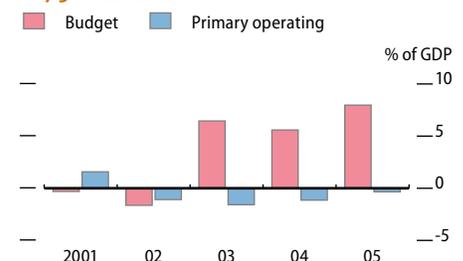
Source: Monetary Authority of Singapore, available: <https://secure.mas.gov.sg/frames/dataroom/msbhlntDom.html>, downloaded 17 March 2006.

2.27.4 Interest rates



Sources: Monetary Authority of Singapore, available: <https://secure.mas.gov.sg/frames/dataroom/msbhlntDom.html>; Datastream, downloaded 17 March 2006.

2.27.5 Fiscal balances



Sources: Singapore Department of Statistics, available: <http://www.singstat.gov.sg/SDDS/data.html>, downloaded 17 February 2006; Asian Development Outlook database.

S\$2.1 billion (1.1% of GDP) in 2004. The overall fiscal balance, including investment income, remained strong (Figure 2.27.5). In the external accounts, the trade surplus rose to US\$38.0 billion in 2005 (Figure 2.27.6), and the current account surplus increased to US\$33.3 billion, equivalent to 28.5% of GDP. Active investment abroad by Singapore companies drove up the outflow of capital, which largely offset the increased current account surplus. Consequently, gross international reserves rose slightly to US\$116.6 billion.

Economic outlook

As the most export-dependent economy in Asia, Singapore's prospects rely heavily on world market conditions, and especially the global electronics cycle. Despite concerns over high oil prices and rising US interest rates, the global economy is expected to grow at a steady pace in 2006, barring major shocks. The consumer electronics upturn (Figure 2.27.7) is likely to continue, holding up electronics demand over most of this year. At home, fiscal policy in 2006 is likely to be stimulative. The budget for FY2006 (beginning 1 April 2006) includes S\$2.6 billion in special direct cash payments. The FY2006 primary operating deficit is forecast to widen to S\$2.9 billion, around 1.4% of GDP. The Monetary Authority is expected to maintain its moderately tight stance in view of the strengthening domestic demand and increasing inflationary pressures.

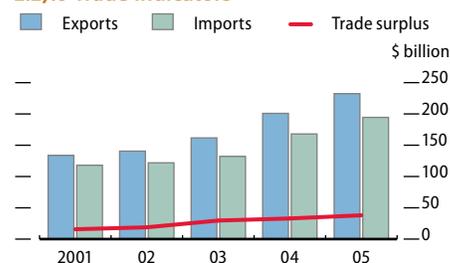
On the assumption of favorable external conditions and a largely accommodative domestic policy environment, the economy is projected to continue its rapid growth pace in the first half of 2006, underpinned by sustained world economic expansion, the global electronics upswing, and the recovery in domestic demand. Growth is expected to soften later in the year and further in 2007, reverting to trend, as the global electronics cycle begins to turn. Overall, the economy is forecast to grow by 6.1% in 2006 and 4.6% in 2007 (Figure 2.27.8).

Domestic demand is likely to play a bigger role in supporting growth in 2006–2007. Consumer sentiment should improve further because of growth in employment and real wages, and the budgeted cash payments could feed consumer spending. Moreover, consumers may benefit from the wealth effects of rising property prices. The upturn in manufacturing investment in the last quarter of 2005 is expected to strengthen, prompted by the upswing in manufactured exports. Construction investment is also forecast to recover in 2006 and 2007, as the building of the casino-resorts moves ahead and the property market picks up. Exports are likely to record solid growth, but stronger imports—a result of the improved domestic demand—will partly offset the contribution of net exports to GDP growth. The current account surplus is forecast to be stable at 28–29% of GDP in 2006 and 2007.

The stronger labor market is likely to lead to further wage rises, exerting larger domestic cost pressures on inflation. As oil and non-oil commodity prices are expected to stay high this year, the cost pressures from imports, which have been building for some time, are also likely to be passed through to retail prices. Consumer prices are therefore forecast to rise by 1.5–2.0% in each of the next 2 years (Figure 2.27.9).

Singapore is undergoing significant structural adjustment, against

2.27.6 Trade indicators



Source: Singapore Department of Statistics, available: <http://www.singstat.gov.sg/keystats/economy.html#trade>, downloaded 17 February 2006.

2.27.1 Selected economic indicators

	2006	2007
GDP growth	6.1	4.6
Inflation	1.7	1.6
Current account balance (% of GDP)	28.6	28.2

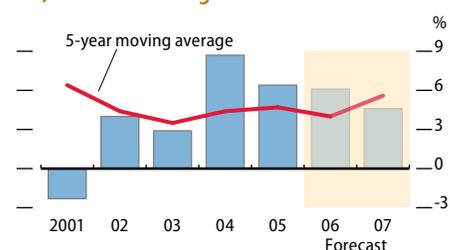
Source: Staff estimates.

2.27.7 Exports of electronics



Source: Ministry of Trade and Industry, available: <http://app.mti.gov.sg/default.asp?id=123&cat=2&intYear=2005>, downloaded 14 March 2006.

2.27.8 Annual GDP growth



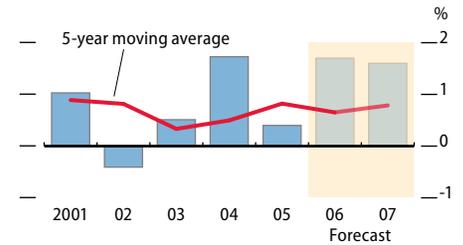
Sources: Singapore Department of Statistics, available: <http://www.singstat.gov.sg/keystats/economy.html#gdp>, downloaded 17 February 2006; staff estimates.

a background of accelerated globalization and increased competition from other regional economies. In response to these challenges, the Government has undertaken a range of structural reforms to diversify the economy and to enhance its competitiveness. Indeed, prospects over the medium term largely depend on the effectiveness of these changes.

Singapore has been moving up the manufacturing value chain into selected knowledge-intensive activities, such as pharmaceuticals. Some traditional manufacturing industries are relocating elsewhere, but others are staying, and upgrading their products. Niche industries such as water technology and interactive media are developing. With its efforts to make wages and other business costs more flexible, Singapore is continuing to attract multinational companies and foreign direct investment. On the assumption of a healthy level of global growth over the medium term and continued efforts to push forward with domestic structural reforms, the growth rate is put at 4.5–5.0% in 2008–2010, broadly in line with potential.

Domestic risks to watch for include growing income inequalities and persistent skills mismatches, which could retard the momentum of structural reform. Nevertheless, given the strong external and fiscal positions, and gradual diversification of growth sources, the economy may well be better placed to face such risks than in the past.

2.27.9 Inflation



Sources: Singapore Department of Statistics, available: <http://www.singstat.gov.sg/keystats/hist/cpi.html>, downloaded 17 February 2006; staff estimates.