ARTICLE FOR THE EDGE

SINGAPORE: BOUNCING BACK TO HEALTH?

After a long period of generally desultory performance, the Singapore economy is stirring to life. Economic growth has picked up, exports are reviving and even the property sector seems to be improving. Yet, other indicators are less exciting, raising the question of whether this rebound is sustainable. So, what is really going on and what are the prospects for Singapore?

Overall, the economy is gaining traction

Singapore's economy expanded 2.5% in the first quarter over the same period in 2016, decelerating a tad from the 2.9% growth in the fourth quarter of last year – but better than the average of below 2% growth from mid-2015 until the third quarter of 2016. However, growth was uneven across sectors:

- **Manufacturing was solid**: The once beleaguered manufacturing sector is responding to the return to health of global and regional trade flows, expanding 6.6% in the first quarter after only inching up 3.6% in 2016. The electronics and precision engineering clusters showed particular strength but biomedical manufacturing, transport engineering and general manufacturing lagged behind.

- **Construction activity contracted** – for the third quarter running. Clearly, the slowdown in private sector construction was too great to be offset by still vibrant public sector infrastructure and related spending.

- **Services sector still a shadow of its former self**: Growth in services stood at 1.5% y/y in the first quarter, better than the 1.0% at the end of last year but well below the 3.5-6.5% range seen in 2013-2015. What growth there was in this sector depended heavily on the recovery in external trade – it was trade-related areas such as wholesale trade and transportation & storage which grew more strongly.

Still, there are grounds for optimism looking forward

First, the forward-looking indicators such as new orders received suggest that activity can accelerate in coming months. Import growth has been very strong, suggesting that businesses were importing intermediate goods for future production as well as capital goods to expand capacity.

Second, there is reason to expect the external sector to gain further momentum. The OECD lead indicator, which forecasts economic growth in the developed economies accounting for about half of world demand, has been rising and now points to above trend growth over the remainder of the year. The lead indicators for some of the large emerging economies are also looking healthier. What is more, oil prices remain in a sweet spot – low enough to spur demand among oil-consuming consumers and companies but not so low as to wreak havoc among oil

producing economies and oil-servicing companies. Not surprisingly therefore for a trade-dependent economy, Singapore's exports are firming up – non-oil domestic exports are growing by about 15% on average in the first three months of the year.

Third, technology demand also seems to be rising again. Semiconductor sales are growing at the fastest pace in six years – that is mighty positive for an economy like Singapore's which is heavily geared towards electronics production. What was encouraging about technology demand is that it is rising pretty much across the board, in all the major economies.

Fourth, there are signs that the domestic property sector is stabilising. The pace of price falls in residential property is easing while new home sales seem to be steadying as well. This is important because a healthy property sector spills over into many other areas – construction, mortgage lending and real estate services.

Some parts of the economy continue to lag though

Still, not everything is running smoothly.

- **First, domestic consumption spending remains lacklustre:** Retail sales fell 2.5% y/y in February – in fact, if we take strong car sales out of the picture, retain sales were down an even worse 4.9%.

- **Second, employment conditions have not been improving much:** Job creation has slowed drastically – only about 16,800 jobs were created in 2016, the slowest pace since 2003 while redundancies rose to their highest levels since the global financial crisis.

So, what's really going on? The best way to understand the Singapore economy is to picture it as a three-speed one:

- There is, first, the trade-related sector which will be an outsized winner from the turnaround in global trade. We think that the recoveries in the developed economies and in China will reinforce one another, producing an upward spiral in global demand. The improving confidence should also result in a revival in capital spending which will help keep the global rebound going for a while. That will be good news for Singapore's export-focused manufacturing activities such as semiconductors and precision engineering while the services which support the trade sector will also do well such as wholesale trade, logistics, transportation and warehousing.

- Another separate part of the economy with a different set of drivers is social services, which should fare decently as the government steps up spending on social welfare such as programmes for the elderly, healthcare and education.

- Then, there are the non-government, domestically-oriented services which currently remain moribund in light of the fragile labour market. But, even here, there is room for hope. The labour market usually takes time to recover as businesses wait to be sure that

the recovery in the economy is sustainable before stepping up their hiring and feeling comfortable about paying higher wages. Since we believe that the recovery described above can continue, we should begin to see improved hiring and therefore consumer confidence over the coming one to two quarters. If the property sector does continue to stabilise, this improvement in consumer confidence could well occur faster.

What can go wrong?

Even a cursory reading of the newspapers shows us what an uncertain world we live in.

Geo-political risks are especially high. For instance, North Korea's pursuit of nuclear weapons seems to have reached a stage where the United States may well be forced to take action. The regime has made progress in developing nuclear weapons as well as the missiles that could deliver them to targets as far as some parts of the United States. Markets have become nervous because all the options available to the US to pre-empt this outcome are horrendously risky, which seems to suggest that can be no good outcome possible. However, simply because the risks of unilateral military action by the United States is so high, we are quite sure that America will proceed cautiously while China will work behind the scenes to contain the dangers.

A more salient fear is the swing to inward-looking populism and more radical ideas across the world:

- The French presidential elections could well produce an upset and bring to power a faction with radical ideas such as leaving the European Union. If that happens, the fledging European recovery would reverse and the sovereign debt crisis there, which has been stabilised, would erupt again.

- In the United States, while President Trump has mercifully drawn back from some of his more exotic policy prescriptions, he is still pushing his America First line – as we saw with this week's new approach to work visas for high-tech foreign workers.

- In Indonesia, it appears that appeals to religious sentiment have succeeded in ousting a dynamic governor of Jakarta who had a good track record of achievements – this could encourage others to make similar appeals to religious intolerance which would be damaging to political stability there.

The main concern we have right now, though, is that increasing uncertainty over all these issues could prompt businesses around the world to hold back from hiring more workers and expanding capacity through the kind of high-multiplier investments that are needed to keep the recovery going.

This risk is most pertinent in the United States where President Trump suffered a serious setback when he attempted to undertake radical reforms to healthcare. That failure has got many worried about his ability to push through tax cuts and higher infrastructure spending, as well as drastic deregulation, the three factors that were key to explaining the higher

business confidence that has boosted the American stock market since Trump's election in November. The tax reform package, in particular, seems to have run into much resistance since it is not clear how the lost revenues can be replaced sufficiently so that the budget deficit does not explode. There are also some concerns that radical members of Congress could object to the continuing resolution needed to keep the American government funded – that bill has to be passed by the end of this month and if it fails, there could be a government shutdown which would seriously damage business and consumer confidence.

Conclusion: what should we expect on the policy front in Singapore?

First, monetary policy has done its job, so we should not expect any further big moves by the Monetary Authority of Singapore (MAS). The economic momentum provided by a more vibrant external sector has boosted cyclical growth prospects for Singapore while the inflation outlook is also supported by the improving economy, higher oil prices as well as administration price hikes covering water, diesel and parking charges. The MAS has opted to maintain the trade-weighted value of the Singapore Dollar at a stable level and has signalled that it intends to maintain this policy stance for an extended period of time.

Second, with the economy now steadier, we do not expect big moves on administrative policies either. The restrictions in the property sector are likely to remain in place though there might be occasional tweaks. Neither is there likely to be any significant liberalisation of restrictions on importing low-skilled foreign workers. Moreover, it is probably still appropriate for macro-prudential policies to remain conservative so as to prevent excessive borrowing at a time when debt levels in Singapore have risen.

Third, the focus may therefore shift towards long term strategies. A few areas stand out. The Committee for the Future Economy outlined some broad strategies for taking Singapore into the next phase. What businesses need is for these broad strategies to be supplemented with more details so that they can appreciate better where to place their own bets. One area of particular need is how to alleviate the high cost structure in Singapore. Now that the immediate risks to the economy have been contained, more attention can be focused on this issue which Singapore businesses are struggling with.

In short, the economy is enjoying a nice cyclical bounce. While there are some near term risks to this recovery, we believe that they can be contained. We have to use the opportunity to push forward with detailed strategies to resolve our challenges and structural weaknesses.

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