

# SINGAPORE

## Outlook For Overall Economy Remains Positive For 2007

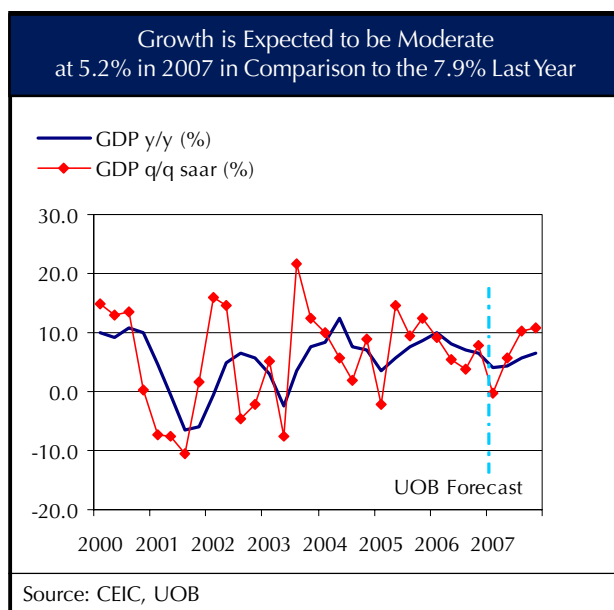
### Summary

- Singapore's economy performed better than expected in 2006 with GDP expanding 7.9%, from 6.6% in 2005.
- Singapore's prospects in 2007 remain optimistic on domestic demand, pharmaceuticals, transport engineering, the financial sector, strong property market interest and an improving construction outlook.
- The government's outlook for 2007 has improved with their 2007 GDP growth forecast range upgraded to 4.5-6.5% (from 4-6% previously). We expect GDP in 2007 to expand by 5.2%.
- Labour market outlook remains healthy in 2007 although we do not expect a repeat of 2006 record job creation.
- MAS' current 'modest and gradual appreciation of the SGD stance' is likely to stay in April's monetary policy meeting, despite the July GST hike.
- While equity markets have since recovered from the March correction, trading volume remained off from the pre-correction high as investors remains cautious, uncertain if the worst is over.

After expanding 7.0%/y/y in 3Q06, Singapore's 4Q GDP moderated its pace of expansion, coming in at 6.6%. This was higher from the previously announced 5.9% in the Jan advance estimates due to upward revisions to all the major economy segments including a stronger manufacturing sector performance (revised to 7.7% to 7.3%) as well as more buoyant construction activity (revised to 4.7% to 2.3%). Services sector contribution was also revised higher to 6.6%/y/y (from 6.0%). On a sequential basis, the fourth quarter GDP expanded at a faster pace of 7.9%q/q SAAR compared to the previous quarter's revised 3.9%.

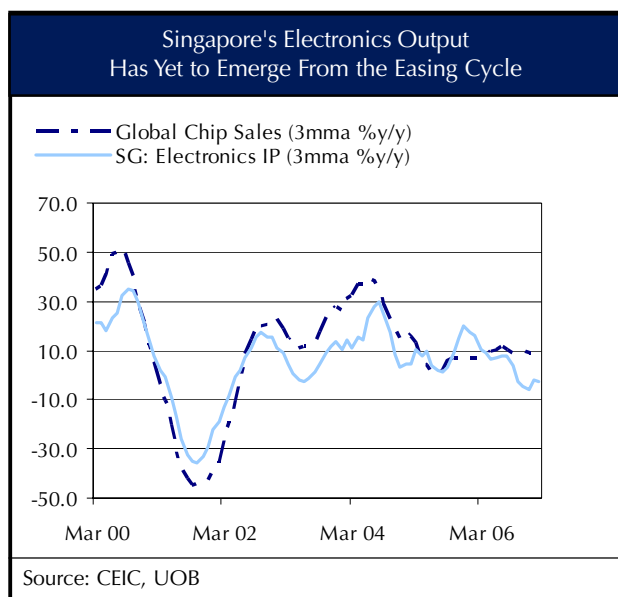
UOB Economics Projections				
	2004	2005	2006	2007F
GDP	8.7	6.6	7.9	5.2
CPI (average, y/y)	1.7	0.5	1.0	2.0
Unemployment (End-4Q)	3.1	2.6	2.6	2.8
Current account (% of GDP)	20.0	24.5	27.5	26.3
DBU Loan Growth (% y/y)	4.5	2.2	6.3	7.5

For the full year 2006, GDP expanded at 7.9%, higher than the revised 6.6% recorded in the previous year as segments of manufacturing, domestic demand and construction activity provided support to the economy although global electronics demand has visibly weakened in the 2nd half of 2006. The government's outlook for 2007 has improved in part due to the positive global developments in recent months and they have upgraded their 2007 GDP growth forecast to 4.5-6.5%. (Previously, the range was 4-6%) Going into 2007, we are fairly optimistic that domestic demand, pharmaceuticals, transport engineering, the financial sector and an improving construction outlook would continue lend support to the Singapore economy. After a strong 2006



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performance, we expect 2007 to expand by a more moderate but respectable 5.2%, well within the revised official forecast range.



oil domestic exports which contracted by 7.5%/y/y even as overall NODX grew by 2.4%. The decline of electronics NODX in Jan-Feb reinforces our view that the global electronics demand is still on the easing path, while the CNY festive holiday during Feb just further exacerbated the contraction seen in that month. All of the top 5 electronics products suffered double-digit contractions in Feb, ranging from 10.8% to 33.2%. On an s/adj'd m/m basis, NODX contracted by 11.1% in Feb following a 6.2% expansion in the previous month, dragged lower by electronics in both months.

For the next few months, we continue to expect softer global demand for semiconductors and continued easing electronics exports growth coupled with the moderate growth prospects for our main export markets, the US economy going into 2007. Nonetheless, we are cautiously optimistic the global chips demand will start picking up with the launch of Microsoft's Vista Operating System in early 2007 and could encourage some additional corporate and consumer PC upgrades by middle of this

**Singapore's GDP Grew Faster in 4Q06, by 7.9% q/q saar Compared to 3Q's Revised 3.9%**

	Weight 2006	2005	2006	1Q06	2Q06	3Q06	4Q06	1Q06	Q06	3Q06	4Q06
				% y/y change				s/adj annualised %q/q			
<b>Real GDP</b>	<b>100</b>	<b>6.6</b>	<b>7.9</b>	<b>10.1</b>	<b>8.0</b>	<b>7.0</b>	<b>6.6</b>	<b>9.1</b>	<b>5.4</b>	<b>3.9</b>	<b>7.9</b>
<b>Goods-producing Industries</b>	<b>33.1</b>	<b>8.0</b>	<b>10.2</b>	<b>15.1</b>	<b>10.3</b>	<b>8.9</b>	<b>7.2</b>	<b>3.4</b>	<b>1.5</b>	<b>11.9</b>	<b>11.1</b>
Manufacturing	27.7	9.5	11.5	18.6	11.9	9.5	7.7	3.4	2.3	12.3	11.5
Construction	3.6	0.7	2.7	-0.7	0.9	5.8	4.7	2.0	-6.9	12.5	12.2
<b>Services-producing industries</b>	<b>63.5</b>	<b>6.4</b>	<b>7.0</b>	<b>8.2</b>	<b>6.9</b>	<b>6.3</b>	<b>6.6</b>	<b>9.6</b>	<b>8.6</b>	<b>0.8</b>	<b>7.9</b>
Wholesale/retail trade	15.2	9.6	10.3	14.8	9.5	10.4	6.9	26.2	0.8	8.2	-3.5
Hotels/restaurants	1.9	4.3	5.1	6.2	3.8	4.4	6.1	8.0	5.7	1.5	9.7
Transport & Comms	13.4	4.2	4.3	5.3	4.0	4.0	4.0	3.9	2.9	2.9	6.1
Financial services	11.2	7.6	9.2	8.7	9.6	7.4	11.1	13.6	25.1	-16.2	28.2
Business services	11.5	5.9	5.8	6.1	6.6	5.1	5.4	0.1	9.9	4.0	7.9

Source: MTI, DOS

### Weakness in Electronics to Persist Till End-2Q

The weakness in electronics demand in the second half last year saw Singapore's electronics output decline to 32% of total manufacturing output in 2006, losing its top position status to the chemicals sector which accounted for 33% on strong oil prices last year. On the surface, manufacturing output seemed to have held up fairly well in Jan-Feb, with the IPI expanding 8%/y/y. However, electronics output remain weak at 1.2% with most of the major segments still in contraction while the semiconductor production - which have been the pillar of growth for the electronics cluster last year - has yet to return to the strong double digit growth seen in 2006. This weakness continued into the Jan-Feb's electronics non-

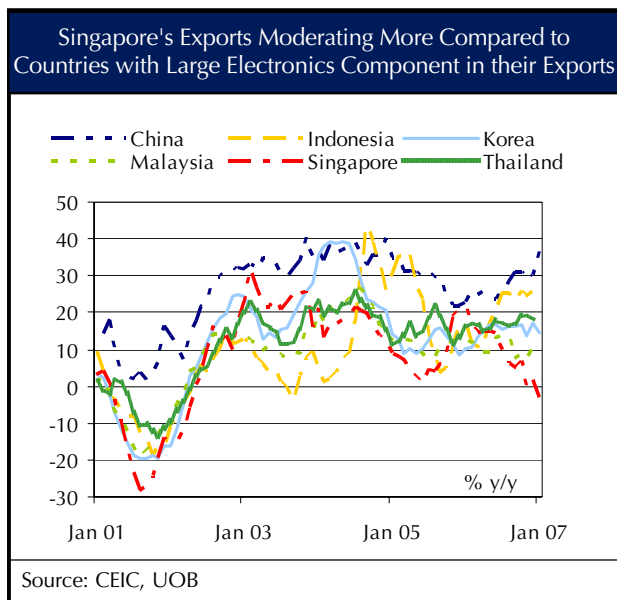
year but the spillover benefits to chipmakers may be lower than expected. Leading indicators like the US SEMI and SEA Japan's Book-to-Bill ratios have been modestly positive in the last 3 months, possibly an indication of a recovery in the electronics demand soon. So we may yet see a rebound in electronics by end-2Q07 but not in a big way. And although demand for exports for emerging markets like China faltered in Feb, we continue to expect Chinese demand to remain robust this year.

Non-electronics exports would continue to support growth in manufacturing, especially pharmaceutical exports which has been buoyant in 2006 (24.0%) notwithstanding the volatile monthly swings. We expect demand for

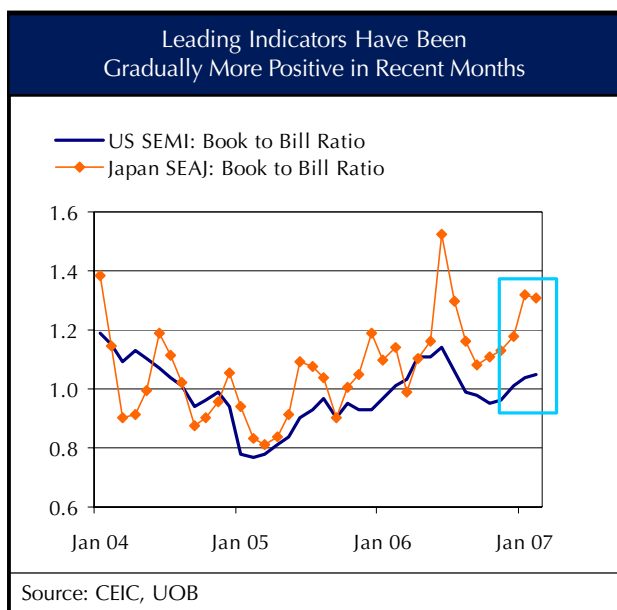
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pharmaceutical exports to remain intact especially to key European and US export destinations although the sector is unlikely to replicate its sterling 2006 performance. Transport engineering cluster was the champion industry in the first two months this year and has been registering healthy double-digit growth since March 2004. We expect the cluster to continue performing strongly as the major players within the transport engineering industry have their book orders filled till 2010. Indeed, the importance of these two segments has increased as reflected by the higher VA share largely at the expense of electronics. We maintain our forecast for the full year NODX growth in 2007 at 6.3%. (IE Singapore's NODX forecast range is 7-9% in 2007).

Private consumption growth came in at a paltry 2.5% in 2006 as exports and investments remain the dominant growth pillars for the economy. Despite the record 9.7 million tourist arrivals last year, retail sales growth continued to moderate from the recent 2004 high of 12.6% to 5.4% in 2006. Even when we exclude cars, growth was only marginally higher at 5.6%. Nonetheless, we remain optimistic about domestic demand in the coming year with private consumption growing by 3.7% supported by improved wage growth and strong buying interest in the domestic property market. We envisaged tourist arrivals to Singapore will increase in the next few years as the foreigners are attracted by the "new buzz" of the island city as Singapore prepares to unveil the two integrated resorts by 2009 and 2010. The possibility of holding a street F1 Grand Prix would also boost local tourism.



The 2% GST hike in July 07 will probably drive up big-ticket item sales (like cars, tour packages and household appliances) in the 1H this year followed by some moderation in the subsequent months when the GST hike is implemented. In the longer term, the impact of the 2% is likely to be minimal as the GST rates here even at 7% are relatively low compared to most countries with GST/VAT. And with the government's vision of increasing the population to 6.5 million will definitely help boost domestic retail industry.



## A Positive Year for Property Market and Construction industry

The construction sector provided a pleasant surprise in 2006 as the sector expanded by a better-than-expected 2.3% after recording a revised mild 0.7% growth in 2005 following 5 years of contraction, possibly signaling a sustained revival of the construction industry here. We anticipate the outlook for construction to shine even brighter in 2007 as the sector is set to be kept busy with the record amount of en-bloc sales in 2006 starting to translate into new property construction and the ongoing new commercial developments along Orchard road and the construction of the two Integrated Resorts. Although the recent Indonesian ban on sand exports to Singapore will increase building costs (estimated at 1-3% increase by government sources), we feel the impact to be mild and with the Singapore government's assurance of short-term fixing the price of construction sand (slightly below the current rate) to ensure stable prices and bearing part of the higher construction costs due to more expensive sand supplies which sourcing the raw material from other countries, we think it should not derail the recovery of the building sector.

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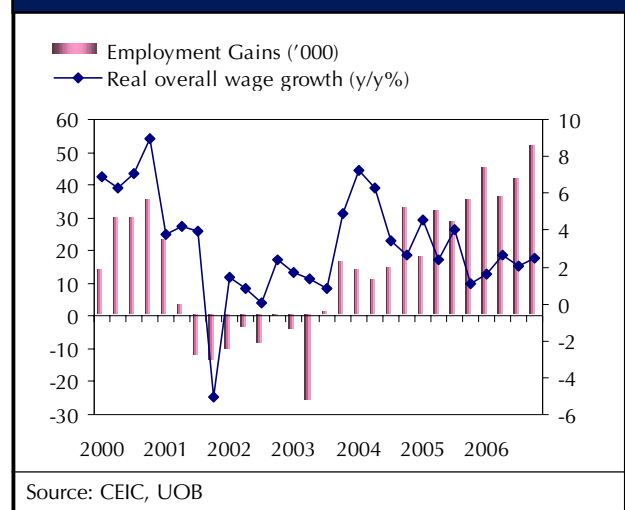
The official estimates from URA pointed to the continued recovery of the private housing segment in 2006, as prices of private homes increased at a faster pace in 4Q (3.8%) compared to preceding quarter (2.7%), bringing the full year 2006 increase to a strong 10.2% compared to 2005's 3.9%. Non-land private property prices rose 11.1% while non-landed prices increased by a lesser 6.7% in 2006. The newly released URA property price sub-indices by geography - which is a rough proxy to classifying non-landed property into high, mid- and mass market segments - also conclusively pointed to the high-end segment being chiefly responsible for the robust private property price increase in 2006 as prices in this segment soared 17% while the prices of the mid-tier and mass market segments only increased by 3% and 4.2% respectively.

Although the foreign purchases of high-end housing projects continues to dominate the headlines (the Marina Bay Residences is an example and more recently CapitaLand sold some units of its Orchard Residences for a new record price of over S\$4000 psf), local demand remains crucial to sustaining a vibrant property market and we believe that the local buyers are starting coming back into the mass-housing market reflected by the recent successful sold-out projects outside the prime district and the pickup in activity in the sub-sale markets. Housing loans are also picking up noticeably in the last few months. The property market recovery is likely to gather more pace and become more broad-based going forward. In addition, the possibility of US entering a cycle of rate cuts later this year would possibly entice more into the housing market as mortgage rates is expected to moderate.

In tandem with the strong private property price increases last year, rental charges for private property also saw

significant increases in 2006. Rentals rose a marked 14.1% in 2006, compared to the 3.0% in 2005 and this was largely driven by rental increases within the non-landed property segment (up 15% in 2006 from 3% in 2005). If the sharp rise in rentals continues to persist in 2007, this may add to the cost burden of expatriates working in Singapore and become a deterrent for foreign talent to choose Singapore as a location of employment.

In Spite of the All-time Record of 176,000 Job Created in 2006, Real Wage Growth was Benign at 2.2%

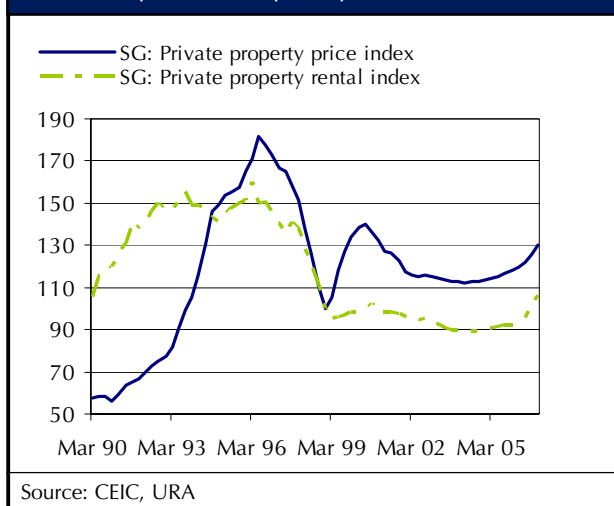


## Labour Market Remains Tight in 2007 but no Repeat of 2006 Job Creation

Although 2006 retrenchment (12,359) was slightly above that during the previous two years (which was mostly from manufacturing), the employment gains last year more than offset the difference. The broad-based improvement in the employment market continued into 4Q with a record quarter of 51,500 jobs created and the increase in employment was evident in all major sectors with the bulk of the jobs coming from the services sector. This robust 4Q data brought the full-year 2006 job gains to an all-time record high of 176,000 greatly exceeding 113,300 jobs created in 2005. More than half of the new jobs created were from the services sector (112,700) while manufacturing and construction sector also posted strong gains of 41,600 and 20,500 respectively.

Local employment expanded by a record 90,900 last year from 63,500 in 2005 (while the rest of jobs created were filled by foreign employees, especially within construction sector). This high number of local placements greatly exceeded the average inflow of 33,000 into the local labour supply each year and this could possibly indicate that some domestic wage pressures is likely to be building up in the next few quarters. With GDP growth expected to moderate in 1H07, productivity will likely to slow and we

Private Property Prices and Rental Rates are Expected to keep its Upward Trend in 2007



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may see a further upside in unit labour cost going into 2007. Indeed, after contracting for 5 straight quarters, ULC turned around in 3Q06, expanding 1.5%/y/y and a smaller 0.1% in 3Q06. Nonetheless, overall wage increase for 2007 remains well within expectations, and is unlikely to lead to excessive wage cost pressures while SGD is expected to remain on the appreciation path for 2007 (USD/SGD to hit low of 1.48 by end-4Q 07) thereby partially offsetting the increases in ULC in real terms.

The robust labour market hiring in the final quarter of 2006 more than exceeded the increase in formerly non-active workers re-joining the workforce as reflected by the lower seasonally-adjusted unemployment rate (albeit insignificantly) to 2.6% in 4Q from 2.7% in 3Q, while resident s/a unemployment rate remained stable at 3.6% for the last 3 quarters. Overall employment prospects should continue to remain positive into 2007 although full-year jobs creation is unlikely to exceed 2006's all time high, coming in at an estimated 80,000 to 100,000 this year. The forecast is more or less in line with the official projections of 450,000 jobs created over the next 5 years with 4,500 positions created in manufacturing annually while the bulk of employment will come from services sector. The seasonally adjusted unemployment rate should remain low at 2.7-2.8% as Singapore economy continues to register moderate healthy growth in 2007.

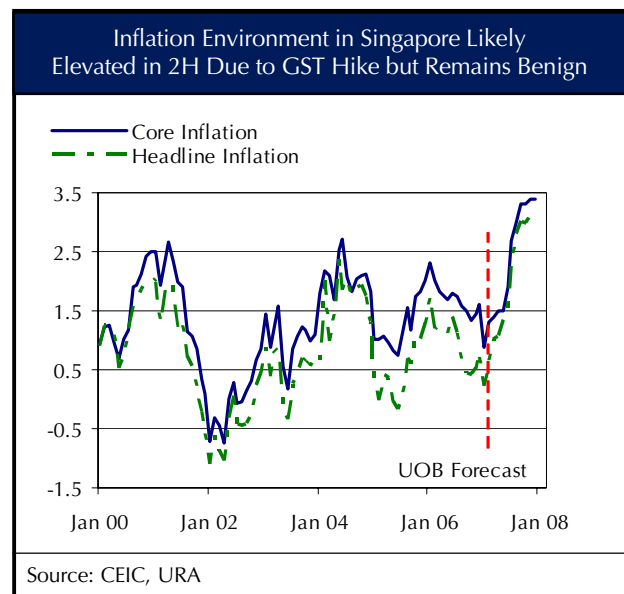
### CPI Likely to Hit 2% on GST Impact but MAS Unlikely to Alter Current Policy

Overall prices grew by a benign 1% in 2006, at the lower end of the MAS preferred range. Most of the major categories registered price increases, ranging from 0.7% (for recreation items and clothing & footwear) to 2.7% (for housing charges). As expected, cheaper transport and communication charges contributed to the benign 2006 inflation rate, registering a contraction of 1.5%.

Going into 2007, although we initially anticipate the hike in fresh food prices (due to the Malaysian floods) to continue into Jan and possibly into Feb, the recent CPI data for Jan-Feb period showed that inflation was at a manageable 0.4%/y/y and these temporary developments did not have any serious impact on overall inflation. We had initially estimated that the headline 2007 full year inflation forecast to 1.4%, factoring in some price increases from oil-related items as well as upward trending housing cost, reflecting the continued strong buying interest of private property in 2007. However, the implementation of the GST hike from 5% to 7% in July 2007 would imply a one-time increase in inflation in 2H07 and 1H08. Assuming that the GST hike affects around 70-75% of the CPI basket (a rough estimate using the methodology by

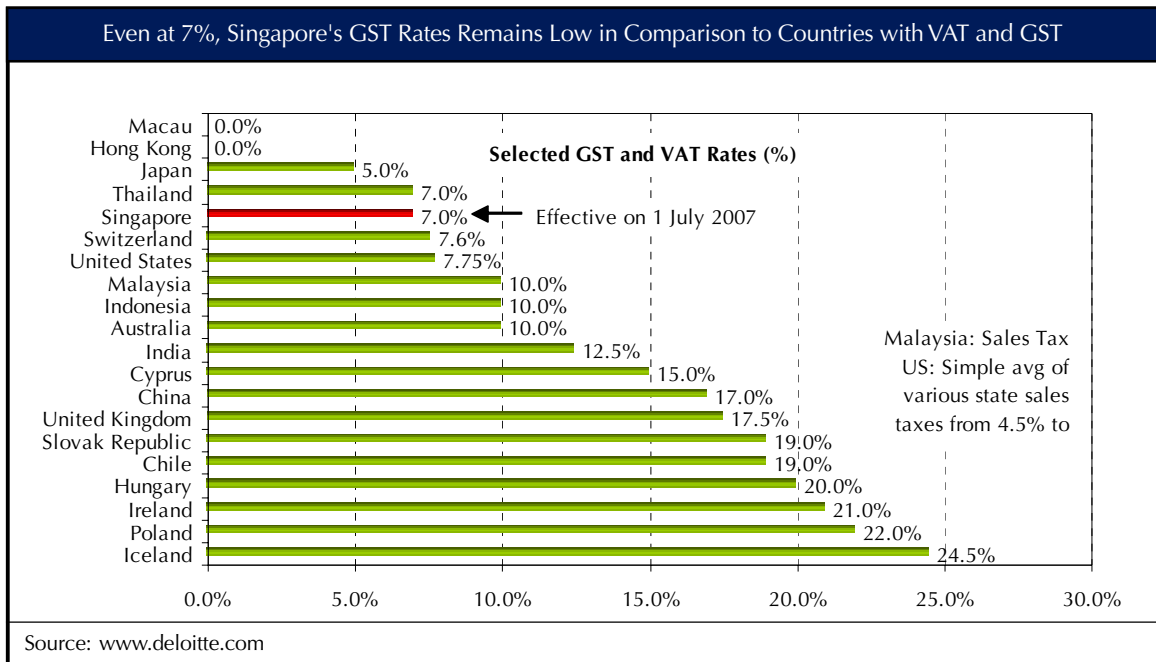
MAS in an earlier report), we expect a one-off GST hike to increase inflation by 0.6%age point in 2007 and result in inflation coming in at 2% for the full year. Inflation in 2008 is expected to remain high at 2.1% (compared to the usual MAS forecast range of 1-2%) due to the GST impact on the first half of 2008. The upside risk factors in 2007 and 2008 still reside with sharp oil price movements and the related geo-political developments.

The current GST rate in Singapore is comparatively lower compared to other countries when matched against the corporate income tax structures. And based on a MOF report released during the FY2007 Budget, tax revenue from GST only makes up 14.9% of total tax revenue in FY 2005 while the rest came from income and other taxes, as compared to OECD countries, which derived an average of 32% of tax revenue on GST/VAT and 35% on income taxes. Thus, looking at the competitive environment, it is conceivable that there is still room for Singapore's GST to be adjusted upwards beyond 7% (probably to 10% by 2010) while corporate and personal tax rates are furthered lowered towards the league of sub-20%. In the near term, as the GST impact is one-off price hike, we do not expect the MAS to change in the current 'modest and gradual appreciation of the SGD stance' in the April's monetary policy meeting.



### Singapore Stock Market Woes

It was a nerve-wrecking week between 28 Feb and 6 Mar as the bourses around the world went on a tailspin with investors fleeing the markets and selling down on equities. The STI fell from a high of 3310 (on 23 Feb) to 2982 by 5 Mar, a sharp 9.9% decline in less than 2 weeks. Although some semblance of stability returned to the stock markets in Asia since 06 Mar 07, market trader remain cautious



even as the STI recovered somewhat from the fallout, closing at 3205 on Friday (23 Mar).

While on the surface, this may seem reminiscent of the correction in May-June last year. But on closer inspection, there are quite a few differences. Using the weekly MSCI All Country Far East Ex Japan (MSFEx), Asian markets declined by nearly 5.7% in the first week of the correction with trading volume at a record high of 36.6bn (weekly volume averaged around 25.9bn in the past 6 months), as the index receded to 414.72 in the week ending on 2 Mar from a record high of 439.64 in the previous week. The index declined by a similar 5.5% in the first week of the 2006 May-June correction (for the week ending 19 May 06) with volume markedly up as well at 29.7bn. However, when we measured the declines suffered by the top 5 Asian equity markets (which are all incidentally included as constituents in the MSFEx), we found that the declines are much more pronounced this time round compared to that in the first trading week of the 2006 correction and also more widespread. In particular, the Chinese stocks were actually trading higher during the 2006 correction, while this time round it has fallen by nearly 7%, more or less in line with the declines in the regional stock bourses. Indeed, the broad market sell-down in Asia was attributed

to the initial plunge in the Chinese stocks as a trigger point. [Chinese shares have since recovered spectacularly to a fresh high of 3122.81 on 27 March, wiping away the recent sell-off completely.] As for the international indices, the degree of the sell-down was also much sharper this time round, possibly caused by a confluence of distinctively different triggers from the 2006 episode such as the Chinese equity sell-down, the weaker-than-expected US data, sub-prime mortgage woes, Greenspan's rhetoric.

Overall, the recent retreat in equity prices was probably exacerbated by an abrupt shift in investor sentiment, which appeared to have been triggered by a sharp overseas markets decline, even as fundamental economic indicators continue to remain unchanged. And it is still not entirely clear if the worst is behind us as the Asian markets took another battering on 14 Mar as the markets that time were spooked by negative sub-prime mortgage developments in the US. And while relative calm has returned to the Singapore stock markets in the past week, uncertainty still lingers and investors are likely to tread cautiously as reflected by the markedly low trading volume. One thing for certain is that one cannot draw parallel conclusions from the last time and apply it to our current situation.