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Email: GlobalEcoMktResearch@uobgroup.com
URL: www.uob.com.sg/research

Macro Note

Singapore Budget Preview: The Need To Take Measures Early

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Barnabas Gan
Economist
Barnabas.GanSC@uobgroup.com

- **Singapore budget will be announced on 18th February 2019.** On the back of a moderating domestic economy coupled with Singapore's rising needs, we perceive a potentially expansionary budget into FY2019. Despite the slower economic growth seen in 2018, we note that 1H18 revenue collection was stronger than budgeted, suggesting that the initial $600mn of budget deficit is likely to print close to our estimate of a surplus of S$1.4bn.

- **The Singapore government's rhetoric on the urgent need to 'take measures early' to ensure enough revenues** to meet Singapore's growing needs will likely continue to take centre-stage in this upcoming budget. Still, shou.ld our budget surplus estimate come to pass in FY2018, Singapore would have seen three consecutive years of surpluses in the current five-year framework. This would suggest a comfortably larger fiscal space into the next two years.

- **We pencil the upcoming budget FY2019 to see a small and manageable deficit of S$1.2 billion.** On this, FY2019 budget will likely give further guidance on (1) the expected revenue drivers into the next decade of 2021 – 2030, (2) empowering the nation to deal with global economic uncertainties and (3) the changing needs of Singaporeans including education, healthcare, and security & defence.

Singapore's FY2019 Budget will be delivered on 18th February 2019. This upcoming budget will be the 4th budget delivered by Finance Minister Heng Swee Keat.

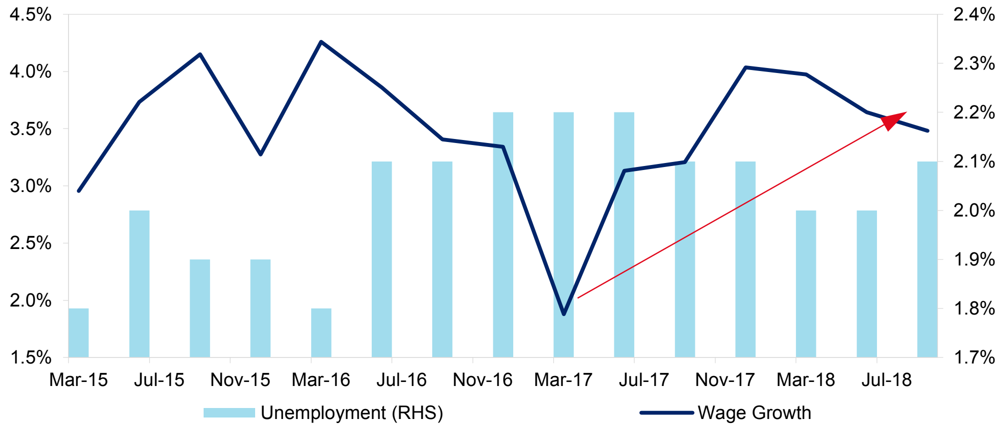
Review Of FY2018: Expect Another Fiscal Year Of Surplus

Compared to 2017, Singapore's economy slowed albeit marginally in 2018. GDP growth tapered slightly to a full-year flash print of 3.3% in 2018, versus 2017's 3.6% pace which coincidentally was Singapore's fastest growth in three years. Still, market-watchers will be greeted with a sense of piquancy given that overall growth momentum was at near the top-bound of MAS' growth outlook of 2.5 – 3.5% in October (an upgrade from MTI's official outlook of between 1.5 – 3.5% made in February 2018).

Even so, the labour market appears to be in a relatively stronger standing in 2018 versus the previous year. Overall unemployment rate averaged 2.0% in the first nine months of 2018 (9M18), which was an improvement from the 2.2% average seen in the same period in 2017. Total employed across the manufacturing, services and construction sectors also rose 0.6% y/y in 9M18 (vs a contraction of 0.3% in 9M17), while the number of retrenchments in these industries contracted 25.6% y/y over the said period, the lowest retrenchment rate seen since post Lehman period of 2010. Accounting for the stronger employment figures, the rise in wage growth of 3.7% in 9M18 (vs 9M17's print of 2.7%) is a clear testament of the strengthening business climate and robust labour environment, which in turn are likely to drive both corporate income tax receipts and personal income tax receipts in FY2018.

Exhibit 1: Unemployment Fell While Wage Growth Accelerated Over The Period 2017 - 2018

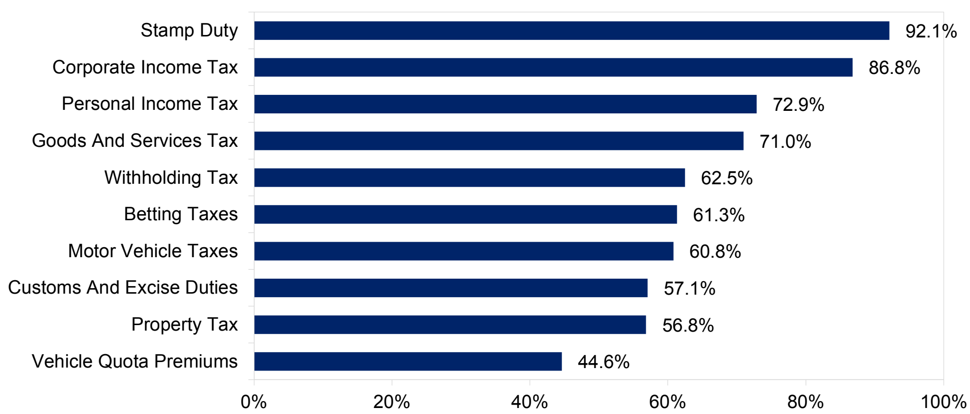
Source: Macrobond, UOB Global Economics & Markets Research



The steady economic growth pace and the tenacious labour environment were likely the key ingredients that underpinned fiscal revenue collection. Total operating revenue generation in the first 8 months of FY2018 was ahead of budget: From April to November 2018, total revenue collection was S$50.78bn (or 70% of budgeted revenue) and has been led by the faster-than-budgeted corporate income tax revenue (S$13.1bn) and personal income tax revenue (S$8.3bn). The collection of stamp duty of S$3.46bn (or 92.1% of budgeted revenue) in the mere first 8 months of the fiscal year was likely due to the increase in the top marginal Buyer's Stamp Duty (BSD) for residential properties to 4% from 3% (for properties that are worth above S$1mn) announced in FY2018 budget last year amid a rise in nominal residential property prices of 7.2% y/y in 1H18. Exhibit 2 shows the detailed representation of 8MFY2018 revenue collection vs. budget.

Exhibit 2: % Of Collection vs FY2018 Budget (8MFY18)

Source: Macrobond, UOB Global Economics & Markets Research



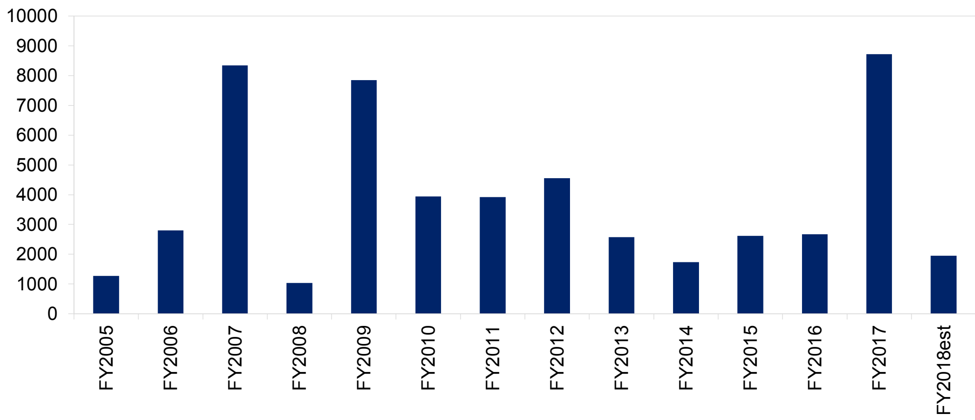
Elsewhere, the pace of total government expenditure in the first six months of FY2018 was a mere 39.4% of budget. Of this, government operating expenditure clocked S$23.3bn (or 40.4% of budget) while development expenditure printed S$8.3bn (or 36.9% of budget). Accounting for both revenue and expenditure, Singapore's primary balance was at an unanticipated surplus of S$8.1bn in the first half of the FY2018, versus the budgeted deficit of S$7.3bn for full-year FY2018. Should we assume an equally weighted division of Special Transfer payments and the income from Net Investment Returns Contribution (NIRC)[1] across the four quarters, Singapore's

1 FY2018 Budget has printed an estimate of S$9.1bn of Special Transfers and S$15.9bn of NIRC contribution. An equally-weighted division of these components across the four quarters of the fiscal year will yield Special Transfers payments and NIRC contributions of S$2.3bn and S$4.0bn respectively per quarter.

overall budget balance printed a strong S$11.5bn of surplus in the first six months of FY2018. Given the strong surplus in the first half, Singapore will see a comfortable fiscal space in the second half of FY2018. Note that Singapore's actual overall budget balance has constantly outperformed the budgeted overall balance since available data of 2005 (see Exhibit 3). Our econometric model suggests that Singapore will clock a potential S$1.4bn of overall budget surplus in FY2018, versus the budgeted deficit of S$600mn.

Exhibit 3: Difference Between Actual Budget Balance vs Budget Estimate

Source: Macrobond, UOB Global Economics & Markets Research



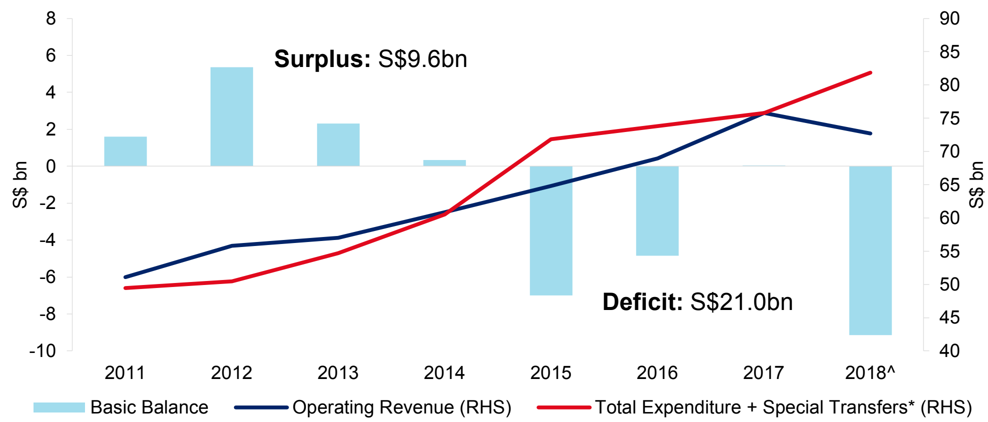
Preview Of FY2019: To Prepare For The Upcoming Decade 2021 – 2030

Even as we welcome the new fiscal year in 2019, it is important to revisit FM Heng's call for Singapore to ensure a 'fiscally sustainable and secure future' back in his FY2018 budget speech. The lynchpin for Singapore's sound fiscal footing in the current 2011 – 2020 decade was attributed to early planning and targeted moves including (1) a higher GST rate to 7% from 5% in 2007, (2) higher Net Investment Returns (NIR) from Temasek's contribution in 2015 and (3) raising personal income taxes for the top income brackets in 2015.

Despite the enhanced revenue generators, empirical evidences showed that deficit seen in the basic balance[2] surpassed the surpluses over the FY2011 – FY2018^ period by S$21.0bn to S$9.6bn. This is because expenditure in Environment & Water Resources, Healthcare and

Exhibit 4: Total Deficits In Basic Balance Still Outweighed Revenue

* Special Transfers excluding Top-ups to Endowment and Trust Funds
^Assuming FY2018 budgeted of –S$9.2bn
Source: Macrobond, UOB Global Economics & Markets Research

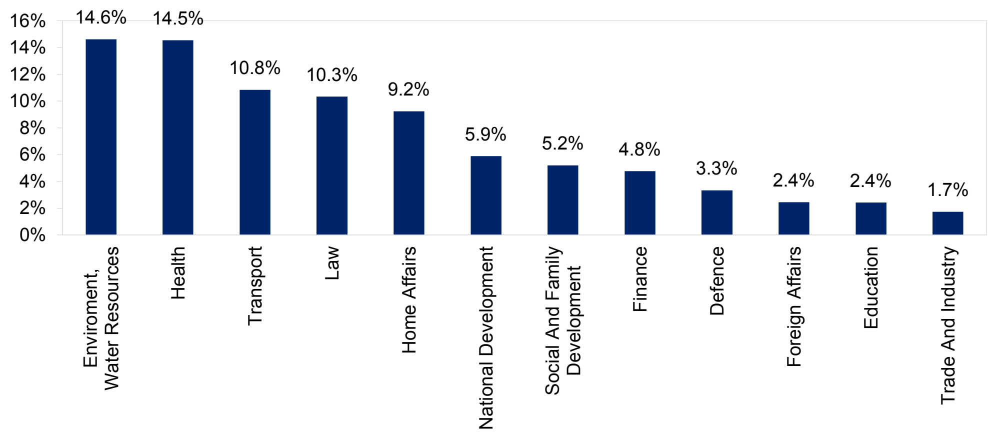


2 Basic Budget Balance is calculated from subtracting total revenue from operating expenditure and special transfers (ex-top ups to endowment and trust funds)

Transport over the period of 2011 – 2017 has grown by a 7-year CAGR of 14.6%, 14.5% and 10.8%, respectively. Special transfers excluding top-ups to endowment and trust funds also rose from a mere S$578.9mn back in FY2005 to its FY2015 peak of S$4.4bn. The expenditure growth in these key areas have starkly surpassed the 7-year CAGR growth in Personal Income Tax (+6.6%), Goods and Services Taxes (+3.4%) and Corporate Income Tax (+3.1%).

Exhibit 5: Government Expenditure Across Clusters (7-year CAGR)

Source: Macrobond, UOB Global Economics & Markets Research



Yet, the need to further strengthen economic resilience and develop social support systems remains well ingrained amid the uncertain economic environment into the year ahead. Singapore has already seen big-ticket expenditure items in the past years, including the Pioneer Generation Package (S$9.0bn in 2014), SkillsFuture Initiative and other continuing education & training ($1.0bn per year from 2015 – 2020) and Changi Airport Development Fund (initial injection of S$3.0bn in 2015) amongst other expenditures.

Recent news surrounding the need for further security measures given the Ministry of Home Affairs (MHA) indication of the rising terrorism threat to Singapore[3], the need to boost the construction sector and training of construction professionals (S$72 million of funding until May 2020) and efforts to support domestic recycling (launched with an initial S$2 million grant) further emphasised Singapore's need to further develop its security, social and economic sectors.

Five Expenditures, Three Revenues

To that end, FM Heng has mentioned in a recent interview that Singapore would need to focus on areas of education, healthcare, security and defence. Citing that the "needs are very large", the budget has one simple aim and it is to improve the lives of Singaporeans.

While it remains crucial to further strengthen Singapore's economic standing to ensure her long term survival and sustainability, it is equally crucial to continue to pursue business-friendly, education-supportive, and risk-mitigating policies in the coming decade. As such, we highlight five key expenditure items that we think may be present in the upcoming FY2019 budget, as well as three key revenue drivers to meet Singapore's growing needs.

The Five-Pronged Expenditure

Firstly, we expect further guidance on the long-awaited Merdeka Generation Package that was announced by Prime Minister (PM) Lee Hsien Loong in his 2018 National Day Rally. The Merdeka Generation refers to the baby boomers born in the 1950s, a generation that had experienced the "indelible, formative" events during Singapore's establishment of its internal self-government from the British back in 1959. As of today, concrete details have not been announced, though we think it is reasonable for the benefits to cover similar areas as the Pioneer Generation Package. We note that PM Lee cited that the package "will not be as large… but will

3 TodayOnline, Terror Threat to S'pore Still High: MHA, 22nd January 2019

go some way to relieve their healthcare worries". The package is said to benefit some 500,000 eligible Singaporeans, which is said to include outpatient subsidies, Medisave top-ups, subsidies for insurance premiums and pay-outs for long-term care.

Secondly, the healthcare needs of all Singaporeans can also be visited in a new tax relief for premiums paid on medical-related or health insurance policies. To-date, there remains no available tax relief incentives for premiums paid on the above-mentioned policies. The provision of this tax relief could encourage more Singaporeans to purchase health insurance policies, which in turn enhances their access to healthcare. Importantly, a study announced by the Life Insurance Association in April 2018 found that 80% of Singapore's working adults have inadequate insurance cover should critical illnesses strike. In the issue of Singapore's aging population, working adults could also have the option to purchase health insurances for themselves or their families, while further relief for health screening for people aged 50 years old and above could encourage preventive care.

Thirdly, helping local companies to digitalise, innovate and internationalise is essential in shaping Singapore's future economy. In the broad sense, the emerging buzz-words that we increasingly hear nowadays – Smart Nation, Artificial Intelligence, Big Data, Robotics etc. are likely to be future platforms that will transform the way Singaporeans live and work. Should we translate this to our business space, especially the Small and Medium Enterprises (SMEs), the need for Research & Development, training (and retraining), incentives to develop eco-friendly systems & the digital economy remain extremely relevant to-date. Policies could present themselves in the form of (1) R&D incentives on qualifying R&D activities, especially given the expected expiry of the Productivity and Innovation Credit (PIC) scheme after the year of assessment 2018, (2) the introduction of a new digital tax incentive/credit that could be offered to encourage companies to invest in new digital products/services, (3) a potential fintech incentive to promote the adoption of digital and mobile payments, authentication and biometrics.

Fourthly, we look for an enhancement to the SkillsFuture credit initiative given Singapore's need to train and reskill workers to stay relevant into the next decade. According to a joint study by Cisco and Oxford Economics in Sept 2018, Singapore will face the biggest mismatch between skills and jobs (20.6% of Singapore's full-time workforce will see their jobs displaced by 2028 given the impact of artificial intelligence) across six South-east Asian countries including Vietnam (13.8% displacement), Thailand (11.9%), Philippines (10.1%), Indonesia (8.1%) and Malaysia (7.4%). As such, an immediate need to enhance our domestic workforce and stay relevant in the ever-changing digital environment is critical. Rolled out in FY2015 budget, the SkillsFuture initiative had allocated S$500 to every Singaporean aged 25 and above, which will be topped up at regular intervals and not expire. The enhancement to the said initiative could take form in identifying and introducing courses that leverage on Singapore's digital transformation, especially in areas of robotics, digitalisation, programming etc. We perceive that such cutting-edge courses may likely not come cheap, so a dollars-and-cents enhancement to the overall SkillsFuture credit account will likely be welcomed too.

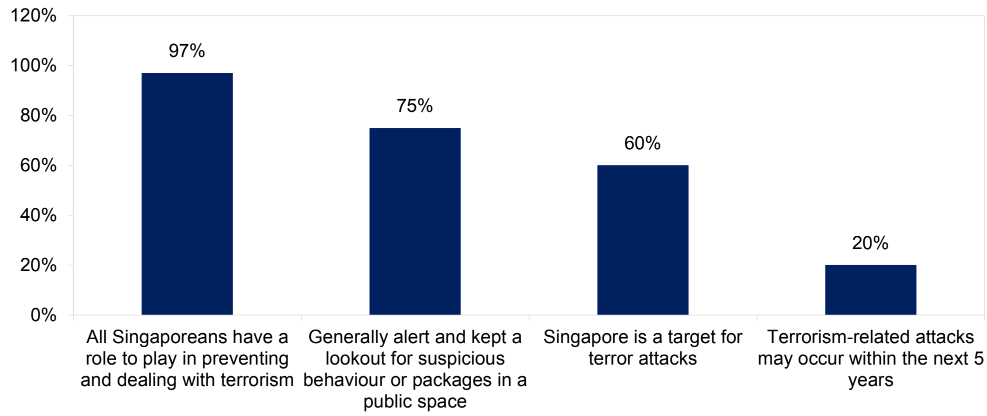
Lastly, the continued need to mitigate the rising threat of crime and terrorism, be it in a form of cyber-security or physically present within our shores will likely take precedence in the upcoming FY2019 budget. According to the Ministry of Home Affairs (MHA), the terrorism threat to Singapore remains high and reiterated that the Islamic State of Iraq and Syria (ISIS) "remains interested in the (South-east Asian) region". In a similar note, the rise in cybercrime-related acts (cybercrime cases grew 16.6% in 2017, up from 15.6% in the previous year), coupled with 2018's SingHealth cyber-attack which in turn is believed to be by state-sponsored hackers[4], highlighted Singapore's need to strengthen its physical and cyber borders. Statistically, defence expenditure has grown by a tepid 3.3% on a 7-year CAGR, which pales in comparison to Social Development expenditure (7.7% over a 7-year CAGR), Economic Development (7.1%), and Government Administration (+8.8%). As such, defence expenditure as a percentage of total government expenditure has fallen from 24.2% in FY2011 to 19.3% in FY2017. For that matter, a recent survey by the Ministry of Home Affairs (MHA) of public perceptions towards terrorism showed that 60% of participants agree that Singapore is a target for terror attacks, and 97% highlighted

4 The Strait Times, Top-secret report on SingHealth attack submitted to Minister-in-charge of Cyber Security, 31 Dec 2018

that everyone has a part to play in preventing or dealing with terrorism. On this note, some dedication of resources towards increasing defence and security expenditure may be possible.

Exhibit 6: A Survey Of Public Perception And Sentiments Towards Terrorism Threat (July 2018)

Source: TodayOnline, UOB Global Economics & Markets Research



Three Revenue Drivers

So far our discussion has emphasised on Singapore's economic, social and security needs into the next decade. Indeed, should our suggested five-pronged expenditure drivers come to pass, they will likely prepare Singaporeans for the ever-changing economic and digital climate, while ensuring that the needs of Singaporeans are being met. However, the need to stay fiscally prudent and sustainable in the rising needs of the nation is paramount as well. We identify three potential revenue drivers that could present themselves in the upcoming FY2019 Budget.

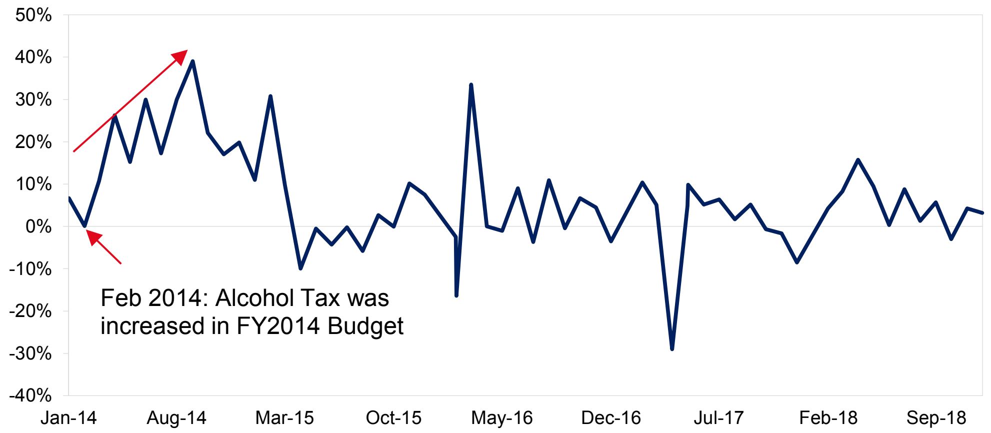
Firstly, a sugar tax could further help the "War against Diabetes" made by the Ministry of Health back in 2016 but it is unlikely to be a significant revenue driver. The World Health Organisation (WHO) cited that Singapore has the second-highest proportion of diabetics amongst developed nations in 2015. Other nations around the world have implemented a form of sugar tax to curb the rise of diabetes. These countries include the UK which implemented tax on drinks with high sugar content (effective April 2018), as well as the Philippines, Estonia, South Africa, and Thailand, amongst many others. Malaysia is also said to implement an excise duty of MYR0.40 per litre to be charged on sugar sweetened beverages, effective 1st April 2019. Importantly, Singapore's move to implement a sugar tax, should it come to pass, will likely be one to change behaviour, rather than to boost revenues.

Secondly, further guidance on how the government will tax digital purchases may be announced in the upcoming budget. In FY2018 budget, FM Heng has announced GST on imported services effective 1 January 2020, which will affect services such as consultancy and marketing purchased from overseas. However, details over taxes on physical goods purchased digitally remain lacking and such will be reviewed "before deciding on the measure to take". The measures could include lowering the S$400 CIF (Cost, Insurance, Freight) threshold value for imported goods, as well as implementing tax collection models (which could include the widely discussed Vendor Collection Model or the Reverse Charge Model). We think further concrete tax measures on the digital purchases of goods and services will likely materialise in the coming FY2019 budget.

Last but not least, we feel that a revisit to another increase in alcohol tax may be possible. The alcohol tax was last increased in the FY2014 Budget by the then Finance Minister Tharman Shanmugaratnam. Specifically, the liquor tax has been raised by 25% to $88 per litre of alcohol content for wine and spirits, and $60 for beer. This may well be increased further as a move to moderate alcohol consumption, given that the initial tax hike back in 2014 has been rather ineffective: the overall effect on alcohol consumption was temporal, in that alcohol tax receipts at the onset of the tax grew by a mere 0.1% before expanding by 30% into June 2014.

Exhibit 7: Liquors Tax Receipts

Source: Macrobond, UOB Global Economics & Markets Research



Will It Be A Pre-Election Budget?

As the next Singapore general election has to be held by 15th Jan 2021, there has been speculation as to whether the FY2019 budget would be a pre-election budget. In the previous pre-election budget in 2015, we saw corporate income tax rebates, personal income tax rebate, the introduction of the SkillsFuture scheme, a Silver Support Scheme for the elderly, and enhancements to the GST Voucher scheme.

Notwithstanding the prospect of a pre-election budget, the need remains for Singapore to stay business relevant and education supportive, amidst the on-going uncertainties in the global economic space including UK's exit from the European Union (or as known as Brexit Risk), US-Sino trade tensions as well as US-related political struggles. These suggest that the FY2019 budget has the need to lean towards an expansionary stance. As pointed out in the earlier sections, we expect the government to also address immediate issues such as the cost of living, retirement financial adequacy & re-employment, and healthcare insurance premiums and coverage.

All-in-all, we note that Singapore's fiscal standing in the current five-year framework has been positive. Should our estimate for FY2018 overall budget balance to print a surplus of S$1.4bn come to pass, Singapore would have seen three surplus years in the current five year cycle. This suggests a comfortably larger fiscal space into the next two years, and gives the government further flexibility to provide the much needed social, economic and security expenditure into the next year. The need to stay fiscally disciplined and prudent will however likely be the main focus of the budget process, which in turn indicates the introduction and enhancement of revenue generators such as Digital Tax, while a potential Sugar Tax, and a possible increase in the existing Alcohol Tax may be based on more altruistic reasons by the government rather than generating more tax revenue.

Singapore's Overall Budget Balance (Including UOB's FY2019 Estimate)										
Variables (S$ million)	2011	2012	2013	2014	2015	2016	2017	2018*	2018 UOB	2019 UOB
Operating Revenue	**51,077.2**	**55,814.5**	**57,020.3**	**60,838.2**	**64,823.2**	**68,964.4**	**75,803.5**	**72,680.0**	**74,000.0**	**75,500.0**
Corporate Income Tax	12,096.3	12,821.3	12,679.6	13,371.5	13,815.1	13,602.2	14,944.0	15,110.0	16,226.9	16,463.8
Personal Income Tax	6,871.4	7,713.7	7,688.1	8,926.7	9,234.9	10,526.2	10,724.0	11,430.0	11,554.1	11,491.7
Withholding Tax	1,258	1,337.3	1,152.4	1,126	1,402	1,474.1	1,531.6	1,350.0	1,498.2	1,564.8
Statutory Boards' Contributions	353.2	539.1	529.8	515.9	438.3	775.4	4,865.8	460.0	460.0	500.0
Assets Taxes	3,901.9	3,768.3	4,181.9	4,340.6	4,455	4,359.5	4,439.6	4,450.0	4,758.2	4,588.5
Customs And Excise Taxes	2,132.8	2,141.7	2,189.4	2,539.7	2,833	2,730	3,133	3,370	3,083	3,302
Goods And Services Tax	8,687	9,038	9,512.7	10,215	10,345.1	11,078.3	10,959.5	11,360.0	11,613.4	11,381.2
Motor Vehicle Taxes	1,919.6	1,802.9	1,654.6	1,602.9	1,759.7	2,148.4	2,152.6	2,810.0	2,611.1	2,699.5
Betting Taxes	2,373.4	2,304.8	2,378.8	2,591	2,719	2,682	2,688	2,750	2,766	2,670
Stamp Duty	3,175.1	4,309.5	3,929.9	2,783.5	2,769	3,278.5	4,905.3	3,760.0	5,243.4	4,996.0
Other Taxes	3,307.3	4,341.8	5,248.4	6,097.1	5,876.2	6,044.5	6,019.3	6,430.0	6,361.3	7,106.8
Vehicle Quota Premiums	2,112	2,572.1	2,721.7	3,394	5,424.8	6,550.6	5,795.9	5,590.0	3,744.6	3,496.5
Fees And Charges (Excluding Vehicle Quota Premiums)	2,587.2	2,707.7	2,903	3,010.5	3,248.9	3,208.9	3,266.7	3,450.0	3,390.8	3,287.5
Others	302	416.1	250	323.8	502.2	505.7	377.9	360.0	688.6	1,952.2
Total Expenditure	**46,563.4**	**49,003.9**	**51,727.8**	**56,648.3**	**67,447**	**71,044.9**	**73,556.4**	**80,020.0**	**79,387.7**	**83,000.0**
Operating Expenditure	35,149.9	36,420.4	39,725.3	42,685.2	48,090	52,128.4	55,581.4	57,670.0	56,516.9	60,855.1
Development Expenditure	11,413.6	12,583.3	12,003.3	13,963.3	19,357	18,915.7	17,975.0	22,350.0	22,870.8	22,144.9
Primary Balance	**4,513.7**	**6,810.6**	**5,292.5**	**4,189.9**	**-2,623.9**	**-2,080.4**	**2,247.1**	**-7,340.0**	**-5,387.7**	**-7,500.0**
Special Transfers	8,426.7	8,859.5	8,583.6	12,356.2	10,369.2	6,372.3	6,230.0	9,110.0	9,110.0	10,220.0
Excluding Top-ups To Endowment And Trust Funds	2,909.2	1,457.5	2,989.6	3,856.2	4,369.2	2,772.3	2,220.0	1,810.0	1,810.0	2,220.0
Basic Balance	**1,604.5**	**5,353**	**2,302.9**	**333.7**	**-6,993**	**-4,852.7**	**47.1**	**-9,150.0**	**-7,197.7**	**-9,720.0**
Top-ups To Endowment And Trust Funds	5,517.5	7,402	5,594	8,500	6,000	3,600	4,010	7,300	7,300	8,000
Net Investment Returns Contribution	7,915.6	7,870.1	8,289.4	8,737.8	8,943.3	14,577.5	14,610.0	15,850.0	15,850.0	16,500.0
Overall Budget Surplus/ (Deficit)	**4,002.7**	**5,821.1**	**4,998.2**	**571.5**	**-4,049.7**	**6,124.8**	**10,627.1**	**-600.0**	**1,352.3**	**-1,220.0**

* FY2018 Budget numbers
Source: UOB Global Economics & Markets Research

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