3.1 External Outlook

The Global Recovery Looks Set to Continue

The momentum in the current recovery will mitigate the impact of recent shocks.

Having ended 2010 on a stronger-than-expected footing, the global economy appears to have gathered sufficient momentum to weather the dual shocks of higher oil prices stemming from the unrest in the MENA region, and the side effects from the Japan earthquake and tsunami. This assumes, however, that the nuclear incident in Japan stabilises and there is no significant escalation of risks from the Eurozone sovereign debt and banking crises.

Although increased energy costs will lower real incomes and curtail consumer spending to some extent, growth prospects for the US and Eurozone remain steady this year. (Table 3.1) The Japanese economy is likely to suffer a sharp contraction in Q2 2011, but this should be partially offset by a rebound later in the year as reconstruction gets underway. The rest of Asia should register healthy growth, albeit slower than last year's exceptional pace as policy tightening measures intensify. Nonetheless, strong employment and rising wages in the regional economies will support consumption spending. For 2011, world economic growth as a whole is expected to reach 4.6%, lower than the 5.8% in 2010, but close to the average over the past decade.

Strengthening private demand will be a key driver of global growth this year. The advanced economies have seen gradual but steady improvements in underlying labour market conditions. At the same time, corporate spending on plant and equipment is poised to pick up slowly in the US and Eurozone, where business confidence has recovered in tandem with improving household and financial sector balance sheets. Fiscal balances, however, are on an unsustainable trajectory in the US, Japan and parts of Europe. While fiscal consolidation is likely to be postponed in the US and Japan, it cannot be deferred indefinitely, and will be a force holding back G3 economic growth over the medium term.

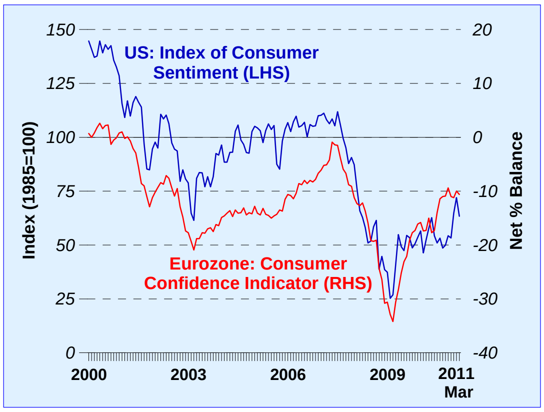
Table 3.1
GDP Growth Forecasts

(%)

	2010	2011	
		March	April
Total*	**5.8**	**4.7**	**4.6**
G3*	**2.6**	**2.3**	**2.0**
US	2.9	3.1	2.9
Eurozone	1.7	1.7	1.7
Japan	3.9	1.4	0.3
NIE-3*	**7.9**	**4.9**	**4.9**
Hong Kong	6.8	5.2	5.3
Korea	6.2	4.5	4.4
Taiwan	10.8	4.6	4.6
ASEAN-4*	**6.9**	**5.4**	**5.4**
Indonesia	6.1	6.2	6.3
Malaysia	7.2	5.1	5.1
Thailand	7.8	4.4	4.3
Philippines	7.3	5.2	5.2
China	10.3	9.4	9.3
India**	8.6	8.2	8.2

Source: CEIC and Consensus Economics Inc.
* Weighted by shares in Singapore's NODX.
** Fiscal year ending March.

Chart 3.1
US and Eurozone Consumer Sentiment



Source: The Conference Board and Eurostat

Renewed US fiscal stimulus will underpin private consumption growth.

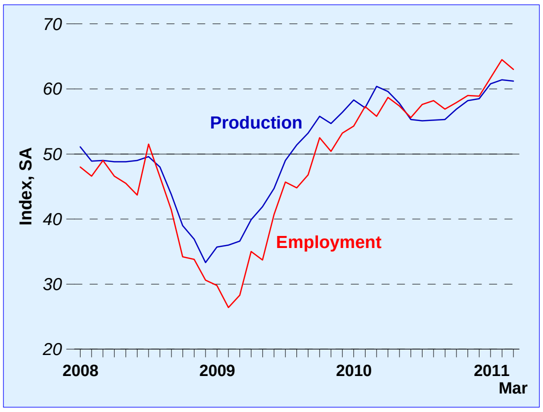
In December 2010, the US government announced additional short-term support for the economy in the form of an extension of the previous administration's income tax cuts, a reduction in payroll tax and new incentives for business investment. The tax cuts will help to boost personal disposable incomes in H1 2011 and stimulate household spending. Indeed, the latest consumer confidence survey conducted by the Conference Board indicates a strong intention to spend on household durable goods such as cars and appliances despite a drop in the overall confidence index in March. (Chart 3.1) On the business front, the latest readings of the ISM manufacturing PMI suggest that industrial production will remain strong in the near term. (Chart 3.2) In view of this rosier outlook, US real GDP is expected to expand by 2.9% in 2011.

The ISM sub-index for employment also stayed high at 63 in March, suggesting that firms are more prepared to hire workers. This should help to bring the unemployment rate down, although gains in employment may be modest initially, due to structural mismatches in the labour market and job cutbacks by state and local governments. Reflecting this, the number of job seekers has risen since April 2010, even though job openings have increased steadily throughout the year. (Chart 3.3)

The outlook for the Eurozone is for continued growth, although risks remain ...

Eurozone consumers remain optimistic about the near-term outlook. Despite the mild appreciation of the euro in late 2010, new foreign orders for manufacturing goods rose by 3.3% in January 2011 and business surveys point to a sustained expansion in the core exporting economies. However, the more fragile economies in the Eurozone periphery are still vulnerable to further bailouts, with mounting pressures to restructure sovereign debt. Even though fiscal consolidation will constrain growth, particularly if coupled with restrictive monetary policy, the impact should be mitigated as public spending cutbacks will be spread out over the medium term. (Chart 3.4) Overall, Eurozone growth is likely to be steady at around 1.7% in 2011, unchanged from 2010.

Chart 3.2
US Manufacturing PMIs

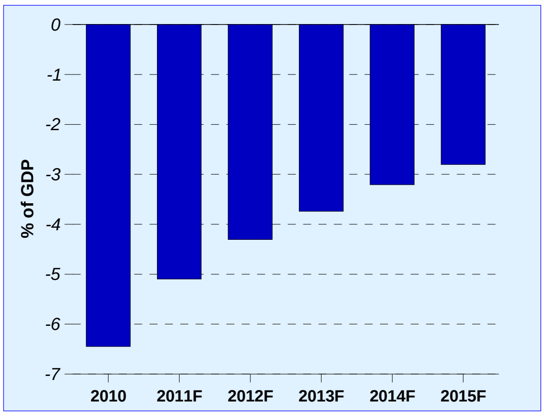


Source: The Institute for Supply Management (ISM)

Chart 3.3
US Job Openings and Job Seekers

Source: US Bureau of Labour Statistics

Chart 3.4
Eurozone Fiscal Balances



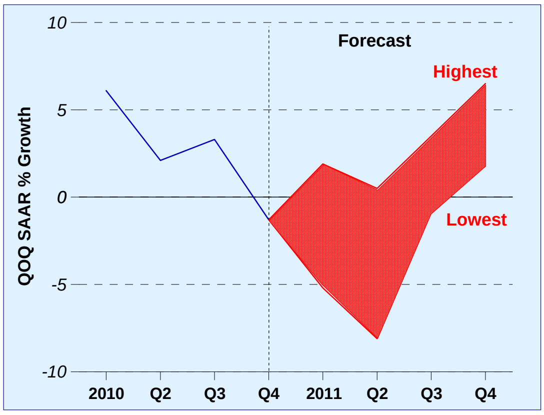
Source: International Monetary Fund

... while Japan will contract in the short term.

After faltering in Q4 2010 on weak private consumption and slowing exports, the Japanese economy showed signs of picking up in early 2011, with industrial production and exports performing well in January and February. However, the huge Tohoku earthquake on March 11 and the nuclear crisis that followed will delay the economy's return to health and adversely impact growth in the near term. This was underscored by the drop in the Japanese manufacturing PMI to a two-year low of 46.4 in March from 52.9 in February, suggesting that industrial production is likely to take a severe hit in the months ahead.

Real GDP is expected to contract in Q2 2011, given the crippled utility and transportation networks, and the resulting interruptions to output. (Chart 3.5) Private consumption and investment will weaken further in the short term as a result of damaged confidence and wealth destruction. Although analysts have predicted a V-shaped rebound when reconstruction spending kicks in during H2 2011, growth of only 0.3% is envisaged for the year, a downgrade of 1.1% points from the pre-quake forecast.

Chart 3.5
Private Sector Forecasts of Japan's GDP Growth

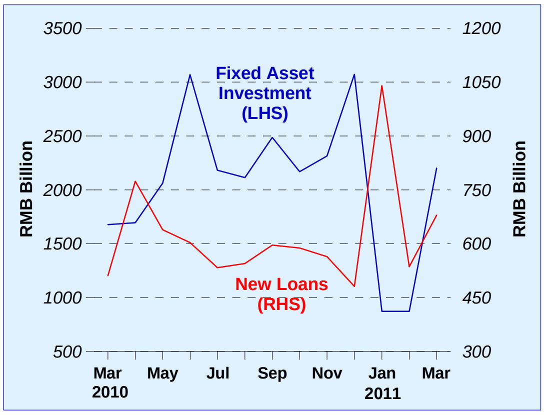


Source: CEIC and brokerage reports

Steady growth in Asia ex-Japan will be driven by the private sector.

After a stellar performance last year, Asia ex-Japan is on course to grow at rates closer to trend this year. China's GDP growth, in particular, is set to ease to 9.3% in 2011 from the heady pace of 10.3% in 2010, after a succession of policy tightening measures were implemented to rein in property investment and inflation. In Q1 2011, growth cooled marginally to 9.7% y-o-y from 9.8% in Q4 2010, as net exports declined. However, fixed asset investment and new loans remained robust. (Chart 3.6) Going forward, fixed investment could come under pressure from policy tightening, while private consumption could contribute an increasing share to growth, following new legislation to raise minimum wages last year.

Chart 3.6
China Fixed Asset Investment and New Loans



Source: CEIC

Meanwhile, manufactured exports from the NIEs of Hong Kong, Korea and Taiwan will be spurred by the recovery in markets in the advanced countries.

While Korean and Taiwanese high-tech industries might face temporary supply disruptions as a result of production stoppages in Japan, they are also likely to gain as producers of substitutes for Japanese components and products.

In ASEAN, growth will slow from the rapid pace in 2010 as regional central banks tighten monetary policy further. Still, household spending will be underpinned by buoyant incomes and higher minimum wages in Indonesia and Thailand. The recent strength in commodity prices will also increase exports of primary products from the region and benefit the resource-rich ASEAN economies.

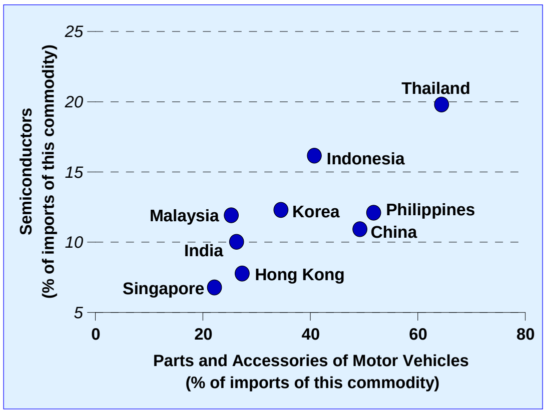
With capacity utilisation having returned to pre-crisis levels in most countries, firms are also looking to increase their investments in factories and machinery, although business confidence may be slightly dented by the recent spike in oil prices and the devastating earthquake in Japan.

Post-quake disruptions will have varying spillover effects across the region.

The impact of widespread supply disruptions in Japan will be most apparent in Asia ex-Japan. Although Japan's importance as a trading partner to the rest of Asia has declined over the years,[1] it continues to have close trade and production linkages with several countries. In particular, Japan is a key source of parts and components used in the automotive and electronics industries in the ASEAN manufacturing centres, many of which are located in Thailand, the Philippines and Indonesia. (Chart 3.7) Similarly, Chinese and Korean factories are also quite dependent on imports of Japanese parts. However, firms will be able to partially offset the impact by sourcing for alternative supplies or running down inventories.

The Japanese earthquake could also have a positive impact on some economies in the region. Asian countries that compete directly with Japan in electrical and electronic goods and automobiles, such as Korea and Taiwan, could stand to gain in terms of increased market share and firmer pricing, as downstream

Chart 3.7
Imports of Parts and Components from Japan



Source: UN Comtrade

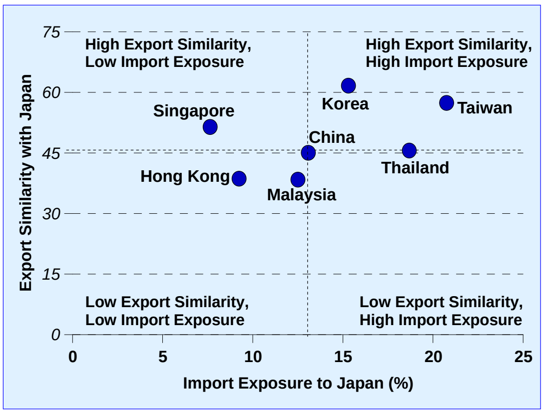
Note: Semiconductors are diodes, transistors and similar semiconductor devices (SITC 7763) and electronic integrated circuits (SITC 7764).

[1] In 2010, trade with Japan comprised 9.6% of Asia's total trade, down from 13.5% in 2003.

firms seek to secure substitutes for Japanese products and diversify input sources to guard against future disruptions. At the same time, global oil prices may rise further due to increased demand from Japan to replace lost nuclear capacity, thus benefiting oil and gas producers like Indonesia and Malaysia.

Chart 3.8 provides a summary assessment of the net impact of the supply-side disruptions in Japan on the key Asian economies. On the vertical axis is the Export Similarity Index.[2] The higher the index, the more similar a country's exports are to those of Japan, and the greater the possibility that some orders could be diverted to that country in the short run. Korea and Taiwan, it appears, are particularly close substitutes for Japanese exports. On the horizontal axis is East Asia's import exposure to Japan. Again, Korea and Taiwan are very reliant on Japan as a source of imports. Singapore is the only country in the region in the upper left quadrant of the chart – it not only displays high export similarity *vis-à-vis* Japan, but also has relatively lower import exposure to Japan.

Chart 3.8
Regional Export Similarity and Import Exposure to Japan



Source: CEIC and UN Comtrade

Headline inflation is vulnerable to upside risks.

Notwithstanding the expected slowdown in growth, substantial upside risks to inflation in Asia ex-Japan remain, given the region's vulnerability to food and oil price inflation, and in view of the already elevated level of activity in many of these economies. While policy rate hikes by regional central banks and capacity expansions would help to restrain inflationary pressures, high and volatile oil prices due to continued tensions in the MENA region and unrelenting capital inflows could still lead to a strong uptick in Asian ex-Japan inflation rates this year.

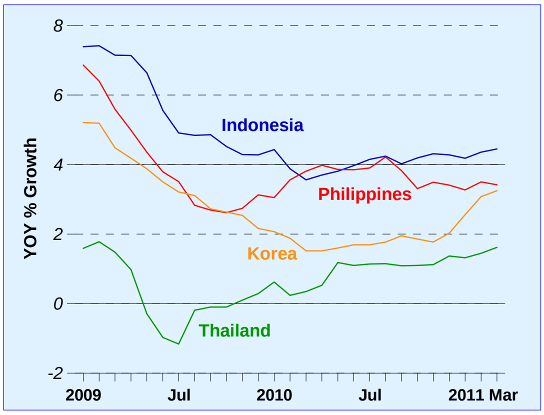
[2] The Export Similarity Index between country A and country B in exporting to the world C is computed as S(AB,C) = $\{\sum_i \text{Minimum } [X_i(AC), X_i(BC)]\}100$, where $X_i(AC)$ is the share of commodity i in A's exports and $X_i(BC)$ is the share of commodity i in B's exports to the world C. S(AB,C) takes a value between 0 and 100 – the higher the index, the greater the export similarity between countries A and B. This analysis was based on SITC trade definitions at the 3-digit level, apart from Taiwan which was based on SITC 2-digits due to data unavailability.

In China, the run-up in food and house prices as well as business costs will keep domestic inflation high during the first half of the year, but the inflation rate may ease somewhat in the second half, partly on base effects and as the impact of recent policy tightening sets in.

Core inflation in the region is also likely to rise further, especially in countries such as Korea, where there are no state subsidies to shield consumers from high global prices. (Chart 3.9) With aggregate demand staying buoyant, cost pressures from tightening factor markets will probably be passed on to consumers more quickly.

Following the earthquake and tsunami, supply shocks and rising oil costs could lift Japan's prices in the short term, but these pressures could be mitigated by weakened overall demand. In the US and the Eurozone, headline inflation rates have also risen since the turn of the year and unit costs are likely to creep up as output gaps narrow and labour market conditions tighten. Nonetheless, core inflation rates are still below 2% and inflation expectations are well-anchored.

Chart 3.9
Core Inflation of Selected Asian Economies



Source: CEIC and Datastream

3.2 Outlook for the Singapore Economy

The Recovery has Moved to an Advanced Phase

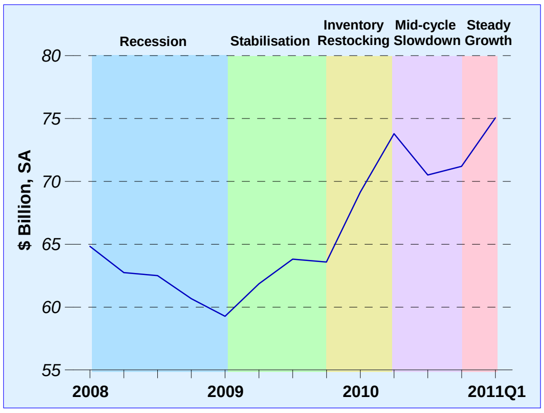
The firm start in Q1 has set the stage for broad-based growth in 2011.

The Singapore economy has undergone several stages of recovery since its rebound from the trough in Q1 2009. (Chart 3.10) In Q1 2011, the domestic economy transited to a more mature stage of recovery. Unlike the initial recovery phase when GDP growth was driven by transitory factors, such as inventory restocking, the step-up in economic activity in the first quarter of this year reflected an improvement in end demand in Singapore's key export markets, which in turn provided support to a wide range of industries.

Nonetheless, the immediate economic outlook is clouded by uncertainty arising from the spike in oil prices and the calamity in Japan. At this stage, EPG's assessment is that there is sufficient momentum for the global economy to grow at a moderate pace in 2011 despite these headwinds. Supported by a gradual improvement in the labour market and accommodative fiscal measures, the US economy should continue on its recovery path. In Asia ex-Japan, resilient household spending and a pickup in business investment are expected to underpin growth.

Against this backdrop, the domestic economy should remain supported by broad-based expansions across most sectors in the quarters ahead. After the surge in Q1, there could be a temporary pullback in economic activity in Q2. Nevertheless, barring a major dislocation in the global economy and anchored by the strong performance in Q1, Singapore's GDP growth is expected to come in at the higher end of the 4-6% forecast range in 2011.

Chart 3.10
Singapore's Real GDP



Barring a full-fledged nuclear disaster, the crisis in Japan is unlikely to derail Singapore's growth this year.

Following the massive earthquake and tsunami that struck in March, the Japan economy has been affected by widespread disruption to power infrastructure and transportation networks. EPG's assessment is that Singapore's economic activity could be dampened in the immediate months ahead as temporary interruptions in manufacturing production and trade-related services filter through from the supply-side disruptions in Japan.

However, unless there is greater-than-expected collateral damage arising from a full-blown nuclear disaster, which could in turn lead to a significant fall-off in the global economy, there is likely to be a rebound in domestic activity once some normalcy has been restored in Japan. In fact, in previous episodes of non-economic shocks – such as the SARS outbreak and the September 11 terrorist attacks in the US – the impact on the Singapore economy was short-lived and the subsequent turnarounds quite sharp.

This assessment also stems from the fact that Japan is a relatively small end market and import source for Singapore's goods and services. Last year, Japan accounted for 4.7% of Singapore's total merchandise exports and 7.9% of total merchandise imports. In fact, as alluded to in Section 3.1, disruptions to Singapore's overall production and trade through the import channel could be counter-balanced by a potential increase in new orders re-directed from Japan. While utilisation rates in the domestic manufacturing sector are currently high, there is still room to ramp up production.

Similarly, the impact of the Japanese disaster on Singapore's tourism-related industries is likely to be muted. Unlike the early 2000s when Japan was an important tourism market for Singapore, the share of Japanese tourists has steadily declined from 12% in 2000 to 4.5% in 2010. Furthermore, post-crisis disruptions could lead to a diversion of Japan-bound tourists to other parts of the region. Singapore could benefit from this as it shares a similar tourist profile with Japan, including a significant proportion of tourists from China, Korea, Taiwan, Thailand and the US.

As such, while the recent disaster in Japan could cast a pall on the near-term outlook of the Singapore economy, the firm and broad-based growth in Q1 2011 has set the stage for steady growth for the rest of the year, underpinned by expansion in the manufacturing sector as well as a wide range of services.

Manufacturing will be supported by the moderate turnaround in the global IT industry.

Growth in the global IT industry petered out in the middle of last year, as the effects of inventory restocking dissipated. Based on latest indicators, there are some signs of a strengthening in global IT demand. In addition to the resilient emerging markets, corporate demand from the US re-emerged in Q4, suggesting that the PC replacement cycle remains fairly intact. (Chart 3.11) Alongside a positive corporate earnings outlook in the US, enterprise spending growth is expected to continue this year, driven by the upgrading of ageing systems as well as an increased demand for IT networking products, in line with the growing adoption of new technologies such as cloud computing and desktop virtualisation.

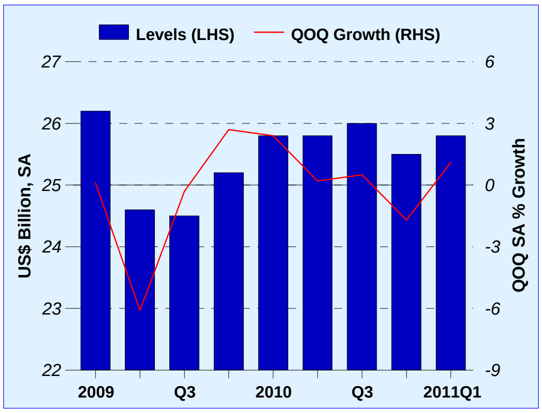
Meanwhile, US retail sales of electronics products edged up 1.1% q-o-q in Q1, reversing the 1.7% sequential decline in the previous quarter. (Chart 3.12) The turnaround was due in part to strong demand for tablets and smartphones, which will provide support to the downstream segment this year. According to Gartner, global tablet shipments will quadruple this year to 70 million units, compared with 18 million in 2010. In the same vein, smartphone shipments are expected to grow nearly 60% in 2011. New product launches in the pipeline, including dual-core smartphones and Android-based tablets, will help to generate fresh consumer demand.

On the whole, the prospects for the downstream segment remain generally healthy, with global PC and handset demand forecast to expand by around 11% in 2011, slightly lower than the 14% in 2010. (Chart 3.13) Nevertheless, this will depend on a relatively sanguine macroeconomic environment in the key industrialised countries.

Chart 3.11
US and China Corporate IT Spending

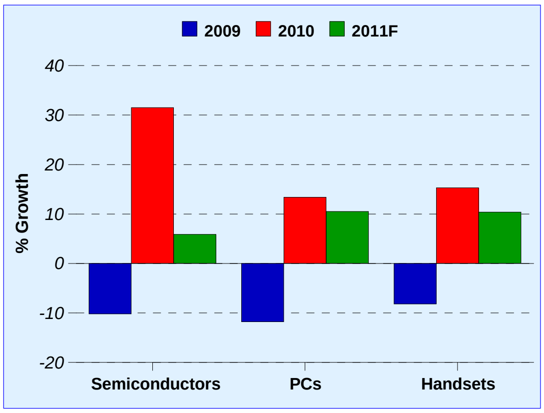
Source: CEIC and EPG, MAS estimates

Chart 3.12
US Electronics Retail Sales



Source: CEIC

Chart 3.13
Global IT Forecast



Source: Gartner, IDC and company reports

The more positive outlook in the end markets has started to benefit the midstream semiconductor segment. Global chip sales rose by 20% on average in Jan-Feb 2011 compared to Q4 2010 levels, following three quarters of lacklustre activity. (Chart 3.14) This surge has persuaded some market analysts to raise their global semiconductor revenue estimates for 2011 from low to high single-digit growth. Alongside the proliferation of tablets and smartphones, the higher semiconductor content in these gadgets will further boost chip sales this year. Continued growth in the automotive market will also encourage chip sales.

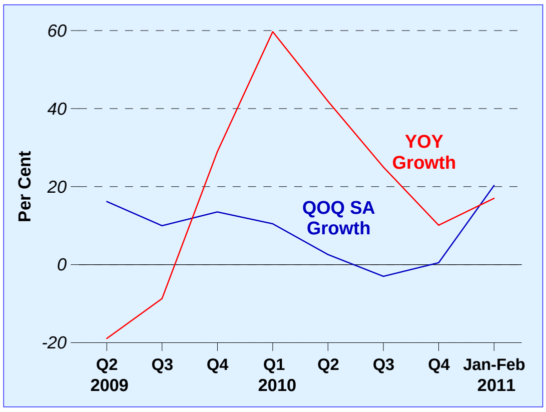
There is a possibility that the near-term prospects for the semiconductor segment could be dampened by supply-side disruptions arising from the Japanese earthquake. At this stage however, there appears to be sufficient inventory buffer to withstand the short-term disruptions in supply. In Q4 2010, global semiconductor inventories reached their highest level in two and a half years, arising in part from the lull in the global electronics cycle in H2 2010. At the end of last year, semiconductor suppliers had 83.6 days of inventory, up from 78.1 days in Q3. (Chart 3.15) In addition, there could be a diversion of production to alternative manufacturing centres outside of Japan, which would benefit IT hubs in the region.

As such, while the domestic IT industry could see some weakness in the immediate quarter, it should grow at a moderate pace in the second half of the year. Supply-side expansions, such as the ramp-up in production from NAND manufacturer IM Flash Technologies, as well as GlobalFoundries' expansion of its existing wafer fabrication plant, could provide further support to the sector this year.

Heightened activity in the transport engineering segment will boost growth.

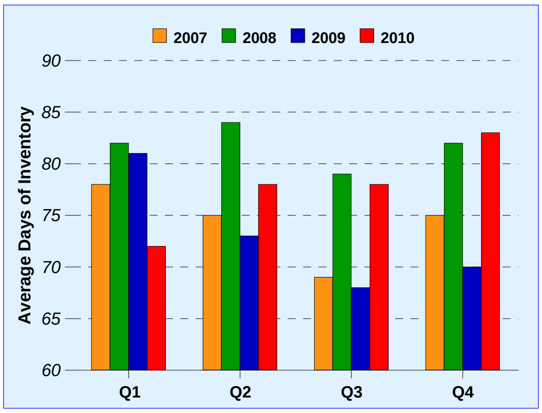
The domestic non-electronics manufacturing segment is also expected to turn in healthy growth. For instance, the marine & offshore engineering industry is likely to see a comeback, following two years of declines in output. Local yards have received a spate of new rig orders in Q4 2010 and Q1 2011. (Chart 3.16) The influx of new contracts has strengthened yard order books and will improve capacity utilisation in 2011.

Chart 3.14
Global Chip Sales



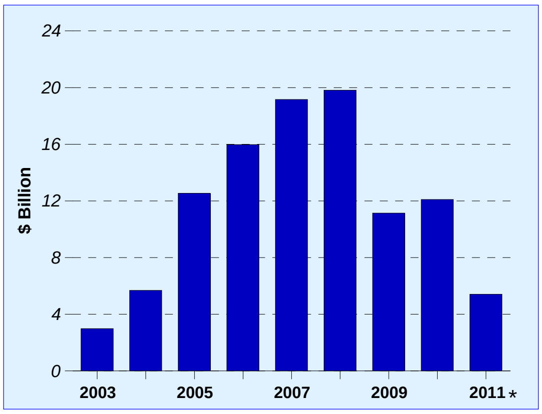
Source: Semiconductor Industry Association and EPG, MAS estimates

Chart 3.15
Inventory Held by Semiconductor Suppliers Worldwide



Source: Capital IQ and Deutsche Bank

Chart 3.16
Net Order Books for Oil Rigs



Source: Keppel Corp and Sembcorp Marine
* As at 13 April.

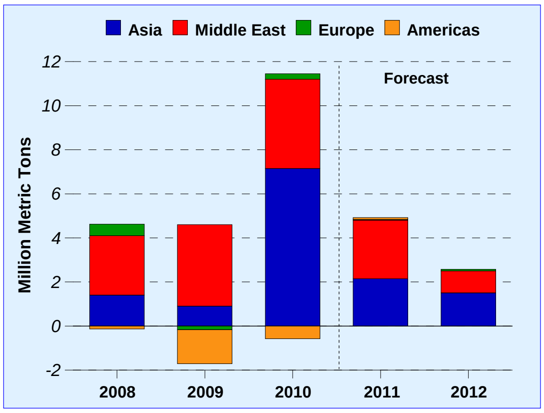
In view of the pickup in capex spending in 2011, new orders for high-end jack-up rigs should remain strong, given that 70% of the existing fleet are over twenty years old, and will need to be upgraded in line with more stringent global regulations. Rising oil prices will also spur explorations deeper offshore. At the same time, there are signs of revival in the semi-submersible sector, alongside the gradual resumption of drilling activity in the US Gulf of Mexico.

Similarly, the aerospace segment should also witness an upturn in activity, with the recovery in regional air travel translating into greater demand for aircraft maintenance, repair and overhaul (MRO) services.

The chemical and pharmaceutical industries will expand further.

The chemicals cluster has recorded four consecutive quarters of sequential increases since Q2 2010, driven by robust expansions in the petroleum refining and petrochemical segments. Growth should remain firm, albeit slower, going forward. While capacity expansion from new crackers in Asia and the Middle East will add to the global supply overhang, which could exert competitive pressures on output, strong Asian demand for chemical products will provide underlying support in 2011. (Chart 3.17)

Chart 3.17
Ethylene Capacity Additions



Source: Chemical Market Associates, Inc.

Moreover, capacity additions in the biomedical cluster will provide a further uplift to manufacturing. Two new biologics plants from Lonza and GlaxoSmithKline (GSK) are expected to commence operations this year, on the heels of the Roche facility that started commercial production in 2010.

Trade-related services will continue to be underpinned by regional demand.

In addition to firm demand from emerging markets, growth in the global IT market will provide further support to Singapore's trade-related services.

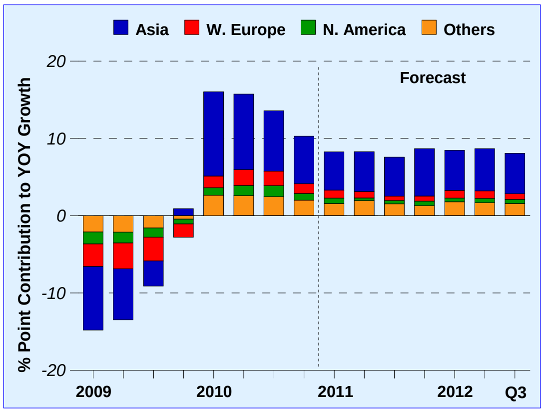
As a key re-exports hub for the region, activity in the wholesale trade sector will be lifted by the rise in global and regional trade flows. Likewise, the prospects for the domestic shipping industry remain positive.

According to shipping consultancy firm Drewry, global container growth is expected to come in at around 8% this year, above its historical trend. Asia will continue to be a key source of growth, accounting for more than half of global container growth in 2011. (Chart 3.18) While growth could be capped by a capacity overhang as a significant number of new vessels come on-stream this year, the continued outsourcing of production from the West to the East, coupled with rising consumption in the developing economies, should sustain overall shipping activity. Moreover, the growing trend of slow steaming, where ships operate at lower speeds to reduce fuel costs, will help to reduce vessel supply.

Mirroring the container market, the demand for air transport has risen. After the weather-related dip in December, air passenger volumes saw a strong rebound in January and have remained at high levels through Q1 2011. (Chart 3.19) In addition, air cargo volumes, which peaked in May last year as the business inventory restocking cycle ran its course, appear to have picked up again, supported this time by growth in final sales of capital and consumer goods.

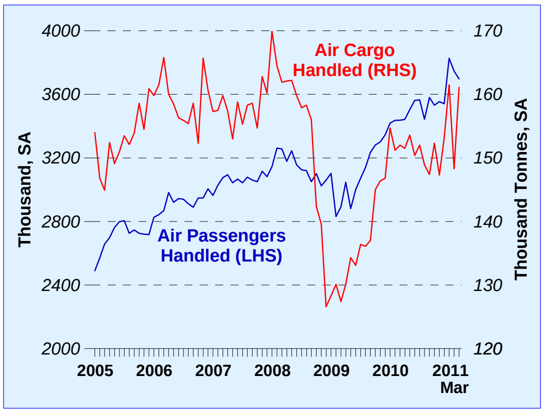
Overall, IATA expects air traffic volumes to grow approximately 5-6% this year, broadly in line with the rise in overall capacity. While there are risks to growth, including rising fuel costs and uncertainty in the external environment, the robust traffic within the region should provide support. Passenger traffic through Changi Airport to both Southeast and Northeast Asia increased by more than 18% last year and is set to grow further in 2011. The rapid expansion of low cost carriers will also play a significant role; these carried more than a fifth of Changi's global air passenger traffic last year.

Chart 3.18
Container Growth Forecast, by Region



Source: Drewry Container Forecaster, Q1 2011

Chart 3.19
Air Cargo and Passengers Handled

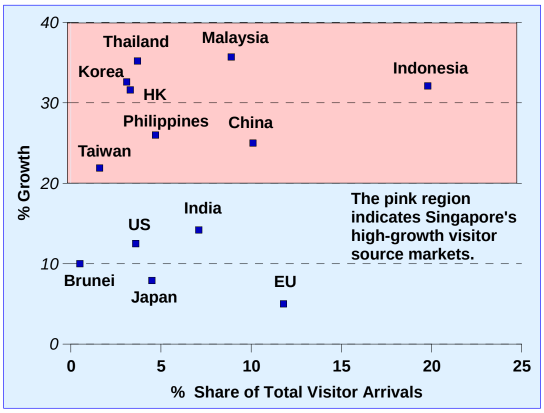


Source: Changi Airport Group and EPG, MAS estimates

Tourism-related industries are well-positioned to capitalise on increasing visitor flows.

Singapore's tourism-related industries are poised to benefit from another year of strong visitor inflows. According to the United Nations World Tourism Organisation (UNWTO), tourist arrivals in Asia will grow at nearly twice the global rate of 3-4%. This will be spurred by intra-Asia travel, led by tourists from China and India, who are beginning to travel more frequently. Singapore should benefit from this trend, given that the Asian market accounts for the bulk of its tourist arrivals. (Chart 3.20) Furthermore, improvements in

Chart 3.20
Visitor Arrivals to Singapore by Country of Origin in 2010



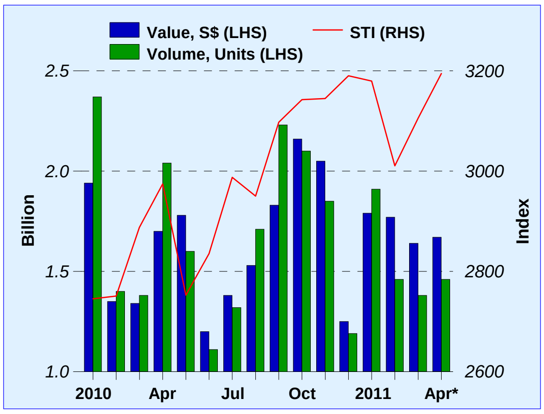
tourism-related infrastructure will be made this year. Besides an expansion in Changi Airport's passenger handling capacity and the recent opening of the ArtScience Museum, other attractions such as Gardens by the Bay and the International Cruise Terminal will be launched later in 2011. Major events such as the Asia Fashion Exchange and TravelRave will also enhance Singapore's international profile as a tourist destination.

Demand for financial services will remain generally firm despite volatility in sentiment-sensitive activities.

The domestic financial services sector should continue to be supported by robust domestic and regional demand. Notwithstanding the ongoing uncertainties in the external environment, the sentiment-sensitive cluster saw a slight improvement at the end of Q1. This was reflected in the modest inflows into Asia ex-Japan equity funds at the end of March, marking the end of nine consecutive weeks of outflows since late January. This renewed interest in regional equity investments has spilled over into the local stock market, with average daily turnover volumes coming in slightly higher at 1.5 billion units in April thus far, compared to the 1.4 billion units recorded in March. (Chart 3.21) Trading on the local bourse has also intensified recently, with funds raised from IPOs reaching $7.5 billion in Q1 compared to the $6.7 billion for 2010 as a whole.

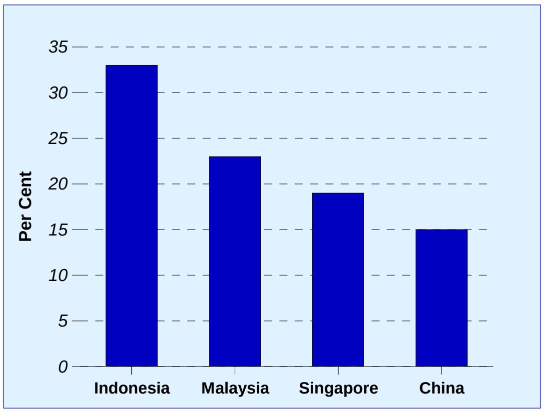
Alongside existing markets like China, the ASEAN region has also started to emerge as a source of growth opportunities for Singapore's financial services sector. The domestic fund management industry, for instance, will be underpinned by rapid wealth generation in both China and ASEAN. Notably, high net worth individuals (HNWIs) in ASEAN tend to hold a higher percentage of their wealth in cash, providing a significant pool of readily-investible assets. (Chart 3.22) Private banks in Singapore have intensified their efforts to capture revenues from this segment accordingly. On the corporate front, capital market activity in ASEAN is also projected to grow firmly in line with the rest of Asia. (Chart 3.23)

Chart 3.21
Stock Market Average Daily Turnover and Straits Times Index (STI)



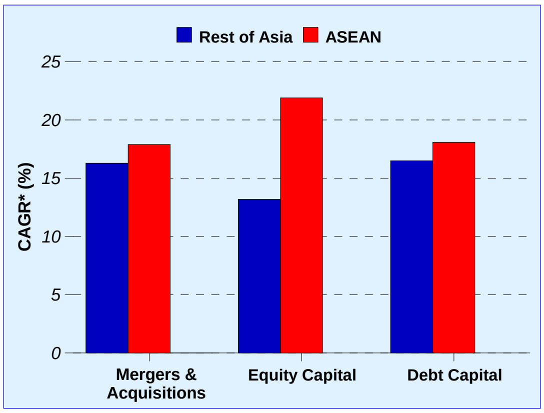
Source: SGX
* As at 21 April.

Chart 3.22
Share of Cash Holdings in High Net Worth Individuals' Financial Assets



Source: Merrill Lynch-Capgemini Asia-Pacific Wealth Report 2010

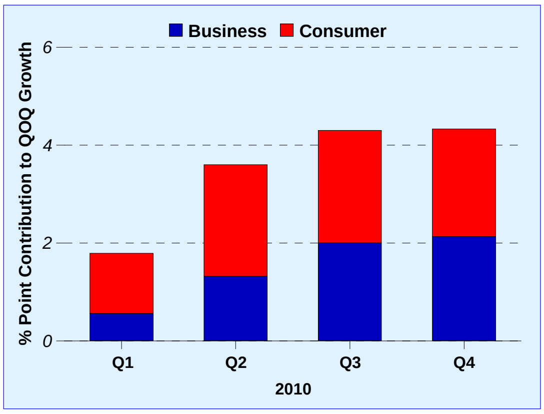
Chart 3.23
Growth of Capital Market Activity in Asia



Source: McKinsey Quarterly
*Based on projected growth rates (2009-14).

Financial intermediation should continue to anchor growth for financial services as a whole, with consumer lending remaining firm, supported by the drawdown of existing mortgage loans in the pipeline. Support will also come from the business lending segment, led by gains in the non-bank financial institutions and the trade-related sectors, alongside the pickup in domestic economic activity. (Chart 3.24)

Chart 3.24
Contribution to Domestic Non-bank Lending

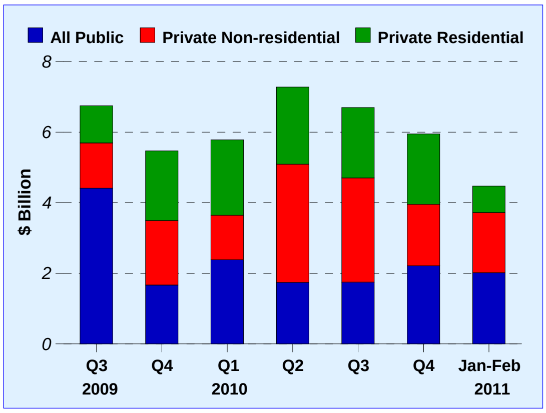


As for offshore loans, lending to the East Asian markets should continue to increase, boosted by demand for financing of infrastructure and expansion in business activities. Lending to the advanced economies is also likely to see steady growth as their outlook improves.

Construction output should see stable growth given the pipeline of projects.

Construction activity should grow slowly but steadily in the months ahead, underpinned by a pipeline of projects in both the non-residential and residential sectors. There was a rebound in contracts awarded last year, on the back of major projects such as the Singapore Sports Hub and the International Cruise Terminal. (Chart 3.25) Growth will also be supported by ongoing construction projects, such as the Seletar Aerospace Park and the Liquefied Natural Gas Terminal. Meanwhile, residential building activities should also increase, with high take-up rates for both HDB Build-to-Order launches and private property developments over the past year.

Chart 3.25
Contracts Awarded



However, in real terms, construction output could be dampened due to rising construction costs. Prices of essential building materials such as concrete and steel have been rising since last year. In addition, costs of raw materials like crude oil and copper remain elevated.

Domestic activity should be sustained at high levels this year.

Notwithstanding the heightened uncertainty in the global landscape arising from recent external shocks, growth prospects for the world economy remain fairly sanguine this year, anchored by steady improvements in final demand from the developed economies and continued resilience in the region. While the tragedy in Japan continues to unfold, the economic fallout from the crisis on the rest of the region is contained at this juncture, cushioned by adequate inventory and a switch to alternative suppliers. Moreover, the negative spillover effects from the crisis could be offset by a rebound later this year as rebuilding in Japan gets underway.

Overall, the Singapore economy is envisaged to grow at a moderate pace for the rest of 2011. While the domestic economy could hit a soft patch in Q2, activity is likely to be sustained at high levels for the rest of the year, supported by growth in the trade-related sectors as well as the financial and tourism industries.

3.3 Labour Market

Wage Pressures are on the Rise

Hiring sentiment is positive for the near term.

The pace of job creation will continue to be firm in 2011, although somewhat uneven across the key sectors. Services, which make up around two-thirds of the economy, will account for more than three quarters of total employment gains this year. Conversely, job creation in manufacturing and construction will be somewhat more subdued.

In a recent ManpowerGroup report, a third of the 622 employers surveyed expect to increase headcount while only 3% foresee a reduction. The net employment outlook of +30% is the most optimistic since Q3 2008. (Chart 3.26) As a result of the favourable employment outlook and tight underlying labour supply, wages are expected to rise further this year.

Chart 3.26
Net Employment Outlook

Source: ManpowerGroup

Services will continue to lead job creation.

Within services, the tourism-related and financial services sectors are anticipated to increase employment strongly. For example, with the Singapore Tourism Board (STB) forecasting a record number of visitor arrivals this year, more jobs will be created in this sector. Likewise, buoyant growth across a range of financial services, such as wealth management and corporate banking, will require more highly skilled workers. The strong performance of these two sectors will also have positive spillovers on job creation in other services such as business services and information & communications.

In manufacturing, hiring sentiment in the transport equipment industry has improved as order books have strengthened in the last six months. The electronics segment should also expand employment on the back of firm global IT demand, although the pace is likely to be more moderate compared to 2010. In petrochemicals, however, there could be some further job losses in view of the global supply overhang. Overall, manufacturing employment will increase modestly after declining sharply in 2009 and falling slightly in 2010.

Within the construction sector, hiring sentiment is likely to be subdued following the slowdown in private residential construction demand from the record volume in 2010 and the gradual moderation in on-site construction activity.

Beyond the short term, structural changes in the construction sector will have future implications for job creation. In addition to the significant revisions in the foreign worker levy for the construction sector and the introduction of the new skills framework[3], the MND and the Building and Construction Authority (BCA) have formulated a roadmap to steer the industry towards higher productivity. Regulatory changes, in particular, will be made in July this year to the Buildability Framework to encourage builders to adopt more labour-efficient construction methods, such as pre-fabrication. Financial incentives, such as the Mechanisation Credit scheme, will also be given to encourage the adoption of technology. These measures are meant to increase the usage of capital and raise productivity such that the reliance on low-skilled workers will decline over time.

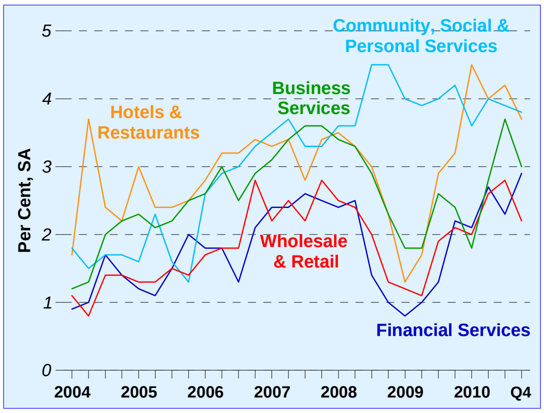
With limited upside to labour force growth, further job creation will place upward pressures on wages.

On the supply side, any further increase in the resident LFPR is likely to be modest, given that it is already at a historical high. At the same time, inflows of foreigners, particularly work permit holders, will generally be lower than in past periods of economic expansion as the government tightens its policies on immigration and low-skilled foreign workers. Indeed, the number of permanent residencies granted in 2010 was half that in 2009.

Wage pressures will be more broad-based.

In view of the tight labour market, wage pressures will build up further in 2011. The tightness in the labour market is reflected in the rising, or near record high, vacancy rates in several services sectors, which suggests that firms are finding it difficult to fill available positions. (Chart 3.27) In financial services, for example, competition for a limited pool of workers

Chart 3.27
Job Vacancy Rates in Services



Source: EPG, MAS estimates

[3] From July 2011, BCA will introduce a new skills framework which recognises and distinguishes the skills and experience of work permit holders for the construction sector. Workers will be classified as “higher-skilled” and “basic-skilled”, while unskilled construction work permit holders will be phased out.

has bid up wages. This is partly because more foreign banks are using Singapore as a base to serve the growing pool of HNWIs in Asia, which has increased the demand for various front-office roles, including relationship managers and private bankers, as well as middle-office and back-office professionals. In other services industries, such as hotels & restaurants and retail trade, automation and the transition to productivity-led growth will be more difficult and could take longer to materialise. This will imply a continued reliance on labour input, exacerbating the manpower shortage and putting further upward pressure on wages.

In manufacturing and construction, there is likely to be greater competition for resident and skilled workers as firms progressively substitute away from work permit holders. In the short term, this could drive up wages for resident workers even though employment growth in these sectors will be relatively muted this year.

For 2011, resident wage growth could come in slightly lower than the 5.6% in 2010, although significantly stronger than the historical average of about 3.3%.

Continuous productivity enhancements are necessary to counter higher labour costs.

Higher wage growth, coupled with the rise in the foreign worker levy and the employers' CPF contribution rate[4] later this year, will add to firms' labour costs. This will, however, be partially offset by the corporate income tax rebates and SME cash grants introduced in the recent budget. (See Box C on the impact of the budgetary measures on businesses.)

Nevertheless, companies will need to make structural improvements to productivity to mitigate the higher labour costs in the economy. As such, more companies could be encouraged to tap on the recent enhancements to the Productivity and Innovation Credit (PIC) scheme, which supports a broad range of productivity investments including the purchase of automation equipment, training of employees, and research and development.

[4] The employer CPF contribution rate will be raised by 0.5% point while the CPF salary ceiling will be revised up from $4,500 to $5,000 per month. Both changes will take effect in September 2011 to give employers sufficient time to prepare for the changes.

3.4 Inflation

Price Pressures will Ease Gradually

CPI inflation will moderate gradually over the course of the year.

After peaking at 5.2% in Q1 2011, CPI inflation will ease over the course of the year as the base effects associated with car prices and accommodation costs dissipate. However, with the rise in the cost of these items and global oil prices in recent months, CPI inflation is expected to moderate only gradually to around 3% in Q4 2011.

Car prices will stay elevated amidst the tight COE supply.

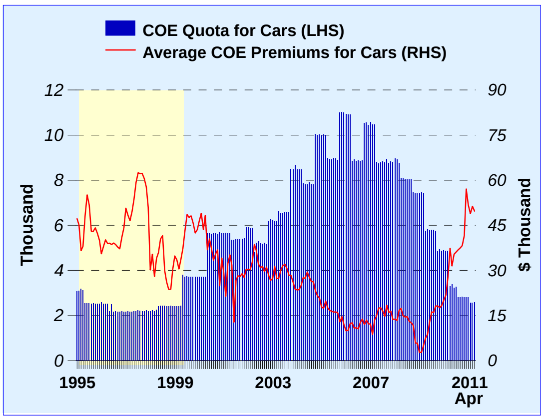
Following the surge in December 2010, COE premiums have corrected on the back of weak consumer demand for cars, as indicated by the progressively declining number of COE bids. (Chart 3.28) Nonetheless, current premiums are still about 30% above the average in Aug-Nov 2010.

The present low COE quota for cars is comparable to 1995-98. (Chart 3.29) At that time, COE premiums averaged around $47,000 before the onset of the Asian Financial Crisis, similar to now. Given that the economy continues to grow, COE premiums are expected to stay firm. In addition, there could be upside risks as car de-registrations have generally been on the decline, and another cut in the COE quota in August 2011 is thus likely.[5] (Chart 3.30)

However, even if COE premiums were to stabilise, car prices will still contribute considerably to CPI inflation in the first three quarters of this year. For the whole of 2011, the cost of private road transport, excluding petrol, will contribute more than 1% point to CPI inflation.

Chart 3.28
Number of Bids Received for Car COEs

Chart 3.29
Car COE Supply and Premiums



5 The COE quota for the period August 2011 to January 2012 will be partially determined by the number of vehicles de-registered between January and June 2011. For the first three months of 2011, the average number of car de-registrations is around 16% below the average for Jul-Dec 2010, which could be indicative of a further tightening in the COE quota if this persists.

Accommodation costs will also add significantly to CPI inflation due to a step-up in rentals.

Rentals for both private residential properties and HDB flats have continued to rise in recent months, although the rate of increase has slowed due to new supply coming on-stream. (Chart 3.31) This year, a higher-than-average number of private residential property units will be added, suggesting that residential property rentals could increase at a more moderate pace compared to that in H2 2010. (Chart 3.32) Accommodation costs will add more than 1% point to CPI inflation in 2011, compared to 0.2% point last year.

Services inflation will persist given buoyant economic growth.

Services inflation will be driven by firm consumer demand and further increases in business costs. As noted above, recent manpower surveys point to positive hiring sentiments. With the domestic economy close to full employment, the strong demand for workers will translate into higher wage growth. Coupled with the increase in the foreign worker levy and employers' CPF contribution rate later this year, the Unit Labour Cost index will rise further following a 5.5% increase since Q2 2010. Businesses will also face increases in other costs such as electricity tariffs, in tandem with the rise in oil prices.

Alongside strong economic growth, these cost increases will likely be passed on to consumers, with the pass-through possibly strengthening over time. This year, services inflation is projected to add about 0.5% point to CPI inflation, slightly more than in 2010.

Oil-related items will contribute more to inflation with the recent spike in oil prices.

Since the outbreak of political unrest in several oil-producing countries, WTI prices have climbed to a two-and-a-half year high of US$112 per barrel. However, a comparison with previous episodes of supply disruptions suggests that the impact of the Libyan civil war is likely to have been largely factored into current global oil prices. (Chart 3.33)

Chart 3.30
Number of Car De-registrations

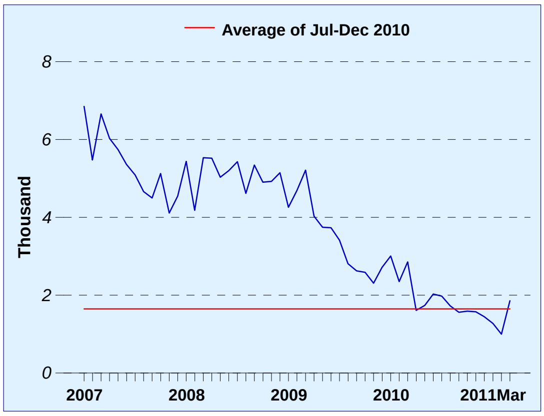
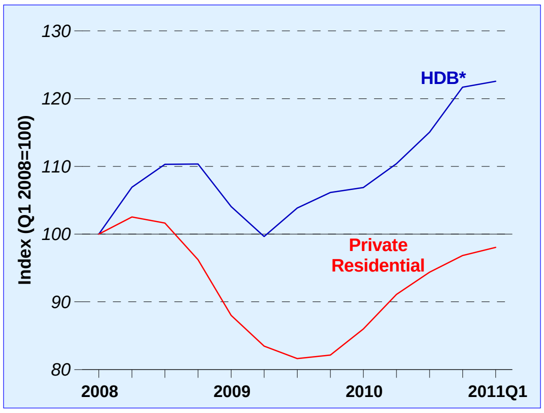
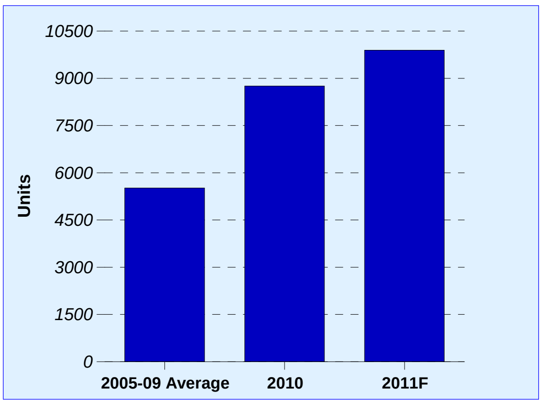


Chart 3.31
Private Residential and HDB Rental Index



* EPG, MAS estimates using HDB median subletting rentals by flat types.

Chart 3.32
Supply of New Private Residential Properties

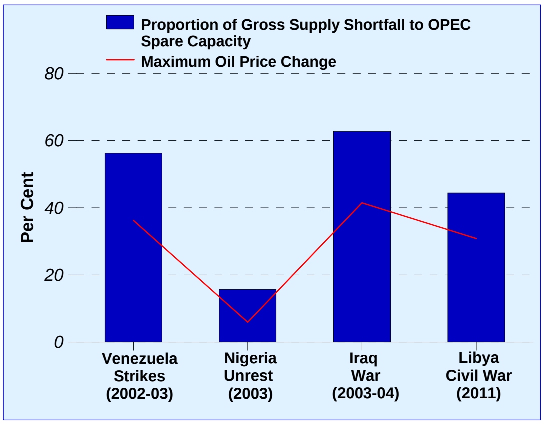


Hence, unless there is a further escalation in geopolitical tensions, subsequent price developments will be driven more by underlying demand factors.[6]

Global oil consumption growth in 2011 will be stronger than previously projected as the recovery in the developed economies gains traction and with Japan likely to raise fuel imports later in the year to make up for the loss of nuclear power generation.[7] However, there will be sufficient spare capacity to meet the increase in oil demand. Indeed, the Energy Information Administration (EIA) recently estimated that even after accounting for Libya's loss in production, OPEC's spare productive capacity remains above the average of the last ten years. (Chart 3.34)

In view of this, financial markets expect global oil prices to stay close to current levels for the rest of the year, but this will still be more than 20% higher than a year ago. For 2011, oil-related items will contribute around 0.5% point to CPI inflation.

Chart 3.33
Impact on Production and Prices of Oil Supply Disruptions



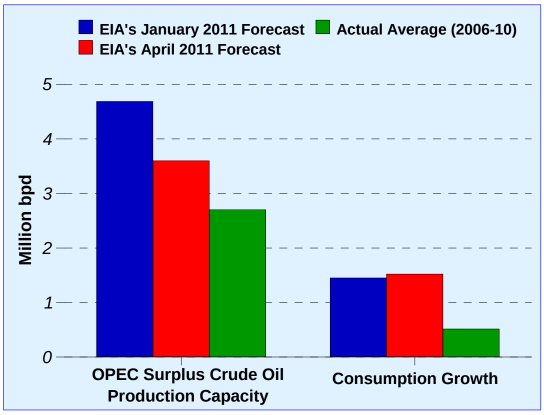
Source: EIA and EPG, MAS estimates

Note: Maximum oil price change refers to the percentage change between the peak during the crisis period and the average price right before the crisis.

Food prices are likely to rise more slowly.

After reaching a record high in February 2011, global food prices, as measured by the UN FAO Food Price Index, fell for the first time in eight months. (Chart 3.35) This came on the back of reduced uncertainty over production prospects in the major agricultural commodity exporting countries such as Argentina and Brazil, as the La Niña phenomenon weakened. At the same time, the US Department of Agriculture has projected record levels of corn production and higher soybean harvests compared to 2010. As fears of supply disruptions continue to ease amidst a pickup in demand, global food prices should increase only moderately.

Chart 3.34
OPEC Surplus Crude Oil Production Capacity and Global Oil Consumption Growth



Source: EIA

[6] Apart from the civil war in Libya, Saudi Arabia, the only oil producer with substantial spare capacity, continues to face the risk of a spillover of the social unrest in its neighbouring countries (Bahrain and Yemen), which would then further disrupt oil supplies. However, this risk has diminished considerably in recent weeks.

[7] Japan imported about 4.6 million barrels of oil per day in March 2011. The International Energy Agency has estimated that if Japan was to replace its affected nuclear capacity entirely with oil, it would have to import an additional 375,000 barrels per day, which is about 0.5% of global oil demand.

Against this backdrop, domestic food prices are expected to rise further as food vendors pass on the higher cost of food commodities to consumers. However, the increase will be milder than that in the first quarter of the year, when firms traditionally raise prices during the Chinese New Year period.

For the whole year, food price inflation is expected to come in at 2-3%, above the 10-year historical average of 2.0%, but much lower than the average of 5.3% in 2007-08.

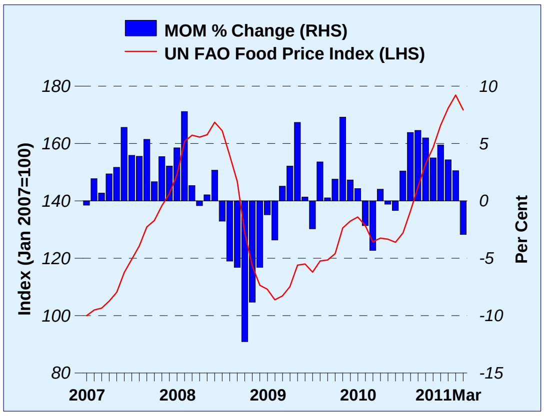
CPI inflation will come in at the upper half of the 3-4% forecast range.

In sum, CPI inflation has largely risen because of domestic factors, as the overall level of economic activity has remained high and resource markets have tightened. CPI inflation will stay elevated even as sequential price increases moderate over the next few quarters to near the historical average, due mainly to a slower rise in car prices and accommodation costs. (Chart 3.36)

CPI inflation is expected to have peaked at 5.2% in Q1 2011 and should moderate gradually to around 3% in Q4. (Chart 3.37) For the whole year, CPI inflation is likely to come in at the upper half of the 3-4% forecast range. The cost of cars, accommodation and commodity-related items will together account for close to 90% of CPI inflation, with roughly equal contributions from each.

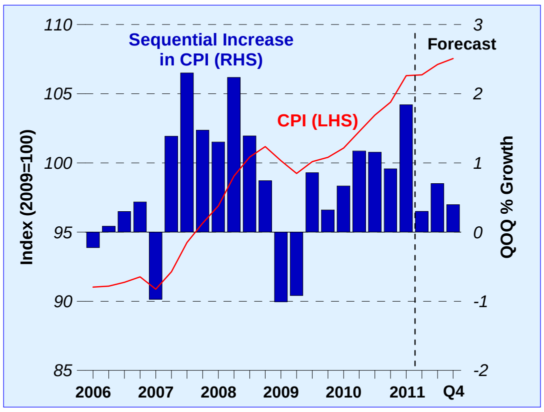
MAS Core Inflation, which excludes the costs of accommodation and private road transport, will remain broadly stable and average 2-3% in 2011. The relative stability reflects the offsetting effect of easing food price inflation on stronger price increases in oil-related items.

Chart 3.35
UN FAO Food Price Index



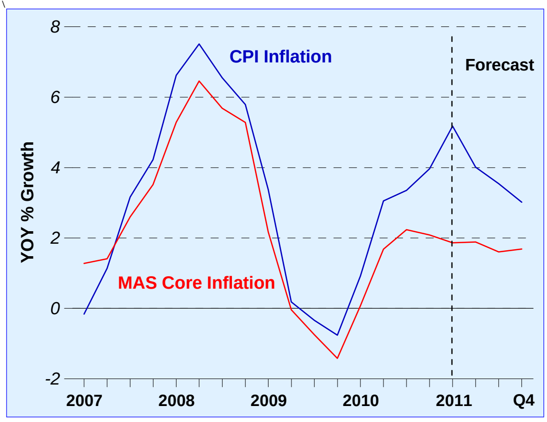
Source: FAO

Chart 3.36
Forecasts of Sequential CPI Increases



Source: EPG, MAS estimates

Chart 3.37
CPI Inflation and MAS Core Inflation Forecasts



Source: EPG, MAS estimates

3.5 Assessing the Macroeconomic Policy Mix

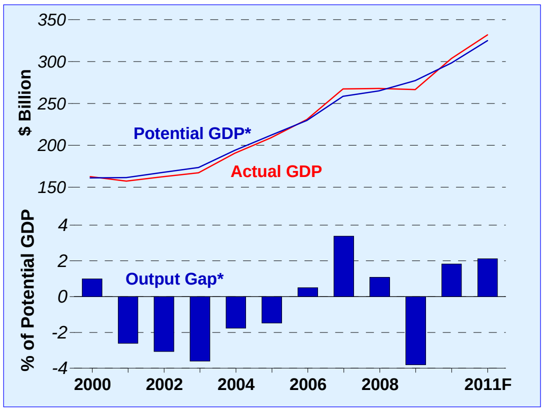
Monetary Policy

The monetary policy stance was tightened further in April 2011, in view of firm domestic cost and price pressures.

Following the slowdown in H2 2010, economic activity in Singapore picked up in Q1 this year, with GDP expanding by 23.5% on a q-o-q SAAR basis. Growth was broad-based across the trade-related and services industries, and was underpinned by strengthening global final demand. While GDP growth is expected to moderate from the strong pace set in Q1, economic activity will remain at a high level for the rest of the year, given the continued recovery in the US and firm growth in Asia ex-Japan.

Singapore's GDP growth in 2011 is thus expected to be near the upper end of the government's forecast range of 4-6%, exceeding the economy's potential growth rate for a second year in a row. (Chart 3.38) With the widening of the positive output gap, there will be a concomitant increase in resource utilisation and a further tightening of the labour market. This could lead to stronger wage growth, a greater degree of pass-through to services costs, and eventually higher CPI inflation. Additionally, imported inflationary pressures are likely to pick up in tandem with the rise in global commodity prices, especially that of oil.

Chart 3.38
Real GDP and Output Gap



* EPG, MAS estimates.

Accordingly, MAS announced on 14 April 2011 that it would re-centre the S$NEER policy band upwards. The policy band would be re-centred below the prevailing level of the S$NEER, with no change to its slope or width. This calibrated adjustment took into account MAS' previous pre-emptive tightening in April and October 2010. The macroeconomic restraint implied by these earlier moves will continue to filter through the economy for the rest of this year. In addition, there have been policy-induced increases in the relative cost of labour inputs and the prices of goods such as cars.

These cost and price adjustments are necessary to ensure a more efficient allocation of resources in the economy, but do impact headline CPI inflation in the short term. Thus, tighter monetary policy will anchor inflation expectations and help to prevent “second-round effects”, although the pass-through of these cost increases will not be fully offset.

The April decision kept the policy band width unchanged, bearing in mind the volatility of international financial markets, amidst the geopolitical unrest in the MENA region and the lingering macroeconomic and financial effects of the earthquake in Japan.

In MAS’ assessment, the policy stance adopted in April 2011 is calibrated to ensure price stability in an economy at an advanced phase of expansion and to keep growth on a sustainable path.

Fiscal Policy

The FY2011 Budget was presented against a strong economic backdrop.

The FY2011 Budget was delivered on 18 February following record GDP growth of 14.5% in 2010. The Budget's focus was to share the fruits of strong growth with Singaporeans, address concerns over rising inflation and build on the longer-term measures introduced in the past. Compared to the FY2010 Budget, which was introduced at the beginning of the domestic recovery, the sustained increase in economic activity since then has provided the Government with greater flexibility to push forward with targeted supply-side measures that will lay the foundations for more sustainable and equitable growth over the longer term. These include initiatives to raise real income, support the economically vulnerable and reduce income inequality.

Specific budget measures can be categorised according to their underlying policy objectives.

In a recent article in the *American Economic Review*, Romer and Romer (2010)[8] distinguished between two types of legislated tax changes: "endogenous", taken to offset short-term shocks to real GDP and return growth to normal; and "exogenous", taken to raise long-run growth. The latter includes measures aimed at dealing with an inherited budget deficit arising from past economic and budgetary decisions, or achieving some long-run goal, such as higher normal growth and increased fairness.

We classified key measures of the FY2011 Budget using the Romer and Romer (2010) framework, with two notable adjustments. First, we broadened the framework from specifically tax (revenue) changes to encompass more general fiscal tools including changes in government expenditure.

Second, in addition to offsetting shocks to *growth*, we broadened the definition of endogenous measures to include changes in fiscal policy used to offset shocks to *inflation*, which we will examine further below. Table 3.2 shows that the bulk of the FY2011 Budget measures can be classified as exogenous, as they are geared towards longer-term policy objectives.

Endogenous measures provide some relief to the rise in inflation.

The endogenous measures in the FY2011 Budget were centred on alleviating the current impact of high inflation on the cost of living and preserving the purchasing power of households and businesses, rather than raising the level of output. With the economy at an advanced stage of economic expansion and inflation pressures coming to the fore, the key components of the "Resilience Package" introduced during the 2009 Recession have been fully phased out. Instead, many of the transfers were aimed at helping Singaporeans, especially those from lower-income households, to deal with higher costs of living. These include top-ups to the ongoing Utilities-Save and S&CC rebates. On the whole, the Budget was estimated to lower CPI inflation by up to 0.3% point. (See Box C for more details on the macroeconomic effects of key budgetary measures.)

The FY2011 Budget also went a step further to help firms cope with rising business costs via a one-off corporate income tax rebate and SME cash grant. These measures provided temporary income support to help offset some of the higher costs faced by firms. These include higher medium-term labour costs, as targeted schemes facilitating the shift towards greater productivity growth and capital-intensive production are implemented.

8 Romer, C and Romer, D (2010), "The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks," *American Economic Review*, 100(3), pp. 763–801.

Exogenous measures lay the foundation for more sustainable and equitable growth over the longer term.

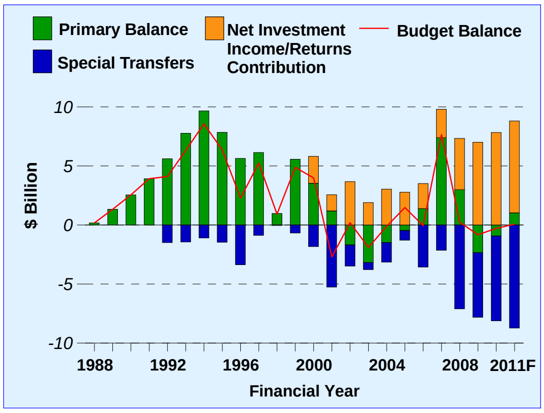
As the economy had transited to a more mature phase of expansion, the focus of the Budget was on structural and longer-term issues. Thus, the FY2011 Budget focused on *exogenous* measures to raise real income and make growth more inclusive, as encapsulated in the twin objectives of "Growing Incomes, Strengthening our Society". On the latter, measures were unveiled to alleviate rising income inequality. A large portion of the $3.2 billion "Grow & Share" Package was targeted at supporting the economically vulnerable groups, such as the lower-income and elderly via the one-off Workfare Special Bonus and enhanced childcare and education bursaries.

Over the longer term, the fundamental factor that preserves real income is sustained growth in an economy that creates high value-added jobs. To this end, the increase in foreign worker levies would encourage firms to invest in and upgrade the skills of their local workforce, while the enhancements to the productivity measures announced in the FY2011 Budget – such as the $1 billion top-up to the National Productivity Fund and higher payouts of Productivity and Innovation Credit (PIC)[9] – would support the economy's innovative capacity in the long run.

An overall balanced budget is estimated for FY2011.

The government is expected to run a largely balanced budget in FY2011, with a small overall budget surplus of $0.1 billion (0.02% of GDP), compared to the deficit of $0.3 billion (0.1% of GDP) in the previous year. (Table 3.3 and Chart 3.39) The basic balance, which is revenue less expenditure including special transfers, but without taking into account the contribution from net investment returns and top-ups to endowment and trust funds, is estimated to be a deficit of $2.2 billion (0.7% of GDP), slightly less than the $2.5 billion (0.8% of GDP) deficit incurred in FY2010. The size of special transfers is projected to increase slightly to $8.7 billion (2.6% of GDP), from $7.2 billion (2.3% of GDP) last year. This includes $2.6 billion in benefits to households as part of the "Grow & Share" Package,

Chart 3.39
Components of the Budget



[9] The PIC scheme provides firms with tax deductions for investment across a broad range of activities along the innovation value chain. In response to feedback from the industry after the FY2011 Budget announcement, the government allowed a one-year tax deferral under the PIC scheme to ease the cash flow of businesses.

as well as the continuation of top-ups to endowment and trust funds, such as the Community Care Endowment Fund and National Productivity Fund, to meet longer-term social investment needs and to build up economic capabilities.

Table 3.2
Key Initiatives of the FY2011 Budget

Endogenous Measures
(a) Changes in fiscal policy to offset factors that affect short-term output
Nil
(b) Changes in fiscal policy to offset factors that affect prices
"Grow & Share" Package • Additional U-Save and S&CC Rebates ($194 mn) • Corporate Income Tax Rebate and SME Cash Grant ($560 mn)
Exogenous Measures
(a) Changes in fiscal policy to deal with inherited budget deficits/surpluses
Nil
(b) Achieving long-run goals of "Growing Incomes, Strengthening our Society"
Growing Incomes *Boosting Skills and Productivity* • Top-up to the National Productivity Fund ($1 bn) • Top-up to the National Research Fund ($1 bn) • Enhancements to the Productivity and Innovation Credit (PIC) ($520 mn per year) • Additional increases in Foreign Worker Levy • Enhanced Enterprise Development Fund ($850 mn over 5 years) • Lifelong Learning Endowment Fund ($500 mn) ***Strengthening our Society*** *"Grow & Share" Package* • Growth Dividends to all Singaporeans ($1.5 bn) • Personal Income Tax Rebate of 20%, capped at $2,000 ($580m for YA2011) • Top-up to CPF Medisave Accounts of Singaporeans aged 45 and above ($504 mn) • Workfare Special Bonus ($224 mn in FY2011, $226 mn over next two years) • Child Development Credit for Singaporean children aged six and below ($93 mn) *Fund Top-ups* • Community Silver Trust ($1 bn for one-for-one matching of donations to Voluntary Welfare Organisations) • Top-up to ElderCare Fund ($700 mn) • Top-up to Medifund ($500 mn) • Top-up to ComCare Fund ($500 mn) *Other Longer-term Benefits* • Training support for PMETs, including subsidies for those pursuing their first degree or diploma on a part-time basis, and for increasing the capacity and quality of Continuing Education & Training • Reduction of Personal Income Taxes: Marginal tax rates will be reduced for the first $120,000 of chargeable income ($590 mn per year) • Removal of Radio and TV Licence Fees ($120 mn per year) • Raising Employer CPF Contribution Rate by 0.5% point, bringing the total CPF contribution rate to 36% and Revision in CPF Salary Ceiling from $4,500 to $5,000 per month • Kindergarten Financial Assistance Scheme (KiFAS) and Centre-based Financial Assistance Scheme for Childcare (CFAC)

Table 3.3
Budget Summary

	FY2010 Revised		FY2011 Budgeted	
	$ Billion	% of GDP	$ Billion	% of GDP
Operating Revenue	45.5	14.4	48.1	14.2
Total Expenditure	46.4	14.7	47.1	13.9
Operating Expenditure	34.1	10.8	35.9	10.6
Development Expenditure	12.3	3.9	11.2	3.3
Primary Surplus/Deficit (-)	**-0.9**	**-0.3**	**1.0**	**0.3**
Less: Special Transfers (excluding top-ups to endowment/trust funds)	1.6	0.5	3.2	1.0
Basic Surplus/Deficit (-)	**-2.5**	**-0.8**	**-2.2**	**-0.7**
Add: Net Investment Income/Returns Contribution	7.8	2.5	7.8	2.3
Less: Special Transfers (top-ups to endowment/trust funds)	5.6	1.8	5.5	1.6
Budget Surplus/Deficit (-)	**-0.3**	**-0.1**	**0.1**	**0.0**

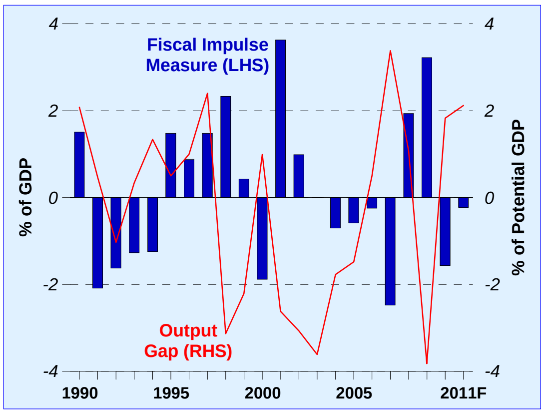
Note: Figures may not tally due to rounding-off effects.

The fiscal policy stance will be close to neutral in 2011.

For CY2011, the Fiscal Impulse (FI) measure is estimated at -0.2% of GDP. (Chart 3.40) This indicates a slightly contractionary fiscal policy stance, suggesting that the FY2011 Budget is a measured one, tailored to the opportunities and challenges at this stage of the business cycle, without being indiscriminate in spending.

By gauging the direction of change in the budgetary stance relative to the previous year, the FI measure provides an indication of the short-term aggregate demand stimulus arising from fiscal policy. It does not, however, fully quantify the impact of the budget on the economy. Doing so would require a full-scale macroeconomic model, such as the Monetary Model of Singapore (MMS), that can capture the more subtle multiplier effects of detailed expenditure and revenue items. Box C presents the simulations of the near-term impact of some key budgetary measures on GDP growth and CPI inflation. This confirms the generally neutral impact of the Budget on the macro economy, although there are important microeconomic price and income effects.

Chart 3.40
Fiscal Impulse Measure and the Output Gap



Source: EPG, MAS estimates

Box C
Assessing the Macroeconomic Effects of the FY2011 Budget

The FY2011 Budget delivered a broad spectrum of initiatives, ranging from one-off benefits contained in the "Grow & Share" Package (e.g. growth dividends and personal income tax rebates) to longer-term investments supporting the elderly and families with children, as well as measures to boost skills and productivity. This box presents the near-term macroeconomic effects of some key budgetary measures, simulated using the Monetary Model of Singapore (MMS). Table C1 lists the measures which are included in the simulations, together with their estimated impact on GDP growth and CPI inflation.

Table C1
Budget Measures Simulated and their Macroeconomic Impact in 2011

<table>
<tr><th rowspan="2">Measures</th><th rowspan="2">Amount in FY 2011 ($ Million)</th><th>GDP Growth</th><th>CPI Inflation</th></tr>
<tr><th colspan="2">% point deviation from baseline</th></tr>
<tr><td colspan="4">Affecting Households</td></tr>
<tr><td>Growth Dividends</td><td>1,549</td><td rowspan="5">0.3</td><td rowspan="3">0.1</td></tr>
<tr><td>Personal Income Tax Rebate</td><td>580</td></tr>
<tr><td>Workfare Special Bonus</td><td>224</td></tr>
<tr><td>Additional U-Save and S&CC Rebates</td><td>194</td><td rowspan="2">-0.4</td></tr>
<tr><td>Removal of Radio and TV Licence Fees</td><td>120</td></tr>
<tr><td>Sub-Total</td><td>2,667</td><td>0.3</td><td>-0.3</td></tr>
<tr><td colspan="4">Affecting Firms</td></tr>
<tr><td>Employer CPF contribution Rate at 16% and CPF Wage Ceiling of $5,000</td><td>460*</td><td colspan="2" rowspan="2">Neutral</td></tr>
<tr><td>Corporate Income Tax Rebate and SME Cash Grant</td><td>560</td></tr>
<tr><td>Total</td><td>3,687</td><td>0.3</td><td>-0.3</td></tr>
</table>

* EPG, MAS estimates.

The measures that affect households, such as cash transfers and rebates, raise GDP growth by about 0.3% point in 2011, primarily through increased private consumption. This additional spending by households, in turn, results in a marginal increase in the CPI inflation rate of 0.1% point. However, this is more than offset by other measures, such as the additional U-Save and S&CC rebates and removal of the radio and TV licence fees. Altogether, these other measures reduce the CPI inflation rate by about 0.4% point. On balance, therefore, the CPI inflation rate will be lower by approximately 0.3% point compared to the baseline.

For firms, restoring the employer CPF contribution rate to 16% this year and simultaneously raising the wage ceiling to $5,000, increases labour costs by an estimated $460 million. Also, firms may incur an additional $400 million this year in foreign worker levies, on account of the levy hikes announced in the FY2010 and FY2011 Budgets.[1/]

The corporate income tax rebate and SME cash grant in the current budget provide a helpful, albeit temporary, relief to the higher labour costs arising from CPF changes and steeper foreign worker levies as well as other cost pressures that have emerged in the economy. Moreover, given that the rebate and grant are capped at a modest level for each qualifying company, they are unlikely to stimulate significant additional capital investment in 2011, and therefore, will likely have a negligible impact on GDP growth and CPI inflation. More importantly, since both the current and the previous budgets contain financial incentives for firms to encourage capital-deepening, these should also help to mitigate cost pressures over the medium term.

1/ This was not included in the simulations as most of the increase was due to levy hikes announced in FY2010 Budget.