4 Macroeconomic Policy

An Appropriate Policy Mix For Medium-term Price Stability And Sustainable Growth

In an unscheduled policy move in January 2015, MAS reduced the slope of the S$NEER policy band but kept it on a modest and gradual appreciation path. Global oil prices fell sharply late last year and are, in 2015, likely to average well below the US$93 recorded in 2014. Meanwhile, wage growth and cost pass-through have also been moderate. As such, the balance of risks had tilted towards lower inflation. Nevertheless, underlying cost and price pressures could pick up beyond the short term, given the continued tightness in the labour market.

MAS subsequently maintained the policy stance in April, as economic growth and inflation had evolved as envisaged in the January Monetary Policy Statement (MPS), with no material change to the outlook. This policy stance is consistent with the benign inflation outlook for the whole of 2015 and with the level of economic activity at close to its medium-term potential.

On the fiscal front, Budget 2015 continued to further the aim of economic restructuring and facilitating Singapore's next phase of development. Accordingly, it placed significant emphasis on long-term investment to develop human capital and infrastructure, and encouraged businesses to innovate and internationalise. In addition, the budget reinforced Singapore's social security framework with the Silver Support Scheme and higher returns on CPF balances, complementing the Pioneer Generation Package (PGP) introduced in 2014.

Overall, the continuation of the modest and gradual appreciation path for the exchange rate policy band, together with an expansionary fiscal policy stance, is assessed to be appropriate given the prevailing growth and inflation dynamics in the economy.

4.1 Monetary Policy

Appreciation Path Of Exchange Rate Policy Band Eased

Global oil prices have fallen sharply since the October 2014 MPS. Along with a weaker-than-expected pass-through of accumulated business costs and a reduction in healthcare costs, the balance of risks tilted towards lower inflation for the first time since MAS embarked on its monetary policy tightening cycle in April 2010. In light of the significant shift in inflation dynamics, MAS reduced the slope of the S$NEER policy band in an unscheduled policy move in January 2015, but kept the band on a modest and gradual appreciation path. This policy stance was maintained in April 2015, given the broadly unchanged outlook for the economy and the risk that underlying cost pressures could mount.

The slope of the S$NEER policy band was reduced in an unscheduled policy move in January 2015.

Following the October 2014 monetary policy review, global and domestic growth evolved largely as anticipated. The world economy expanded steadily, led by the US where growth was underpinned by an improving labour market. Meanwhile, the Eurozone and Japanese economies remained weak at that time and GDP growth in China slowed as domestic demand moderated. Although activity in Singapore's external-oriented sectors received some impetus from the overall strengthening in global demand, the extent of uplift was capped by the unevenness of growth across the major economies and domestic supply-side constraints. At the same time, the domestic-oriented sectors were resilient. Thus, after a weak first half in 2014, the Singapore economy gained momentum in the second half. For the year as a whole, it grew by 2.9%, and was expected to continue expanding at a moderate pace in 2015.

In comparison, inflation dynamics shifted significantly after the October 2014 MPS. Notably, weaker demand for oil coupled with rising supply caused global oil prices to plummet. Imported inflation declined by 8.7% y-o-y in Q4 2014, the steepest correction since Q3 2009, and fed into lower consumer prices. At the same time, the pass-through of accumulated business costs was weaker than expected despite the tight labour market, while government subsidies, such as those under the PGP, led to a reduction in healthcare costs. MAS Core Inflation thus eased to 1.6% y-o-y in Q4 2014 from 2.1% in Jan–Sep. Reflecting these factors, as well as lower car prices and imputed rentals on owner-occupied accommodation, CPI-All Items inflation fell to 0% y-o-y in Q4 2014, from 1.4% in the first nine months of the year.

Although global oil prices are expected to pick up, for the whole of this year they would still average well below the US$93 recorded in 2014.[1] At the same time, poor sentiment could continue to constrain the extent of business cost pass-through. Accordingly, MAS lowered the forecast for MAS Core Inflation for 2015 from 2–3% to 0.5–1.5%, and that for CPI-All Items inflation from 0.5–1.5% to −0.5–0.5%.

The revised forecasts implied a significant and sustained downshift in the outlook for inflation. Although the labour market remained tight amid an expanding economy, the balance of risks had, for the first time since the beginning of the monetary policy tightening cycle in April 2010, tilted towards lower inflation. Accordingly, MAS reduced the slope of the S$NEER policy band but kept it on a modest and gradual appreciation path. There was no change to the width or the level at which the band was centred.

This adjustment to the policy stance, together with the revised inflation forecasts, was announced in an unscheduled MPS on 28 January 2015.

[1] Based on the West Texas Intermediate benchmark.

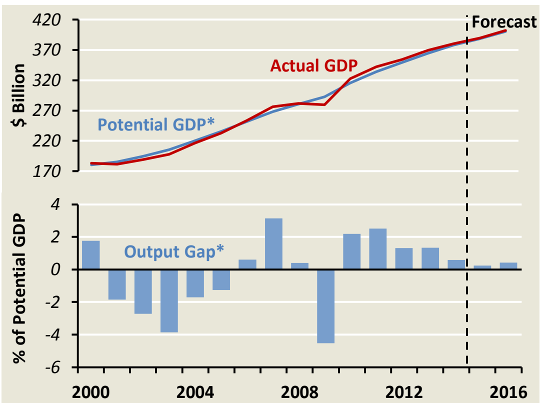
The policy stance was maintained in April 2015.

In Q1 2015, the Singapore economy expanded at a slower pace of 1.1% q-o-q SAAR, from 4.9% in the quarter before. This was largely due to the pullback in activity in the financial services sector, following the exceptionally strong performance in Q4 2014. The manufacturing sector also remained lacklustre, with the transport engineering cluster—specifically, the marine & offshore segment—weighed down by low oil prices and the electronics cluster affected by the realignment of operations in some firms. Overall GDP growth was supported by the construction sector, which expanded robustly on the back of a surge in the residential segment.

Global growth prospects remain disparate across the major regions but have improved slightly on aggregate, led by the G3 economies. The Eurozone and Japan are seeing an incipient turnaround. The launch of the ECB's quantitative easing programme increased bank lending and resulted in a weaker euro that has, in turn, boosted exports; meanwhile the Japanese economy is recovering from the drag exerted by the earlier consumption tax hike. Despite some recent slowdown, the US economy will be underpinned by the continued strengthening of the labour market. In comparison, growth in China has decelerated, and this has weighed on regional economies through commodity and trade-related channels. Nevertheless, growth in the other Asia ex-Japan economies should be bolstered by the synchronised upturn in the G3 and resilient private consumption.

The sustained, albeit uneven, recovery in the global economy should provide some support to the external-oriented sectors in Singapore. Within manufacturing, electronics output should benefit from the expansion in the global IT market, although the gains would be limited by ongoing structural shifts in the domestic electronics industry towards higher-margin, lower-volume activities. Meanwhile, there could be some recovery in the oil-related manufacturing segments in the latter part of this year, with the anticipated rise in global oil prices. In the domestic-oriented sectors, demand for key services such as healthcare and education, is expected to remain resilient, while construction activity would be boosted by a pipeline of large-scale transport infrastructure projects. On balance, Singapore's GDP is projected to grow by 2–4% in 2015, unchanged from the January MPS, with output close to its potential. (Chart 4.1)

Chart 4.1
Real GDP and the Output Gap



Note: EPG's estimate of Singapore's output gap is derived from a weighted average of three methods—a structural vector autoregression (SVAR) approach using the Blanchard-Quah decomposition, the Friedman variable span smoother and a simple univariate Hodrick-Prescott filter.

* EPG, MAS estimates.

On the inflation front, the forecasts for both MAS Core Inflation and CPI-All Items inflation remain as announced in January. Inflation outturns in recent months continue to be benign and largely within expectations.

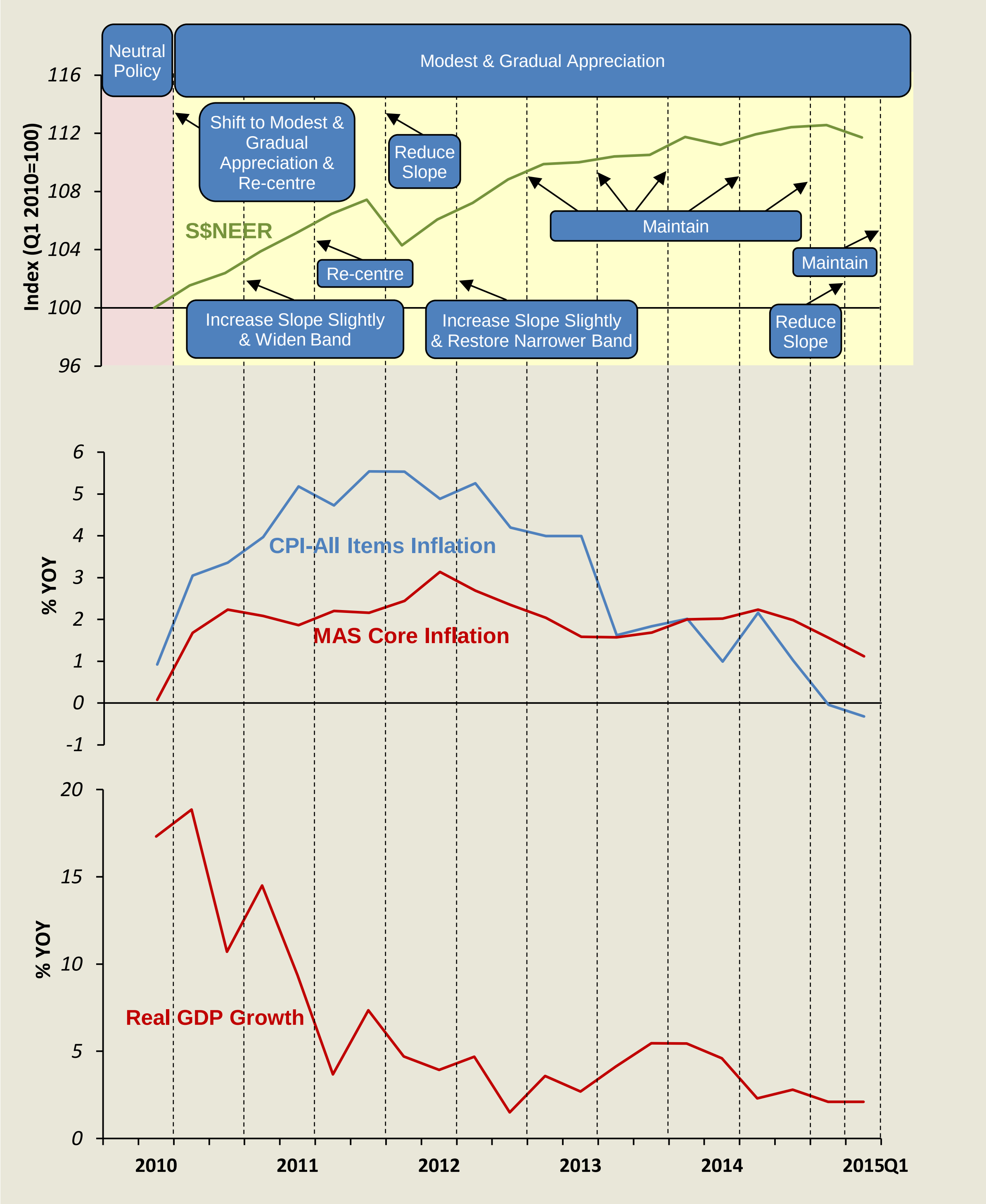
Inflation is expected to ease further before rising towards the end of 2015 and into 2016. External price pressures should be contained due to favourable supply conditions in key commodity markets, but could pick up slightly as global oil prices rise in the latter part of this year. At the same time, the disinflationary effects of the government's budgetary measures will abate from Q4 2015. While the pass-through of accumulated business costs will be moderate in 2015, this could reverse if the labour market remains tight and economic sentiment improves beyond the near term.

Compared to January, the downside risk to inflation in the short term is significantly reduced, and core inflationary pressures could pick up next year. Thus, the prevailing policy stance continues to be appropriate in ensuring domestic price stability over the medium term. Indeed, EPG's model simulations show that a further loosening of monetary policy, for example, by flattening the slope of the policy band, would compromise price stability in the outer years, with little material support for short-term growth.

MAS therefore announced on 14 April 2015 that it would maintain the modest and gradual appreciation of the S$NEER policy band, with no change to the slope, width, and level at which it is centred. This policy stance is consistent with the benign inflation outlook and moderate growth prospects for the whole of 2015, and is appropriate for ensuring medium-term price stability in the economy.

Chart 4.2 traces the evolution of monetary policy in relation to growth and inflation developments in the Singapore economy.

Chart 4.2
Key Macroeconomic Variables and Changes in the Monetary Policy Stance



Exchange rate movements have been volatile since October 2014.

Although the S$NEER has broadly appreciated since 2012, it did not change by much from point-to-point between the October 2014 and April 2015 MPS. The sharp movements in the S$ bilateral exchange rates of Singapore's major trading partners over the past six months had eventually caused the S$NEER to revert to near its starting point in October last year. (Chart 4.3)

During this period, the S$ rose by 12% against the euro following the expansion of the ECB's asset purchase programme, the removal of the Swiss franc-euro floor and concerns over a Greek default. The S$ also appreciated by 3.9% against the Japanese yen, with the expansion of the BOJ's Quantitative and Qualitative Monetary Easing programme. In addition, the S$ strengthened by 5.1% against the Malaysian ringgit. (Chart 4.4)

Nevertheless, the S$NEER has also been impacted by the broad-based strength of the US$, with firm economic data increasing the likelihood that the Federal Reserve will begin raising interest rates in the near future. Between October 2014 and the week of 20 March 2015, the S$ depreciated by 8.4% against the US$.

More recently, the US$ has weakened, as key economic data softened and Federal Reserve officials appeared to suggest that the Federal funds rate would be raised more gradually. Since the week of 20 March 2015, the S$ has gained 1.9% against the US$.

Overall, the S$NEER has fluctuated within the lower half of the policy band since the October 2014 MPS. It weakened following the January 2015 policy announcement, but rebounded in late March.

The CPI-deflated S$REER has depreciated from its peak in Q1 2013.

The S$ real effective exchange rate (S$REER) is a measure of the prices of goods and services in Singapore relative to its trading partners, expressed in terms of a common exchange rate index, the S$NEER. Using the CPI as a deflator, the S$REER depreciated by 1.2% between Q1 2013 and Q4 2014. (Chart 4.5)

Chart 4.3
S$NEER

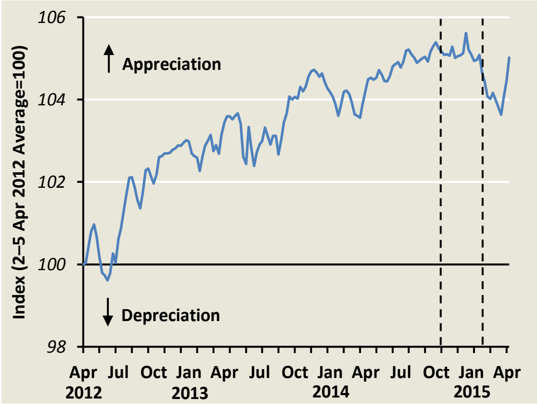


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Chart 4.4
Singapore's Bilateral Exchange Rates

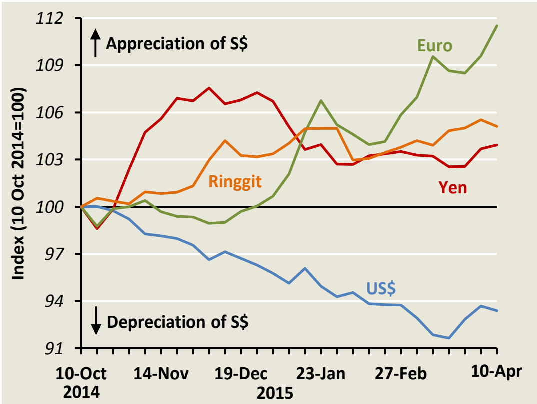
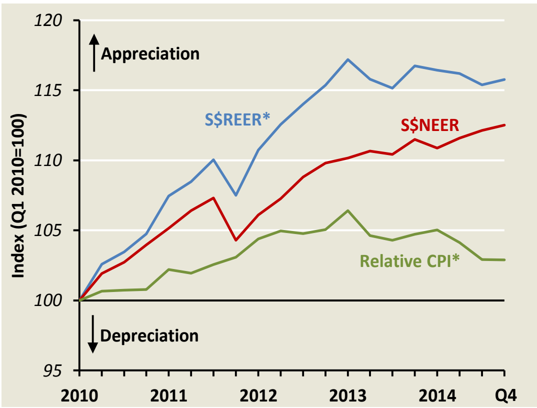


Chart 4.5
Components of the S$REER Deflated by CPI



* EPG, MAS estimates.

Although the S$NEER strengthened in line with the modest and gradual appreciation stance of monetary policy, relative prices fell to a greater extent, with domestic CPI-All Items inflation rising more slowly than inflation in Singapore's major trading partners. The fall in relative prices was largely due to the moderation in the cost of private road transport and imputed rentals on owner-occupied accommodation, as supply conditions in the housing and COE markets improved.

The depreciation of the S$REER was due to the fall in the price of tradable goods in Singapore.

The S$REER can alternatively be decomposed into external and internal components. The external S$REER is derived by deflating the S$NEER by the domestic price of tradable goods relative to the foreign price, in terms of a common reference currency. The internal S$REER refers to the price of non-tradables relative to tradables in the domestic market compared to abroad.

Although the external S$REER was fairly stable between Q1 2013 and Q1 2014, it depreciated by 6.1% over the next three quarters. (Chart 4.6) This resulted from the fall in the prices of tradables (proxied by the Wholesale Price Index[2]) in Singapore over the course of the year, particularly, of mineral fuels and electronics. Notwithstanding the global nature of the oil shock, the prices of tradables abroad generally rose, given the different composition of output in Singapore's trading partners. (Chart 4.7) The fall in the relative price of tradables outweighed the modest appreciation of the S$NEER, resulting in the depreciation of the external S$REER.

The internal S$REER was also stable up till Q1 2014, but strengthened by 5.9% thereafter. Although the price of non-tradables fell in Singapore, the decline in the domestic prices of tradables was greater. On balance, the relative price of non-tradables to tradables in Singapore rose compared with that abroad.

Chart 4.6
External and Internal S$REER

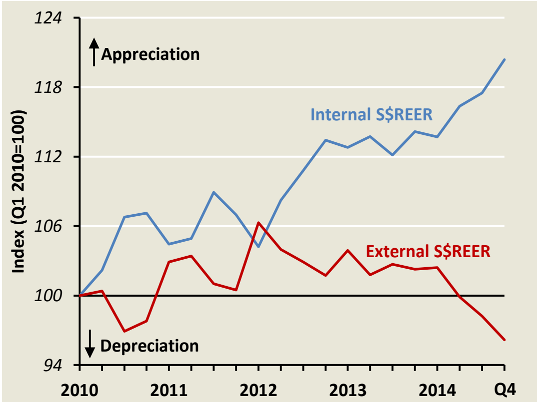
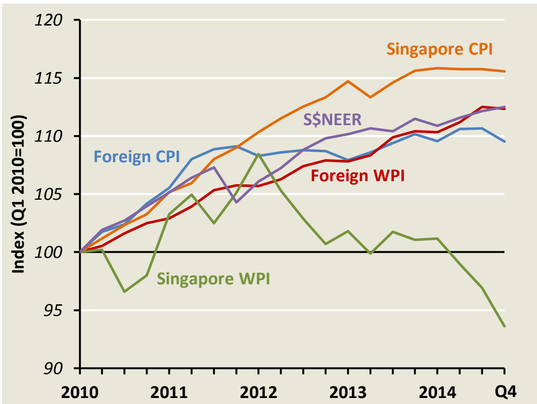


Chart 4.7
Components of the External and Internal S$REER

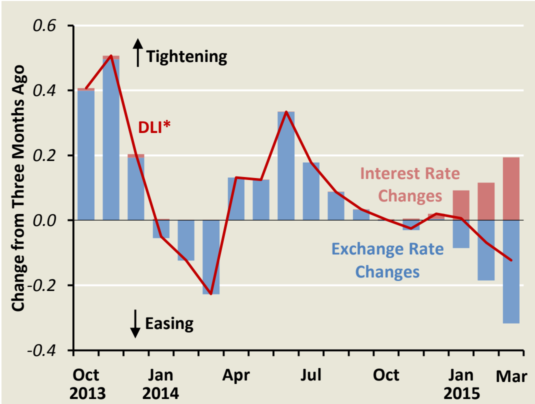


2 The Wholesale Price Index is a reasonable proxy for the price of tradables as it encompasses a wide range of exportables and importables, and is closely associated with producer prices. For Singapore, we use the Manufactured Product Price Index as a proxy for the domestic price of tradable goods.

Liquidity conditions loosened over the first three months of 2015.

Overall liquidity conditions in the economy are captured by changes in the Domestic Liquidity Indicator (DLI), which reflects movements in the S$NEER and the three-month S$ SIBOR. While domestic liquidity conditions were largely unchanged between October to December 2014 on account of the stable S$NEER, the DLI eased in the first three months of 2015. (Chart 4.8) This was due to the depreciating S$NEER, which more than offset the rapid increase in the S$ SIBOR.

Chart 4.8
Domestic Liquidity Indicator

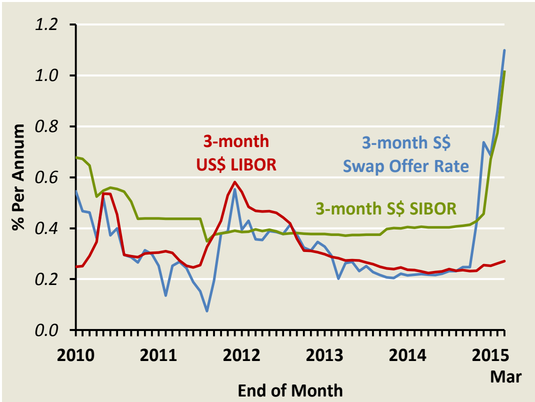


* EPG, MAS estimates.

Domestic interbank rates have risen since the beginning of 2015.

The three-month S$ SIBOR has been at a premium over the three-month US$ LIBOR since September 2012. (Chart 4.9) This premium widened significantly to an average of 56 basis points (bps) in the first three months of 2015, compared to an average of 18 bps in 2014.

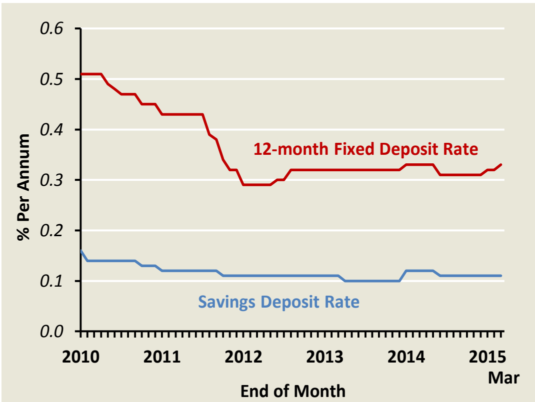
Chart 4.9
Interbank Rates



The US$ LIBOR inched up to 0.27% in March 2015 from an average of 0.23% in 2014. While the S$ SIBOR was stable over 2014 at an average of 0.41%, it rose rapidly from January 2015, as markets re-priced S$ interest rates to incorporate expectations of further US$ strength against the S$. These expectations came after six years of very low US interest rates and a general strengthening of the S$ against the US$. By March 2015, the S$ SIBOR had risen to 1.01%, its highest since October 2008. The three-month S$ Swap Offer Rate (SOR), which began rising in December 2014, reached 1.10% by March 2015, its highest in six years. More recently since the announcement of the April MPS, the S$ SIBOR has eased back below 1%.

Notwithstanding the general rise in domestic interbank rates, savings and fixed deposit rates remained low. Compared to 2014, savings deposit rates and 12-month fixed deposit rates were broadly unchanged in the first three months of 2015, averaging 0.11% and 0.32%, respectively. (Chart 4.10) However, these board rates belied the significantly higher promotional rates that banks continued to offer on deposit accounts.[3] In terms of lending, the effective interest rate on floating mortgages has risen as these are priced off the S$ SIBOR/SOR.

Chart 4.10
Deposit Rates



Note: Each line represents the simple average of the top 10 banks' deposit rates.

3 For example, OCBC was offering 1.40% p.a. on fresh 12-month fixed deposits with a minimum placement sum of $20,000, while the Standard Chartered e$aver account was paying between 1.25–1.40% p.a. on incremental fresh funds.

Money supply growth has picked up from the trough in May 2014.

Growth in monetary aggregates has broadly risen in y-o-y terms from the trough in H1 2014. (Chart 4.11) After contracting by 0.8% y-o-y in June 2014, M1 increased steadily over H2 2014 as economic growth improved. Although M1 growth fell to 0.1% in January 2015, this was likely due to seasonal effects associated with the amount of currency in active circulation (CIAC) around the Lunar New Year. (Chart 4.12) CIAC subsequently rebounded in February, while the growth of demand deposits also picked up, resulting in M1 growth recovering to 3.1%.

Likewise, M2 growth accelerated to 3.3% y-o-y in February 2015, compared to its trough of −0.2% in May 2014, while M3 growth also showed a broadly similar trend. This was largely attributable to the turnaround in fixed deposits from a steep contraction to a slight expansion.

Credit growth has slowed due to softer business loans.

Credit growth has come off sharply in recent months, easing from 10.6% y-o-y in Q3 2014 to 5.9% in Q4 and 3.3% by February 2015. (Chart 4.13) This largely reflected slower growth in business loans, which fell from 13.9% y-o-y in Q3 2014 to 2.4% in February 2015, as loans to non-bank financial institutions shrank while demand for credit from the manufacturing and commerce sectors was lacklustre. In comparison, consumer lending grew at a gentler pace of 4.7% y-o-y in February 2015, down from 5.7% in Q3 2014. With housing loans expanding steadily, this was mainly a result of a decline in other credit to professionals and private individuals, specifically, loans for cars and share financing.

Chart 4.11
Money Supply

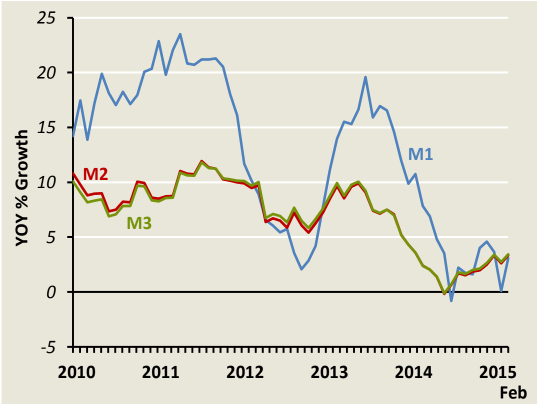


Chart 4.12
Components of the Money Supply

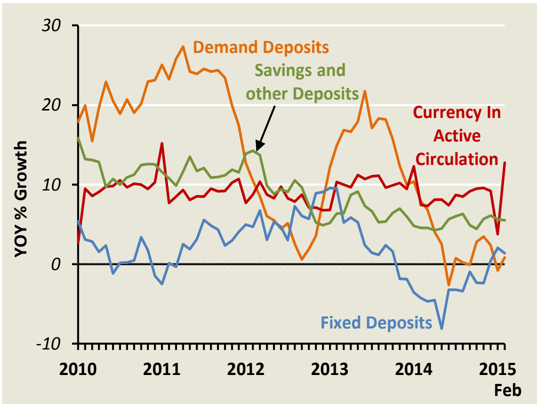
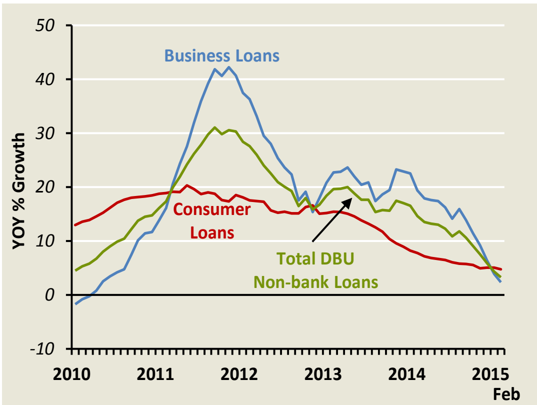


Chart 4.13
DBU Non-bank Loans



4.2 Fiscal Policy

Laying The Foundations For Sustainable And Inclusive Growth

Budget 2015 had a strong focus on the next phase of Singapore's development and, accordingly, committed significant resources to long-term infrastructure investment and sharpened the incentives for individuals and businesses to invest for the future and improve productivity. Continuing the trend of recent budgets, Budget 2015 further strengthened social safety nets, emphasising retirement assurance for the elderly. Overall, the fiscal policy stance for CY2015 is projected to be expansionary compared to last year.

Budget 2015 focused on laying the foundations for future growth.

Budget 2015 projected a larger overall deficit compared to last year, with a strong focus on preparing Singapore for the future. Specifically, this budget committed extensive resources to invest in human capital, infrastructure and innovation. Table 4.1 below summarises the key measures of Budget 2015.

With the Singapore economy expected to continue on a moderate expansion path of 2–4% and inflation relatively muted in 2015, cyclical concerns are less pressing than in previous years. These generally benign macroeconomic conditions, together with the strong fiscal position, enable the government to lay the foundations for future growth and meet the challenges ahead as the economy matures.

The budget continued to chart a steady course in restructuring the economy ...

The Singapore economy has been undergoing important structural changes towards productivity-driven growth. Since restructuring initiatives began in 2010, broad incentive structures have been put in place to help firms become more capital-intensive and reduce their reliance on labour. Amid the tight labour market, the government's productivity schemes have been well-received by firms. However, productivity gains have been low, particularly in domestic-oriented sectors, while business costs have continued to mount due to supply constraints. Recognising these transitory headwinds, Budget 2015 recalibrated some of the incentive structures and support measures to help firms cope with the short-term cost of restructuring while sustaining efforts to improve productivity.

First, the Transition Support Package (TSP), which was due to expire this year, was extended for two more years at lower support levels. Specifically, the Wage Credit Scheme (WCS) and Corporate Income Tax Rebate were extended, but with lower co-funding rates for the former and at a reduced cap for the latter. This will give firms more time to adjust to rising costs as they restructure. The Productivity Innovation Credit (PIC) Bonus will be discontinued after Year of Assessment (YA) 2015.

Second, the schedule of planned foreign worker levy increases for S pass holders was deferred for a year across all sectors (from July 2015 to July 2016). The schedule for hikes in the Work Permit Holder levy was also moderated—levy increases for the services, marine and process sectors were deferred to 2016, levies for the manufacturing sector were frozen at the 2014 levels for the next two years and man-year entitlement waiver levies were reduced for higher-skilled foreign construction workers.

… by enhancing and targeting support for breakthroughs in innovation and productivity.

Budget 2015 marked a progressive shift in the government's approach towards restructuring. While still retaining a base level of support to encourage improvements in productivity and ease the cost of resource reallocation, this budget further shifted the emphasis towards innovation and value creation that would eventually underpin breakthroughs in growth and productivity. To this end, measures targeted at local businesses and workers focused on expanding their capabilities and empowering them to exploit opportunities in a globally competitive world.

Specifically, a slew of measures to help SMEs innovate, internationalise and increase scale were unveiled. For example, a tax incentive to support larger companies in their internationalisation efforts was introduced and a new risk-sharing scheme was piloted in order to provide young and fast-growing companies with alternative financing options. In particular, these measures build on the foundations of existing schemes aimed at incentivising innovation and overcoming the hurdle rate of investment. These include the extension of Budget 2014's 50% additional tax deduction on qualifying research and development expenditure and measures to enhance risk-sharing mechanisms (Internationalisation Finance Scheme, Micro-Loan Programme and Phase 2 of the Co-Investment Programme).

The introduction of SkillsFuture underscores the importance of enhancing and leveraging on human capital.

In this Budget, the government focused on raising the skills of workers to enhance competitiveness and raise incomes. A key plank of this strategy was the introduction of SkillsFuture, a pioneering initiative to redefine education as a continuous and lifelong process, as well as to help Singaporeans develop and master skills in new growth clusters. The SkillsFuture scheme encompasses credits for work-skills related courses, awards to develop mastery in specialist skills in identified growth clusters, training support for those in mid-career and stronger industry collaboration. Critically, SkillsFuture aims to address the long-term imperative of keeping our workforce competitive and relevant. The development of human capital has always been a key priority in Singapore's development and, indeed, the rapid increase in educational attainment has led to better jobs, higher incomes and an improved standard of living over the past five decades. However, given intense global competition and technological developments that could rapidly alter business landscapes and displace labour, the need for relevant skills, rather than formal education *per se*, has gained greater significance. For example, a recent study in *The Review of Economics and Statistics* suggests that employment and earnings growth are strongest for young workers who possess both cognitive (technical expertise) and social skills, given the increasing complementarity between these two types of skills.[4]

Accordingly, SkillsFuture's measures are appropriately targeted at addressing the problem of skills mismatch (in which the specific skills demanded by employers do not match those of workers), and the need for workers to continuously up-skill in response to a dynamic labour market. Empirical studies show that even a highly-qualified individual may not be rewarded according to his human capital if his skills are not job-specific and the effect of skills mismatch on wages can be significant.[5] Taken as a whole, the economic measures in Budget 2015 appear to have recognised that Singapore's progression towards a truly advanced economy would require intrinsic changes by businesses and individuals, and that the government can play the role of an active enabler in this regard.

Major infrastructural investments were committed to meet Singapore's future economic and social needs.

Budget 2015 committed to major long-term infrastructural investments, announcing that the government's development expenditure would increase by 50% by the end of the decade. In particular, the new Changi Airport Development Fund was set up to support the development of

4 See Weinberger, C J (2014), "The Increasing Complementarity between Cognitive and Social Skills", *The Review of Economics and Statistics*, Vol. 96(5), pp. 849–861.

5 An upcoming article in the *Journal of Labour Economics* estimates that science college graduates or business majors who work in jobs unrelated to their field of study earn approximately 30% less than those working in related jobs, even after controlling for their unobserved ability. See Kinsler, J and Pavan, R (2015), "The Specificity of General Human Capital: Evidence from College Major Choice", *Journal of Labour Economics,* forthcoming.

Changi Airport's Terminal 5. Budget 2015 also announced the continued expansion of healthcare and public transport infrastructure.

Budget 2015 built on previous measures to build a fairer and more inclusive society.

To develop an inclusive society, previous budgets had already laid out the primary strategy, comprising upstream interventions aimed at ensuring equality of opportunity and preserving social mobility, as well as direct transfers to reduce inequality of outcomes and strengthen social safety nets. Examples of the former include levelling the playing field for children by raising the affordability and quality of pre-school education and increasing education bursaries. The latter include instituting a more progressive property tax regime, making GST Vouchers permanent and enhancing medical subsidies, including those under the PGP.

Building on the existing measures in our social security system, Budget 2015 introduced the Silver Support Scheme, which provides an income supplement for the bottom 20–30% of Singaporeans aged 65 and above based on their lifetime income, extent of family support and housing type. The raising of the CPF salary ceiling for all workers and CPF contribution rates and interest rates on CPF balances for the elderly goes one step further in helping Singaporeans to build their retirement savings.

A cohesive and sustainable fiscal strategy is needed to achieve our social and economic goals.

The government has taken progressive steps to advance the aim of inclusive growth in a sustainable and consistent manner. Budget 2015 ties together, and hence, improves the efficacy of current schemes and those introduced earlier.

First, key planks of our social security system have been strengthened successively across all groups, including the young, elderly, low-income and disabled.

Second, Budget 2015 underscored the need to keep the economy vibrant in order to advance Singapore's social strategies and aspirations. The restructuring drive is not just about reducing Singapore's reliance on foreign workers, but also about raising productivity and sustaining competitiveness in order to achieve higher living standards in the years to come.

Third, prudent fiscal policies and government savings that have been built up over the years have accorded Singapore an uncommon advantage. However, as the Singapore economy matures, future Budgets will operate in a different growth environment from the past. GDP growth is expected to be several percentage points below the compounded annual growth rate of 7.7% between 1965 and 2014, even as social priorities and infrastructure needs continue to increase. Government expenditure is expected to increase over the medium to long term, driven by spending in healthcare, transport and investments in other critical infrastructure, as well as human talent and capabilities necessary to secure Singapore's future. In view of the anticipated rise in government expenditure, Budget 2015 took steps to strengthen future revenues to put Singapore on a firm fiscal footing for the rest of this decade. Proposed changes to the fiscal revenue structure include raising the top marginal income tax rate from 20% to 22% and incorporating the expected returns of Temasek in the Net Investment Returns (NIR) framework.[6] These serve as steps to preserve the robustness of our tax revenues and ensure the fiscal sustainability of our social and economic strategies.

6 Currently, the spending rule allows the government to spend up to 50% of the expected long-term real returns on its net assets managed by MAS and GIC.

Table 4.1
Key Initiatives of Budget 2015: "Building Our Future, Strengthening Social Security"

Measures for Businesses
(A) Lifelong Learning—SkillsFuture • SkillsFuture Earn and Learn Programme: Government provides substantial support for on-the-job training for fresh polytechnic and ITE graduates. • SkillsFuture Leadership Development Initiative: Develop a pipeline of Singaporeans to take on corporate leadership roles and responsibilities. • Industry Collaborations: Sectoral Manpower Plans.
(B) Phasing Out the Transition Support Package • Wage Credit Scheme to be extended to 2017, at reduced support levels of 20% of government co-funding of wage increases. • Corporate Income Tax Rebate will be provided for another two YAs (YA 2016 and YA 2017), with a cap of $20,000 per company per YA. • Productivity Innovation Credit Bonus to be phased out after YA2015.

(C) Offsetting CPF Changes
• Enhance Temporary Employment Credit (TEC).
  o Raise the TEC from 0.5% to 1.0% of wages in 2015.
  o Extend the TEC by two years (1% of wages in 2016; and 0.5% of wages in 2017).
• Additional Special Employment Credit (SEC).
  o An additional SEC of up to 3% of wages for workers aged 65 years and above in 2015, on top of the up to 8.5% wage offset that employers would receive in 2015.

(D) Recalibrating Foreign Worker Levies
• Defer foreign worker levy increases for S pass for a year (from July 2015 to July 2016).
• For Work Permit Holders (WPHs):
  o <u>Manufacturing</u>: WPH levies for 2015–16 frozen at 2014 levels.
  o <u>Services, Marine and Process</u>: WPH levy increases for 2015 to be deferred to 2016.
  o <u>Construction</u>: (i) Levy for basic skilled R2 workers will be raised from $550 in July 2015 to $650 in July 2016 and $700 in July 2017; and (ii) Man-year entitlement waiver levy rate for more highly skilled R1 workers will be reduced from $750 to $600 from July 2015.

(E) Strengthening Our Support for Innovation • Enhance funding support for the Capability Development Grant. • Enhance Partnerships for Capability Transformation scheme. • Top-up National Research Fund by $1 billion. • Top-up Business Angel Scheme (BAS) by $75 million; increase the co-investment cap for BAS and SPRING's Startup Enterprise Development Scheme. • Pilot a venture debt risk-sharing programme to provide 50% risk-sharing to selected financial institutions offering venture debt, over an initial period of two years.
(F) Going Beyond Our Shores • Raise the support level for SMEs for all activities under IE Singapore's grant schemes from 50% to 70% for three years to 31 March 2018. • Enhance the Double Tax Deduction for Internationalisation scheme to cover qualifying manpower expenses incurred for Singaporeans posted to new overseas entities. • Introduce a new International Growth Scheme to support larger companies in their internationalisation efforts. Qualifying companies will enjoy a 10% concessionary tax rate on their incremental income from qualifying internationalisation activities.
(G) Encouraging Scale • Increase the tax allowance for acquisition costs from the current 5% to 25% of the value of acquisition, with the cap on the allowance remaining at $5 million per YA. In addition, companies will be able to claim merger and acquisition (M&A) benefits for acquisitions that result in at least 20% shareholding in the target company, down from the current threshold of 50% shareholding. Also, the M&A tax allowance scheme will be extended until 31 March 2020. • Extend the scope of IE Singapore's Internationalisation Finance Scheme to cover overseas M&A financing.
(H) Other Measures • Tax deduction rate for qualifying donations increased from 250% to 300% in 2015 and maintained at 250% from 2016–18. • Extend matching grant support for the Care & Share Movement by $250 million till 31 March 2016. • Early Turnover Scheme for commercial vehicles.

Measures for Households

(A) Lifelong Learning—Our Next Phase of Development

- Professional core of education and career counsellors. Enhancing internships in institutes of higher learning to become more structured and meaningful.
- SkillsFuture Credit ($500) for all Singaporeans to be used for education and training.
- SkillsFuture Earn and Learn Programme for fresh polytechnic and ITE graduates.
- Enhance subsidies for mid-career Singaporeans for continued education and training.
- SkillsFuture Study Awards for Singaporeans to develop deep specialist skills.

(B) Enhancing CPF Savings

- Increase CPF Salary Ceiling from $5,000 to $6,000.
- Raise the contribution cap within the Supplementary Retirement Scheme.
- Raise CPF contribution rates for older workers.
  - Above 50 to 55: Increase employer contribution rates from 16% to 17% and employee contribution rates from 19% to 20%. (Total: +2%)
  - Above 55 to 60: Increase employer contribution rates from 12% to 13%, while employee contribution rates remain at 13%. (Total: +1%)
  - Above 60 to 65: Increase employer contribution rates from 8.5% to 9%, while employee contribution rates remain at 7.5%. (Total: +0.5%)
- Raise the extra interest rate on the first $30,000 of CPF balances of members from the age of 55 years, by 1% point.

(C) Silver Support Scheme ($350 million)

- New, permanent Silver Support Scheme will provide a supplement of $300–750 every quarter to the bottom 30% of Singaporeans aged 65 years and above.

(D) Support for Growing Years

- Enhance government support for pre-school via the new Partner Operator scheme.
- Top-up to the Child Development Account.
- Waive examination fees for Singaporean students in Government-funded schools.
- Top-up to the Edusave Account.
- Enhance Financial Assistance Scheme for school students.
- Top-up to the Post-Secondary Education Account.
- Support Self-Help Groups.

(E) Fostering a Spirit of Giving

- Tax deduction rate for qualifying donations increased from 250% to 300% in 2015 and maintained at 250% from 2016–18.
- Donate to causes identified by schools, polytechnics and ITEs.
- Extend matching grant support for the Care & Share Movement by $250 million till 31 March 2016.

(F) Other Measures

- Enhance GST Voucher (GSTV) Scheme.
  - GSTV–Cash quantum increased by $50 from 2015 onwards.
  - Additional GSTV–Seniors' Bonus for 2015.
- Service and Conservancy Charges (S&CC) Rebates.
- Extend and refine Carbon Emissions-based Vehicle Scheme.
- Raise petrol duty and provide road tax rebate.
- Reduce foreign domestic worker concessionary levy.
- Personal Income Tax Rebate of 50%, capped at $1,000 for YA 2015.
- Raise the personal income tax rates for high-income earners in the top 5%.
  - Marginal tax rates for individuals with chargeable income above $160,000 to be raised by 1–2%.
  - Raise top marginal tax rate (chargeable income above $320,000) from 20% to 22%.

Source: MOF

An overall budget deficit is projected for FY2015, reflecting commitments to future long-term investments.

In FY2015, the government is projected to post an overall budget deficit of $6.7 billion or 1.7% of GDP. (Chart 4.14 and Table 4.2) This deficit arose mainly from the $6 billion set aside in funds for future investment. In particular, there was a $3 billion injection into the new Changi Airport Development Fund, as well as significant top-ups for the Special Employment Credit Fund, National Productivity Fund and the National Research Fund. Excluding these top-ups, Budget FY2015 would be close to being balanced.

Chart 4.14
Components of the Budget

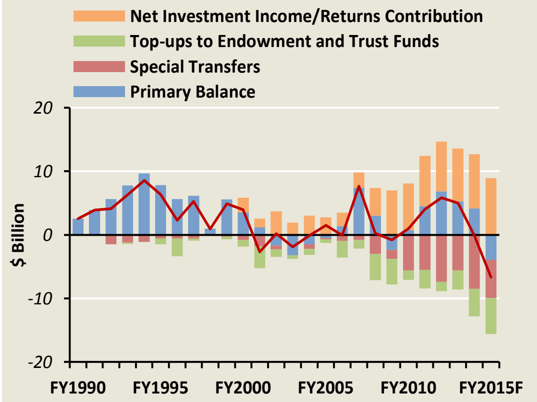


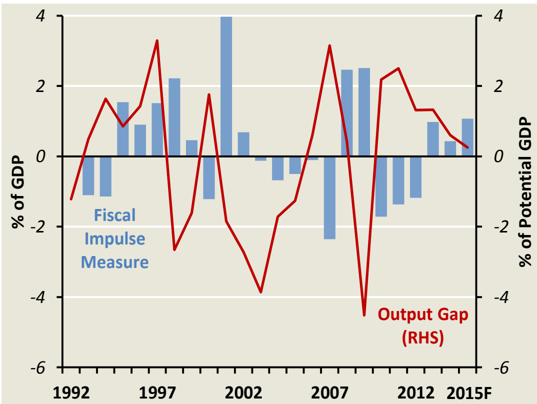
Table 4.2
Budget Summary

	FY2014 Revised		FY2015 Budgeted	
	$ Billion	% of GDP	$ Billion	% of GDP
Operating Revenue	61.3	15.7	64.3	16.0
Total Expenditure	57.2	14.6	68.2	17.0
Operating Expenditure	43.3	11.1	48.7	12.1
Development Expenditure	13.9	3.5	19.5	4.8
Primary Surplus/Deficit (–)	**4.2**	**1.1**	**(3.9)**	**(1.0)**
Less: Special Transfers (excluding top-ups to endowment/trust funds)	4.3	1.1	5.7	1.4
Basic Surplus/Deficit (–)	**(0.2)**	**(0.0)**	**(9.6)**	**(2.4)**
Add: Net Investment Returns Contribution	8.6	2.2	8.9	2.2
Less: Special Transfers (top-ups to endowment/trust funds)	8.5	2.2	6.0	1.5
Overall Budget Surplus/Deficit (–)	**(0.1)**	**(0.0)**	**(6.7)**	**(1.7)**

The fiscal stance is expected to be expansionary in 2015.

The fiscal impulse (FI) for CY2015 is estimated to be moderately positive at around 1.1% of GDP, indicating an expansionary fiscal policy stance compared to last year. (Chart 4.15) This takes place amid a projected closing of the output gap in 2015, compared to 0.6% of GDP in 2014 and above 1% of GDP in the preceding four years. The expansionary stance was not targeted at providing a cyclical boost to the economy, but incorporated, to some extent, the impact of longer-term investment in infrastructure, human capital and productivity, which will help to raise potential output.

Chart 4.15
Fiscal Impulse and Output Gap



Source: EPG, MAS estimates

The FI measure provides a useful indication of the net fiscal stimulus arising from Budget 2015. However, it does not fully quantify the impact of specific budget measures on the economy. To assess these effects, EPG simulated some of the key initiatives using the Monetary Model of Singapore (MMS). (Table 4.3)

Table 4.4 shows the combined macroeconomic impact of the budget measures. GDP growth will be boosted by 0.25% point from baseline in 2015, though the effects on output will fade in 2016.[7] In 2015, the income tax and other rebates for households, as well as subsidies and fee reductions, will enhance disposable incomes and in turn, stimulate private consumption. At the same time, the budget measures targeted at firms should provide some relief from rising labour costs and CPF policy changes. As in the previous year, the budget measures will also support innovation, skills upgrading and investment spending. Meanwhile, the main impact of the expansionary budget on CPI inflation will be felt only in 2016, primarily due to lags in the price transmission mechanism and the expiration of the road tax rebates.

Overall, the Budget 2015 measures are estimated to have a modest impact on GDP growth and inflation over 2015–16.

Table 4.3
Budget 2015 Measures Simulated in MMS

$ million

Measures	Amount in CY 2015	Amount in CY 2016
Measures for Households		
Personal Income Tax Rebate*	876	-
Top-up to the Child Development Account	126	-
Service and Conservancy Charges (S&CC) Rebate	80	-
Reduce Foreign Domestic Worker Concessionary Levy	125	125
Waive Examination Fees for Singaporean Students	26	26
Silver Support Scheme	-	350
Enhance GST Voucher Scheme–Cash	70	70
Enhance GST Voucher Scheme–Additional Senior Bonus	315	-
Measures for Firms		
Strengthen Grant Support for Innovation	200	200
Going Beyond Our Shores	48	48
Corporate Income Tax Rebate	-	400
Temporary Employment Credit	357.5	715
Top-up to Special Employment Credit Fund	25	25
Measures for Households and Firms		
Raise Petrol Duty and Provide Road Tax Rebate**	33	177
Higher CPF Salary Ceiling*	-	1097
Raising CPF Contribution Rates for Older Workers*	-	114

* EPG, MAS estimates.

** Lim, A (2015), "Pump Prices Up across the Board after Petrol Duty Hike", *The Straits Times*, February 24.

Table 4.4
Impact of Selected Budget Measures on GDP Growth and CPI-All Items Inflation

% point deviation

	2015	2016
GDP Growth	0.25	−0.13
CPI-All Items Inflation	−0.07	0.43

Note: The measures simulated include those related to the recalibration of foreign worker levies in Budget FY2015.

7 The measures will raise GDP levels throughout 2015–16. However, with the higher GDP level in 2015, GDP growth in 2016 will be marginally lower than the baseline.

Review of Government's CY2014 Basic Balance

Government operating revenue increased in line with GDP growth in 2014.

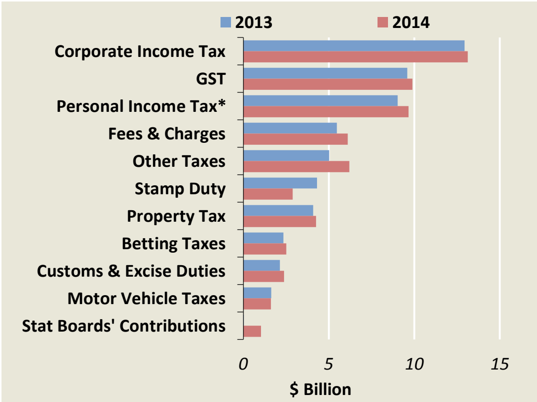
The following section reviews the government's budgetary outturn in CY2014 compared to CY2013. Operating revenue increased by $2.9 billion to $60.0 billion (15.4% of GDP) in CY2014. This increase was largely driven by higher revenue from income taxes, "other taxes", fees & charges and GST, but was partially offset by a fall in revenue from stamp duties. (Chart 4.16)

In 2014, receipts from income taxes and GST rose, alongside moderate growth in the economy. Personal income taxes increased by $0.7 billion, partly due to the one-off 30% tax rebate given in the previous YA, while revenue from corporate income tax rose by $0.2 billion. Statutory boards' contributions added $1.0 billion to total operating revenue. GST recorded an increase of $0.3 billion, tempered by slower growth in consumer spending due to sluggish consumer sentiment and fewer tourist arrivals.

Operating revenues in 2014 were also boosted by increases in "other taxes" and fees & charges. The former rose by about $1.2 billion, mainly driven by an increase in foreign worker levy collections. The $0.6 billion rise in receipts from fees & charges was largely due to the increase in vehicle quota premium collections, on the back of rising new vehicle registrations. (Chart 4.17)

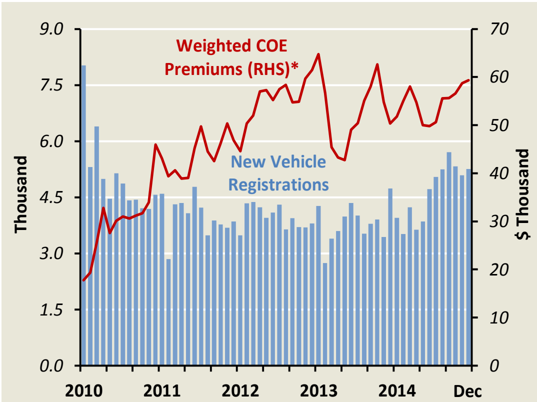
In comparison, receipts from stamp duty fell by $1.4 billion, while property taxes rose slightly. The decline in the former was mostly due to a sharp fall in property transaction volumes, while the latter held fairly steady as they are levied on the stock of existing properties. (Chart 4.18)

Chart 4.16
Components of Operating Revenue



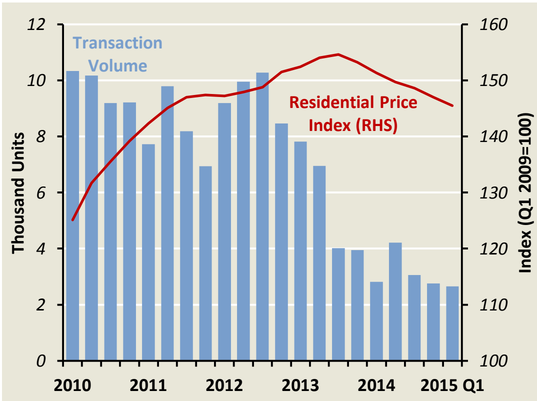
* Includes withholding tax.

Chart 4.17
COE Premiums and New COE Registrations



* Weighted by the COE quota of each category.

Chart 4.18
Residential Price Index and Property Transaction Volumes



Both operating and development expenditure increased.

Total government expenditure rose by $2.5 billion to $54.8 billion (14.0% of GDP) in 2014. This followed from higher spending on both operating and development items. (Chart 4.19) In terms of sectors, the bulk of this increase was due to higher expenditure on social development, which offset the decline in spending on security and external relations. (Chart 4.20)

Operating expenditure, which includes expenses on manpower and operating grants to statutory boards and aided educational institutions, rose by $1.4 billion to reach $41.8 billion (10.7% of GDP) last year. In particular, the Ministry of Education recorded an increase in operating expenditure of $0.9 billion, due to the one-off provision of a seed endowment grant to the Singapore Institute of Technology, as well as higher matching grants for donations to the Institutes of Higher Learning. The Ministry of Health also posted a significant rise in operating expenditure of $0.8 billion, as it channelled more funds to public healthcare institutions and Voluntary Welfare Organisations to cater to the increasing demand for healthcare services as the population ages.

Development expenditure, which comprises longer-term investment in capitalisable assets, such as roads and buildings, increased by $1.1 billion to $13.0 billion (3.3% of GDP) in 2014. The Ministry of Health's development expenditure rose, mainly due to the ramping up of key construction projects such as Ng Teng Fong General Hospital, Changi General Hospital Integrated Building and Yishun Community Hospital. There was also increased funding for the re-development of nursing homes and information & communication technology projects for new healthcare facilities. Meanwhile, the Ministry of Law incurred higher outlays for the acquisition of land for development purposes.

The surplus in the basic balance narrowed, due to an increase in special transfers to businesses.

As the increase in operating revenue exceeded that of total expenditure, the government recorded a slightly larger primary surplus of $5.2 billion (1.3% of GDP) in 2014, from $4.7 billion in 2013. Over the same period, special transfers (excluding top-ups to endowment and trust funds) increased by $1.0 billion.

Chart 4.19
Government Operating and Development Expenditure

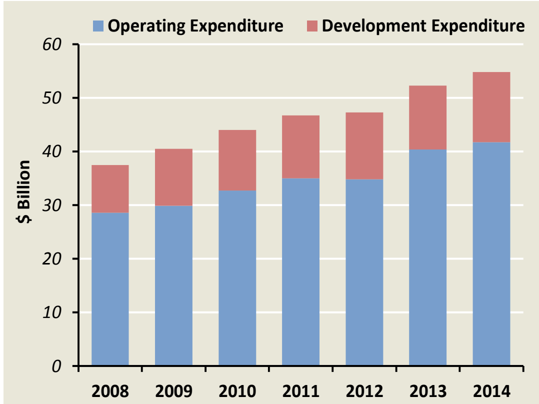
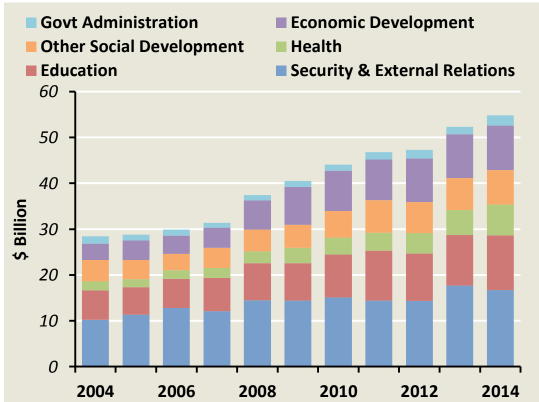


Chart 4.20
Components of Total Expenditure



Note: Expenditure on education and healthcare is included in social development.

This was mainly a function of more special transfers under the TSP, such as the disbursement of the first tranche of payouts from the WCS in Q1 2014, the PIC Bonus and higher take-up rates under the PIC+ Scheme. Accordingly, the basic balance, which is the primary balance less special transfers excluding top-ups to endowment and trust funds, registered a smaller surplus of $2.0 billion (0.5% of GDP) in 2014, compared to $2.5 billion a year earlier. (Chart 4.21)

Chart 4.21
Government's Basic Balance