4 Macroeconomic Policy

Keeping The Economy On An Even Keel

In April 2017, MAS kept the slope of the S$NEER policy band at 0%. Amid the pickup in global demand, Singapore's GDP growth in 2017 as a whole is not expected to be markedly different from 2016. Although core inflation is projected to rise this year, its increase will be restrained and it is still expected to average slightly below 2% in the outer years. MAS has thus assessed that maintaining a neutral policy stance for an extended period is appropriate to ensure medium-term price stability.

As in last year's Budget, Budget 2017 continued to provide near-term relief measures for households and firms, but did so in a targeted fashion to provide the necessary support to the most vulnerable. At the same time, a large number of measures included in the Budget were aimed at implementing the recommendations of the Committee on the Future Economy (CFE) to enable Singapore's next phase of development. Overall, the fiscal policy stance is estimated to be mildly positive for CY2017.

Overall, this macroeconomic policy mix is assessed to be appropriate and in line with a continued, steady, expansion of the economy towards its potential growth rate.

4.1 Monetary Policy

Maintaining The Neutral Policy Stance

Global economic activity has improved since the last policy review, on the back of a gradual recovery in global trade and investment. This will provide some support to Singapore's trade-related clusters in 2017, although the spillover to other sectors in the economy is expected to be uneven. Overall, GDP growth this year will be modest, and not markedly different from that in 2016. Continued slack in the labour market, declining business rents, as well as weak economic sentiment, indicate that demand-driven inflationary pressures will be restrained. While inflation will rise in 2017 because of higher oil prices and the temporary effects of domestic administrative price adjustments, MAS Core Inflation is still projected to average slightly below 2% in the medium term. Accordingly, in April 2017, MAS maintained the slope of the S$NEER policy band at 0%, with no change to the width of the band or the level at which it was centred. A neutral policy stance for an extended period was assessed to be appropriate for ensuring medium-term price stability, as indicated in the October 2016 review.

Maintaining the 0% slope of the S$NEER policy band is appropriate for an extended period.

In the October 2016 policy review, the global economy was envisaged to grow at a stable and moderate pace, even as uncertainty over Brexit and the US presidential election mounted. Global investment demand, which had hitherto been muted, was expected to remain tepid while the prospects for regional trade were subdued. Accordingly, Singapore's externally-oriented sectors, which are more closely linked to the investment cycle and therefore more exposed to the underperforming industries in global manufacturing, were expected to weigh on the domestic economy. Projections then suggested that GDP growth was unlikely to pick up significantly in 2017.

However, since the October review, the underlying growth momentum in Singapore's major trading partners has firmed. In particular, the troughing of oil prices, a turnaround in the IT cycle, and an incipient investment upswing have paved the way for a nascent recovery in global manufacturing and trade. Manufacturing PMIs in the G3 and China are at their highest levels since 2011 and 2014, respectively, while world trade volumes have risen since last November.

The outlook for the global economy has therefore improved, even as downside risks remain due to elevated policy uncertainty and the threat of trade protectionism. In the US, the robust labour market will undergird household demand and GDP growth, while economic activity in the other major economies, such as the Eurozone and China, will be supported by domestic spending. These factors should provide the impetus for a more self-sustaining global recovery for the rest of this year, with positive spillovers to the export-oriented Asian economies, including Singapore.

Against this backdrop, activity in Singapore's externally-oriented sectors saw a step-up in Q4 2016, driven by financial services and the manufacturing sector—principally the electronics, precision engineering, and biomedical clusters. In Q1 2017, *Advance Estimates* indicated that GDP eased slightly by 1.9% q-o-q SAAR after rising by 12.3% in Q4 2016. On a y-o-y basis, growth came in at 2.5%, compared to 2.9%. High-frequency data showed that there was a pullback in biomedical production, but electronics output continued to rise, albeit at a slower pace, and the level of overall manufacturing activity remained elevated.

For 2017 as a whole, the performance of different sectors across the Singapore economy is likely to remain uneven, reflecting in part the still narrowly-based drivers of external demand. Parts of manufacturing remain weak: for example, the marine & offshore engineering cluster continues to contract, albeit at a slower pace. While the global IT recovery is firmly underway and will bolster the electronics and trade-related industries in Singapore, ongoing reconfigurations are altering the nature of production and its attendant

multiplier effects. Specifically, electronics manufacturing is increasingly moving into pre- and post-production services, such as R&D and marketing & sales. Accordingly, the spillovers from rising global demand are expected to be smaller than in previous upturns. The modern services (finance and ICT) and essential services (healthcare and education) sectors will bolster GDP growth, but other consumer-facing sectors, such as retail trade, are likely to remain soft, on account of the subdued domestic labour market. All in, GDP growth in the Singapore economy is likely to remain modest at 1–3% in 2017, not markedly different from the 2% growth in 2016.

There is continuing slack in the labour market as shown by EPG's Labour Market Pressure Indicator, which eased for a third consecutive quarter in Q4 2016. Although wage growth has exceeded 3% in recent quarters, this likely reflected the exit of lower-paid casual workers and still-high vacancy rates in certain industries, rather than general tightness in the labour market.

Inflation has largely evolved as anticipated since the October 2016 policy review. CPI-All Items inflation turned positive in November 2016, averaging 0.0% in Q4 before rising to 0.6% y-o-y in the first quarter of this year. Meanwhile, MAS Core Inflation edged up to average 1.3% in Q1 2017, from 1.2% in Q4 2016. These increases were largely due to higher prices of oil-related items, such as electricity and petrol, following the recovery of global oil prices from their 2016 trough.

Imported inflation is likely to rise moderately in 2017. The price of Brent crude oil averaged US$55 in Q1, and while it is not projected to rise by much more for the rest of this year, it will still be about 20% higher than in 2016, on average. Global food prices have also increased amid tighter supply conditions. At the same time, administrative price increases implemented at the end of 2016 and forthcoming adjustments in 2017 will give a temporary boost to inflation this year.

However, the pass-through from higher import and administrative costs to consumer prices will be dampened for several reasons. First, changes in domestic imported food prices are only partially captured in consumer prices in the short term, with EPG's econometric estimates suggesting that a full pass-through requires several years. Second, other business costs are moderating, as the soft labour market caps overall wage growth, while retail, commercial and industrial property rents have declined for two consecutive years. Third, weak economic sentiment will constrain the extent of cost pass-through from businesses to consumers.

Weighing all these factors, MAS' inflation forecasts for 2017 are unchanged from the October 2016 review. CPI-All Items inflation is expected to rise to 0.5–1.5% from −0.5% in 2016, while MAS Core Inflation is projected to average 1–2%, compared to 0.9% last year. Meanwhile, inflation expectations remain well anchored, as observed in inflation forecasts from the *MAS Survey of Professional Forecasters*.

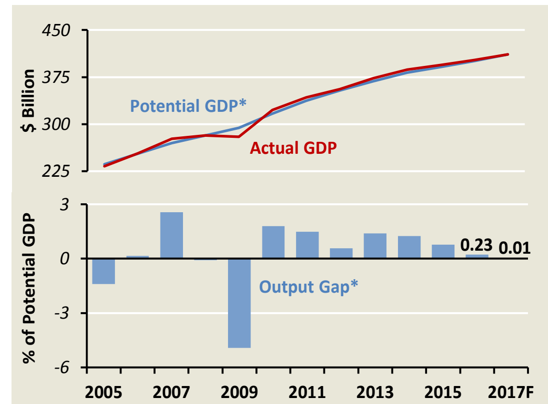
The outlook for the Singapore economy has improved slightly, but GDP growth is expected to remain modest and uneven across different sectors. Conditions in the labour market this year are not expected to be significantly different from 2016, given that any turnaround due to mildly improving economic conditions will only come with a lag. Inflation will rise in 2017, but this is largely driven by supply factors, such as higher oil prices and administrative price increases. As such, the domestic economy is unlikely to see a strong build-up of demand pressures over the short term. In the medium term, MAS Core Inflation is expected to trend towards but average slightly below 2%.

Accordingly, at the April 2017 policy review, MAS maintained the rate of appreciation of the S$NEER policy band at 0%, with no change to the width of the band or the level at which it was centred. MAS also reaffirmed the appropriateness of maintaining a neutral policy stance for an extended period, as was conveyed in the October 2016 Monetary Policy Statement (MPS). Further, EPG's econometric analysis suggests that nearly half of the cumulative impact from MAS' past policy easing moves since January 2015 will continue to filter through to the economy. Together with the maintenance of the neutral policy stance, these effects will help to keep

the level of output close to the economy's potential, and ensure medium-term price stability. (Chart 4.1)

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

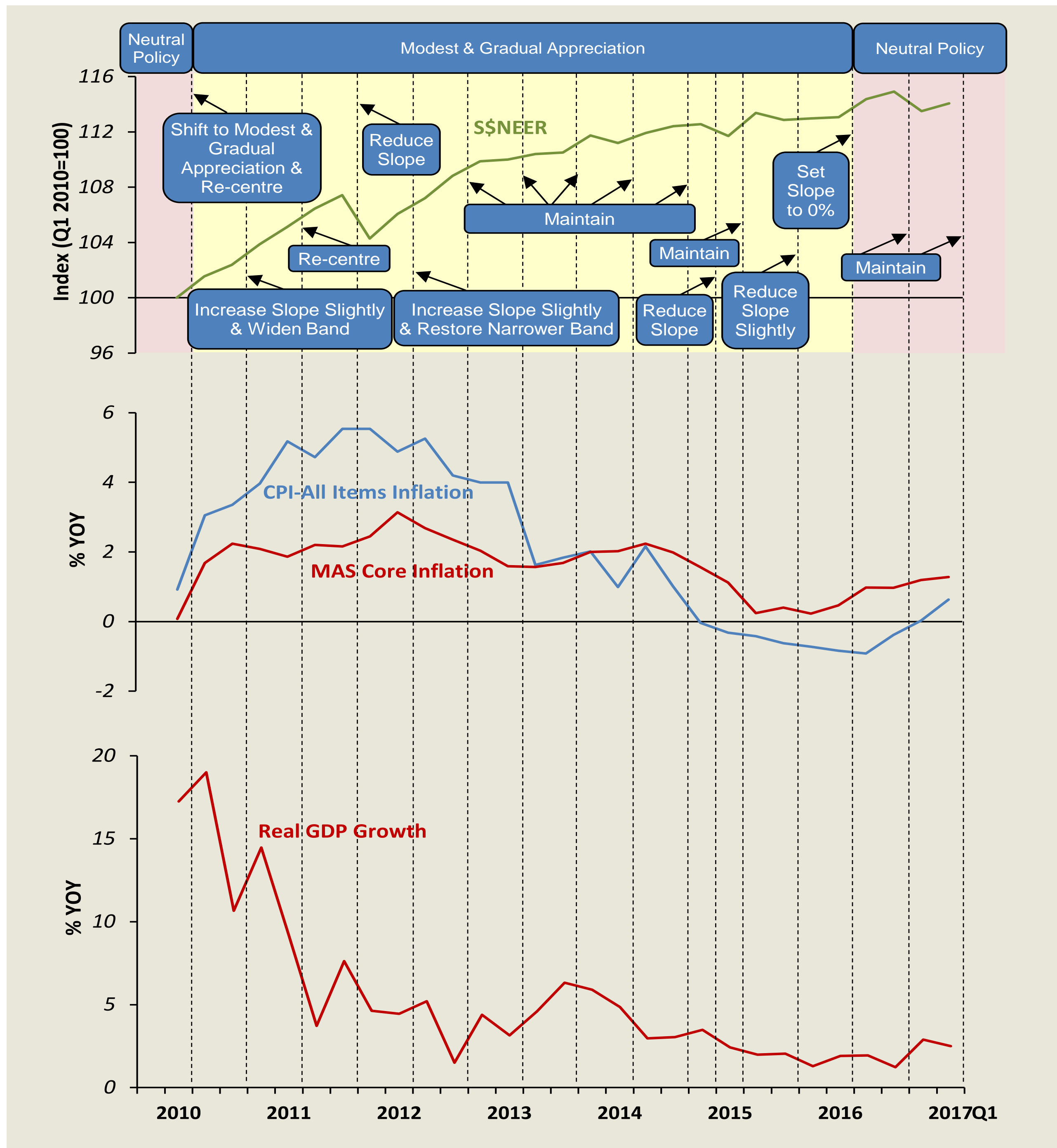
Chart 4.1
Actual and Potential Real GDP



* EPG, MAS estimates.

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. The forecast for 2017 takes into account the policy stance adopted in April 2017.

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



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The S$NEER generally strengthened over the last six months.

Between the October 2016 MPS and end-January 2017, the S$NEER experienced several bouts of volatility, as a result of shifting financial market expectations in the months before and after the US presidential election, as well as growing concerns over the prospects of a hard Brexit. (Chart 4.3) Over this period, the S$ fluctuated against the key reserve currencies, such as the US$, Japanese yen, euro and pound sterling. For instance, while the S$ appreciated by 7.7% against the yen, it fell by 5.3% against the pound. (Chart 4.4) Overall, the S$NEER was almost unchanged over this period.

From February 2017 however, the S$NEER rose more decisively given broad-based weakness in several currencies. This largely stemmed from the firming outlook for global GDP growth and inflation, and market expectations that the US Federal Reserve would only normalise monetary policy settings gradually. Between the week of 27 Jan 2017 and 7 Apr 2017, the S$ appreciated by 2.6% against the pound sterling, and around 2% against the US$ and euro. At the same time, the S$ rose by around 2% against regional currencies, such as the Malaysian ringgit and Chinese renminbi. These currency movements more than offset the downward pressure on the S$NEER due to the depreciation of the S$ against the Japanese yen.

Since the October 2016 MPS, the S$NEER has risen from the lower half of the policy band to the upper half, appreciating by 0.8%. Over this period, the average level of the S$NEER has been close to the mid-point of the policy band.

The CPI-deflated S$REER has continued to decline from its peak in Q1 2013.

The S$ real effective exchange rate (S$REER) is a measure of the prices of goods and services in Singapore relative to its trading partners, expressed in terms of a common currency index, the S$NEER. Using the CPI as the measure of prices, the S$REER has depreciated by a cumulative 4.0% from Q1 2013 to Q4 2016. (Chart 4.5)

Over this period, the S$NEER appreciated by 2.3%, largely reflecting the modest and gradual appreciation of the S$NEER policy band prior to April 2016. At the same time, relative prices in Singapore fell by a larger 6.1%, as Singapore's CPI-All Items inflation declined while overall inflation abroad remained relatively stable.

Chart 4.3
S$NEER

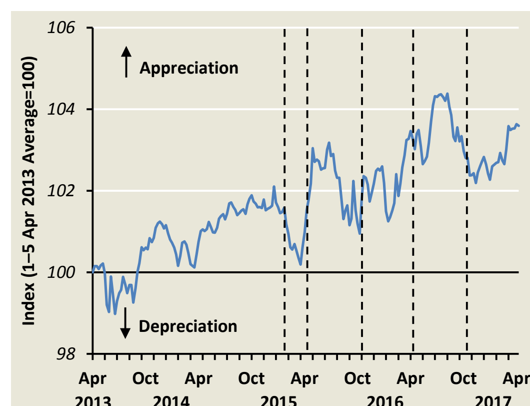

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Chart 4.4
Singapore's Bilateral Exchange Rates

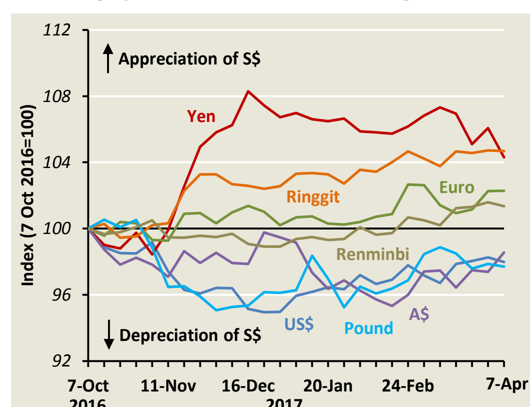
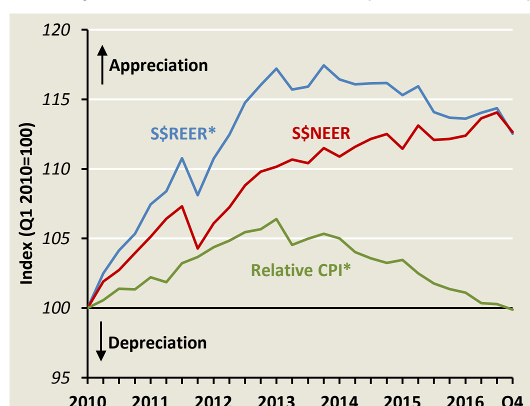


Chart 4.5
Components of the S$REER (CPI-Deflated)

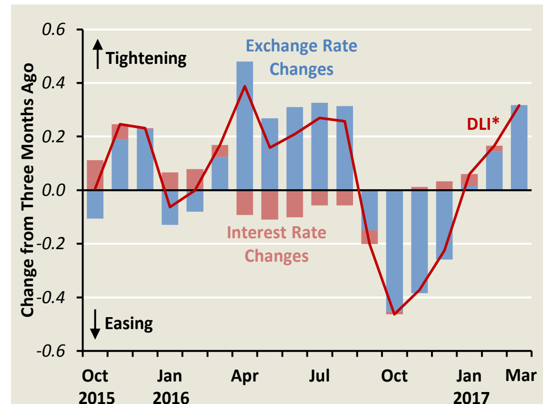


* EPG, MAS estimates.

Domestic liquidity conditions have been driven by movements in the S$NEER.

Since October 2016, overall liquidity conditions in the domestic economy, as measured by changes in the Domestic Liquidity Indicator (DLI)[1], have been primarily driven by changes in the nominal exchange rate. (Chart 4.6) Although domestic liquidity eased in Oct–Dec 2016 due to the depreciating S$NEER, it began to tighten from January 2017 as the trade-weighted index started to rise, particularly in the more recent months.

Chart 4.6
Domestic Liquidity Indicator

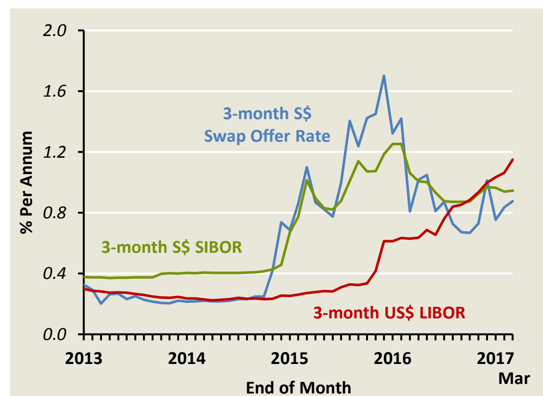


* EPG, MAS estimates.

Domestic interbank rates have been at a discount to US rates since October 2016.

The three-month S$ SIBOR had previously been at a premium over the US$ LIBOR between September 2012 and September 2016. (Chart 4.7) However, in October 2016, the US$ interbank rate rose above the S$ SIBOR. From October 2016 to March 2017, the S$ SIBOR increased from 0.87% to 0.97% in December, before easing to 0.95% in March 2017. In the same six-month period, the US$ LIBOR rose more rapidly from 0.88% to 1.15%. As a result, the discount between the S$ SIBOR and US$ LIBOR widened from 1 bps to 20 bps over this period.

Chart 4.7
Interbank Rates and Swap Offer Rate

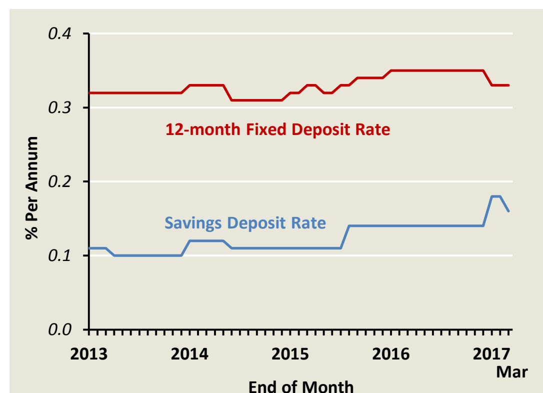


Source: ABS Benchmarks Administration Co Pte Ltd and ICE Benchmark Administration Ltd

The three-month S$ Swap Offer Rate (SOR) has been more volatile than the S$ SIBOR. Between October and end-2016, the SOR rose by 34 bps to 1.01%, but it subsequently fell 14 bps to 0.88% in March 2017.

The savings deposit rate has adjusted as well, albeit with a lag. It was stable at 0.14% throughout 2016, but increased to 0.18% in Jan–Feb 2017, before inching down by 2 bps in March. (Chart 4.8) In comparison, the 12-month fixed deposit rate remained unchanged at 0.35% throughout 2016 but fell to 0.33% in early 2017. Nevertheless, despite low board rates, a number of banks have continued to offer higher promotional rates on fixed deposit accounts.

Chart 4.8
Deposit Rates



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

[1] The DLI captures movements in the S$NEER and the three-month S$ SIBOR.

Money supply growth continued to rise in recent months before moderating in February 2017.

Growth in money aggregates rose between October 2016 and January 2017 before slowing in February. (Chart 4.9) M1 growth stepped up from 7.4% y-o-y in October 2016 to 8.9% in January 2017 as the stock of demand deposits and currency in active circulation (CIAC) expanded at a more rapid pace. (Chart 4.10) In February, however, M1 growth slowed to 8.4% alongside the moderation in CIAC growth. This, in turn, likely reflected the fact that the Lunar New Year festive period occurred in January this year, but February last year.

Meanwhile, the growth trajectories of M2 and M3 mirrored that of M1, although there was a compositional shift. Savings deposits growth continued to rise throughout 2016 to 10.9% y-o-y in February 2017, while fixed deposit growth slowed in the first two months of this year, in line with lower fixed deposit rates.

DBU non-bank loan growth picked up amid rising business loans.

As a result of the stronger growth outturn in Q4 2016, the stock of outstanding DBU non-bank loans began to expand in y-o-y terms in October 2016 after twelve consecutive months of decline. (Chart 4.11) The pace of credit growth continued to rise in February 2017, reaching 5.2% y-o-y. This was due to the recovery in business loans, which took place amid a broad-based turnaround in lending to sectors such as building and construction, general commerce, business services, as well as transport, storage and communications services. In comparison, consumer loan growth remained steady at around 3.2% between October 2016 and February 2017.

Chart 4.9
Money Supply

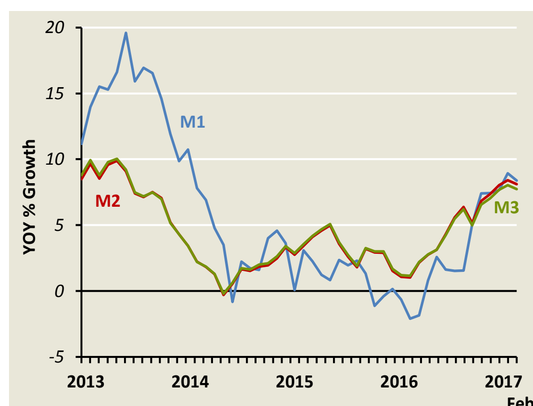


Chart 4.10
Components of Money Supply

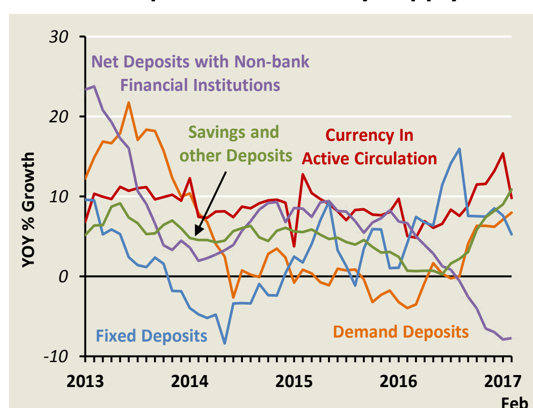
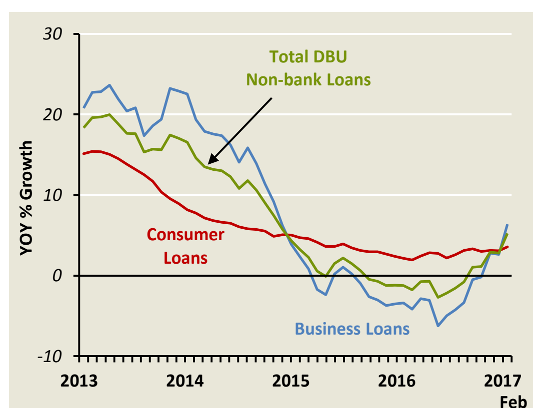


Chart 4.11
DBU Non-bank Loans



4.2 Fiscal Policy

A More Targeted Fiscal Approach

Budget 2017 continued the shift towards a more targeted fiscal policy approach. This was evident in the relief measures that were calibrated to specific sectors and firms facing cyclical headwinds, and the funding support for the initiatives to implement the recommendations of the CFE. A large number of the structural measures contained in the Budget also aimed to leverage on the government's capabilities to help industries and firms in the areas of digitalisation, innovation and internationalisation. In addition, the Budget enhanced Singapore's support for vulnerable groups in society and sought to ensure that the country would retain its high-quality living environment in the longer term. Against the backdrop of modestly improving but uneven growth, the fiscal policy stance for CY2017 is projected to be mildly expansionary.

Budget 2017 was forward-looking even as it addressed cyclical challenges.

Budget 2017 was delivered against the backdrop of lingering cyclical headwinds and structural challenges confronting the domestic economy. GDP growth was expected to be modest and uneven across the various sectors of the economy, while labour market conditions were likely to remain subdued. It was, therefore, appropriate that the Budget was mildly accommodative as a whole, and targeted at the pressure points in the economy. Certain sectors, firms and workers impacted by cyclical and transitional challenges were provided with calibrated support, but the focus of Budget 2017 was facilitating the Singapore economy's progress in line with the recommendations of the CFE.

Given that the economy has entered a more advanced phase of restructuring, Budget 2017 shifted towards a more targeted, micro-based approach to fiscal policy. The economic measures in this Budget were directed at specific segments of the economy and the fine-tuning of previously introduced initiatives. On the whole, Budget 2017 was appropriately calibrated to meet both cyclical and structural objectives, while keeping an eye on long-term fiscal sustainability. The key measures in Budget 2017 are summarised in Table 4.1.

Relief measures for sectors, firms and households were targeted to the current stage of the business cycle.

Budget 2017 continued and extended some of the transitional measures introduced in previous Budgets to address lingering cyclical weakness. For instance, the Additional Special Employment Credit[2] (ASEC) and Corporate Income Tax (CIT) rebate were extended to end-2019 and YA2018, respectively. For YA2017, the cap on the CIT rebate was raised from $20,000 to $25,000, following the increase in the rebate quantum to 50% of tax payable last year. In YA2018, the CIT rebate will fall to 20% of tax payable and be capped at $10,000.

At the same time, Budget 2017 provided specific assistance for sectors facing near-term difficulties. For example, the hike in the foreign worker levy for the Marine and Process sectors was delayed for another year in light of the still-subdued outlook for the oil & gas industry. Similarly, a bridging loan scheme for the Marine & Offshore Engineering cluster had been introduced to alleviate short-term credit constraints. To support the construction sector, the Budget brought forward around $700 million worth of public infrastructure projects to 2017 and 2018. These measures should help tide these sectors over soft patches in the near term.

[2] The ASEC provides wage offsets of up to 3% to employers hiring older Singaporean workers earning up to $4,000 a month, who are above the new re-employment age of 67 years. This is on top of the Special Employment Credit (SEC) of up to 8% for eligible Singaporean workers aged 55 and above.

Meanwhile, the SME Working Capital Loan scheme[3] introduced in Budget 2016 will remain in place for another two years, thereby facilitating SMEs' access to financing amid rising global interest rates. Together with the enhancement and extension of the CIT and SEC, which should be of relatively greater benefit to SMEs than to larger enterprises given the fixed caps on the corporate tax rebate and employment credit, these measures will provide support to SMEs facing cash flow constraints.

Budget 2017 also provided targeted near-term relief measures for households and individuals. For example, eligible individuals will receive a personal income tax rebate equivalent to 20% of tax payable, capped at $500 for YA2017, while lower-income Singaporeans will receive the one-off GST Voucher–Cash Special Payment of up to $200. The S&CC rebates were also tiered such that households in smaller HDB flats received a larger quantum of financial assistance.

Otherwise, the Budget's measures focused on helping unemployed workers to re-skill and find jobs, thereby seeking to alleviate structural mismatches in the domestic labour market. For unemployed residents, the enhanced National Jobs Bank and new "Attach and Train" scheme provided more avenues to search for suitable jobs and new careers. Budget 2017 also boosted financial support for wages and training provided under the Career Support, Professional Conversion and Work Trial Programmes, so as to speed-up residents' re-employment across industries and occupations.

Budget 2017 leveraged on the Government's resources for the next phase of restructuring.

The bulk of the Budget's measures were structural in nature, thereby setting in motion the CFE's broad recommendations. The main thrusts of the CFE report emphasised the need for industries and firms to digitalise, innovate, and internationalise, and for workers to deepen their skills. It also stressed the importance of Singapore remaining connected with the rest of the world, and open to the movement of goods and services, people and ideas. The report highlighted the role of the Government in supporting these strategies by investing in Singapore's physical and social infrastructure, and by playing a key coordinating role through the Industry Transformation Maps, to ensure that strategies were executed in a mutually reinforcing way. In addition, the Government could also work with the private sector more closely to facilitate growth and innovation. In this vein, Budget 2017 presented several initiatives that leverage on the Government's know-how, networks, and risk-bearing capacity to partner firms and workers in the next leg of the economy's transformation.

First, Budget 2017 introduced programmes in which the public sector would play the role of a proximate enabler of innovation. Indeed, the aim is to catalyse new industries and businesses, and provide an environment conducive to private sector-driven innovation. For instance, the CFE proposal to allow the Government to be a lead purveyor of more innovative and, therefore, more risky solutions would lend smaller firms and start-ups a helping hand. In the construction sector, Budget 2017 introduced a Public Sector Construction Productivity Fund to procure innovative and productive construction solutions for public sector projects. Meanwhile, the introduction of regulatory "sandboxes" in various sectors, such as financial services, will also allow firms to experiment at a lower cost and thereby facilitate the development of new, innovative solutions.

Second, government agencies have re-oriented their focus to help businesses more directly with innovation and technology adoption. For instance, the Government has sought to reduce firms' search costs by tasking A*STAR with the identification of technology solutions for 400 firms over four years (Operation and Technology Road-mapping). In addition, A*STAR will provide access to its advanced machine tools to enable prototyping and testing (Tech Access Initiative), and also train firms in the use of these tools. Budget 2017 complemented this initiative by enhancing the Headstart programme whereby SMEs could enjoy

[3] Under this scheme, the Government co-shares 50% of the default risk for loans of up to $300,000 per SME.

royalty-free exclusive licenses for three years for Intellectual Property (IP) co-developed with A*STAR. The “Headstart Programme” would thus increase the returns to innovation for firms developing IP with A*STAR, even as the cost of R&D would be subsidised for others through the Tech Access Initiative.

Third, Budget 2017 actively sought to leverage on government capabilities to provide targeted, human capital support and, where necessary, financial support to help firms scale up and internationalise. The former is most evident in the renewed push to help SMEs digitalise under the SMEs Go Digital Programme. Recognising that SMEs faced multiple hurdles to digitalisation, the Budget went beyond providing financial incentives to enlisting the expertise of IMDA to help guide SMEs through the process of IT adoption. Under the Go Digital Programme, IMDA and SPRING will also help firms identify digitalisation strategies most appropriate for their level of development and skills. This programme thus emphasised the in-person help available at SME Centres and the new SME Digital Technology Hub for specialist advice. Meanwhile, under a new $600 million International Partnership Fund, the Government will also co-invest with Singapore-based firms that aim to expand overseas. This recognises that local firms face constraints, owing, in part, to the lack of scale in the domestic market.

Fourth, the Budget sought to tap on the Government’s networks to reduce international search costs and promote global connectivity. As part of a new Global Innovation Alliance, three new programmes were introduced to help students, businesses and industries connect to the world’s marketplaces and ideas. Innovation Launchpads, for instance, would facilitate networking opportunities for local entrepreneurs to link up with overseas mentors, service providers and investors. Meanwhile, Innovators Academy will aim to help students build international connections and entrepreneurship capabilities. These initiatives draw on the Government’s extensive international network and a successful existing initiative by the National University of Singapore.

Budget 2017 also contained explicit measures to correct for environmental externalities and distortions …

Budget 2017 recognised that certain market outcomes produced negative environmental externalities. Accordingly, it sought to partially internalise these spillovers through the introduction of a new Vehicular Emission Scheme and a carbon tax from 2018 and 2019, respectively, and by restructuring diesel taxes. These changes were made to ensure that Singapore retains its high-quality living environment, which the CFE had identified as a key source of the country’s competitive advantage.

In the case of the increase in water prices, the objective is to continue to align prices to marginal costs, in recognition of the scarcity value of a basic resource. The Government would provide assistance to households through a permanent increase in GST Voucher–U-Save. After the increase, households in 1- and 2-room HDB flats would not experience any water price increase on average, while monthly water bills of other HDB households would only go up by $2 to $11 a month on average.

… and enhanced support for persons with disabilities.

Budget 2017 enhanced support for persons with disabilities and people with mental health conditions. Under the Third Enabling Masterplan, a Disability Caregiver Support Centre will be set up to provide information, respite care, training, and peer support groups to caregivers. Including existing initiatives, around $400 million a year is expected to be spent on supporting persons with disabilities, while an additional $160 million over the next five years is expected to be spent on community mental health initiatives. The latter is particularly pertinent as it seeks to integrate persons with mental health issues into society and the workplace, and will also be timely as the population ages and the incidence of elderly-related mental health conditions, such as dementia, increases.

Budget 2017 signalled the need to ensure fiscal sustainability.

Budget 2017 highlighted that Singapore's expenditure needs would rise significantly over time, particularly in the areas of healthcare and infrastructure. The Budget recognised that it was necessary for the Government to continue to use fiscal resources judiciously, while considering new revenue streams early so as to ensure fiscal sustainability for the longer term.

On the expenditure front, Budget 2017 announced that the budget caps of Ministries and Organs of State would be reduced by 2% permanently from FY2017. The freed-up funds could instead be used for higher priority requirements and cross-agency projects, such as the initiatives by the Municipal Services Office. This should encourage the civil service to be more efficient in its spending and work across agencies to minimise gaps in public service delivery.

The Budget also pre-emptively signalled that the Government would have to raise revenues in the longer term through new taxes or higher tax rates, in order to ensure that future generations remain on a sustainable fiscal footing. Nevertheless, the Government was cognisant that growing the economy was the most sustainable way to generate revenues. Accordingly, the strengthening of the revenue base would be effected in a pro-growth manner even as the tax structure would remain progressive.

Budget 2017 aimed to facilitate the next phase of restructuring in a fiscally judicious manner.

In sum, Budget 2017 emphasised the need for the Government to act as enablers and partners to businesses and workers, rather than as the main driver of the economy's restructuring. It built on the CFE's premise that the Government could play an important role in bringing together stakeholders and internalising positive externalities by providing "horizontals" that help firms, especially SMEs, and whole industries overcome information asymmetries. At the same time, the Budget re-oriented the broad fiscal approach from a focus on economy-wide targets and relative prices, to measures at the level of the sector, industry, firm, and worker.

This shift away from broad-based pecuniary measures to targeted, micro assistance leveraging on existing government capabilities was appropriate in the context of the stable, albeit modest, pace of expansion, and as economic restructuring proceeds into its more advanced phase. In addition, there was the need to be judicious in spending today. Accordingly Budget 2017 preserved the long-standing principle of ensuring fiscal prudence, even as it implemented the CFE recommendations aimed at enabling firms and workers to flourish and reach their full potential.

Table 4.1
Key Budget Initiatives in FY2017

	For Businesses
(A)	**General Measures**
(A1)	**Enhancement of the Corporate Income Tax Rebate** (additional cost of $310 million over YA2017 and YA2018) • Rebate cap raised from $20,000 to $25,000, at 50% of tax payable, for YA2017. • Extended to YA2018, at 20% of tax payable, capped at $10,000.
(A2)	**SMEs Go Digital Programme** • Industry Digital Plans to advise SMEs on firm-level technologies to use at each stage of growth. • In-person help at SME Centres for basic ICT advice, and a new SME Digital Technology Hub for specialist advice. • Advice and funding support when piloting emerging ICT solutions; Support for consortiums to adopt impactful, interoperable solutions.
(A3)	**Extension of the Additional Special Employment Credit** ($160 million) • Extended until 31 Dec 2019 to provide wage offsets of up to 3%, to help older workers stay employed.
(A4)	**International Partnership Fund** (up to $600 million) • Government capital to co-invest with Singapore-based firms to help them scale-up and internationalise.
(A5)	**Operation and Technology Road-mapping** • A*STAR to help firms identify technology to better innovate and compete. • Support for 400 companies over the next four years.
(A6)	**Improving Access to IP** • Intellectual Property Intermediary, a SPRING affiliate, will match companies with IP that meet their needs. • Headstart Programme offers SMEs that co-develop IP with A*STAR royalty-free and exclusive licences for 36 months, up from 18 months.
(A7)	**Enhanced International Finance Scheme** • Catalyse private cross-border project financing for smaller Singapore-based infrastructure developers. • Catalyse financing for projects in emerging markets.
(A8)	**Tech Access Initiative** • A*STAR will provide interested companies with access to, and training for, its advanced machine tools for prototyping and testing. • Further details available by September 2017.
(A9)	**Regulatory Sandboxes** • Promote innovation by creating space where rules can be suspended to allow greater experimentation, e.g., MAS regulatory sandbox for FinTech; LTA zones for testing of self-driving vehicles.
(A10)	**Base Erosion and Profit Shifting Project** • Seeks to ensure that companies are taxed where substantive economic activities are performed. • In consultation with businesses, Singapore will refine schemes and implement the relevant standards.
(A11)	**Early Turnover Scheme** • Extend the scheme for Euro II and III commercial diesel vehicles to be turned over to Euro VI vehicles until 31 July 2019. • Extend the COE bonus period for Light Goods Vehicles.
(A12)	**Carbon Tax** • To be applied upstream, for example, on power stations and other large direct emitters. • To be implemented from 2019, with the price level and exact implementation schedule decided after consultations.
(A13)	**Restructure Diesel Taxes** • Introduce a volume-based duty to reduce diesel consumption. • Permanently reduce the annual Special Tax on diesel cars and taxis by $100 and $850 respectively. • A 100% road tax rebate for one year, and partial road tax rebate for another two years, for commercial diesel vehicles; additional cash rebates for diesel buses ferrying school children.
(B)	**Industry-specific Measures**
(B1)	**Industry Transformation Maps (ITMs)** • Partnerships between firms, industries, Trade Associations and Chambers and the Government to address issues within each industry. • ITMs for 23 sectors (comprising over 80% of the economy) covering: (i) productivity; (ii) jobs and skills; (iii) innovation; (iv) trade and internationalisation. • Six have been launched and the remaining 17 will be launched within FY2017.
(B2)	**Deferring Foreign Worker Levy (FWL) Increases** • Defer FWL increase in the Marine and Process sectors for one more year to help employers in these sectors.

(B3)	**Accelerating Infrastructure Projects** • Bring forward about $700 million of public sector projects to start in FY2017 and FY2018.
(B4)	**Public Sector Construction Productivity Fund** (about $150 million) • Procure innovative and productive construction solutions for public sector projects.
(B5)	**Top-ups to Funds** • National Research Fund ($500 million). • National Productivity Fund ($1 billion).
	For Households and Individuals
(A)	**Workers and Job Seekers**
(A1)	**Set up a Global Innovation Alliance** • Innovators Academy: Enable students to build connections and capabilities through overseas internships. • Innovation Launchpads: Create opportunities for entrepreneurs and business owners in Singapore-based companies to connect with mentors, investors and service providers in overseas markets. • Welcome Centres: Link up innovative foreign companies with Singapore partners to co-innovate and expand in the region.
(A2)	**Enhance the “Adapt and Grow” Initiative** • Help workers adapt to structural shifts by increasing wage and training support through the: (i) Career Support Programme; (ii) Professional Conversion Programme; (iii) Work Trial Programme. • Introduce “Attach and Train” initiative for sectors that have good prospects, but where companies may not be ready to hire. Industry partners can send jobseekers for training and work attachments ahead of employment, to increase their chances of finding a job in the sector later.
(A3)	**SkillsFuture Leadership Development Initiative** • Support companies to groom Singaporean leaders by expanding leadership development programmes. • Develop 800 potential leaders over three years.
(A4)	**Increase Accessibility of Training** • Through more short, modular courses and expanded e-learning.
(A5)	**Better Job Matching** • Enhance the National Jobs Bank. • Work with private placement firms to deliver better job matching services for professionals.
(B)	**Households, Families and Community**
(B1)	**Water Price Changes (This would affect businesses as well.)** • Starting from 1 July 2017, increase price of water by 30% in two phases, by 1 July 2018. • Impose a 10% Water Conservation Tax on NEWater tariff.
(B2)	**Increase in the GST Voucher—U-Save** (additional $71 million per year) • To soften the impact of the water price increase, permanent increase in the rebate for eligible HDB households, depending on flat type.
(B3)	**One-off GST Voucher (GSTV)—Cash Special Payment** ($280 million) • Up to $200 given to eligible recipients, on top of the regular GSTV—Cash.
(B4)	**Extension of Service & Conservancy Charges (S&CC) Rebate** ($120 million) • Extend and raise by 0.5 months for FY2017.
(B5)	**Personal Income Tax Rebate** ($385 million) • 20% of tax payable for tax residents in YA2017, capped at $500.
(B6)	**Top-ups to Funds** • ComCare Fund ($200 million). • Medifund ($500 million). • GST Voucher Fund ($1.5 billion).
(B7)	**Increase in the CPF Housing Grant** ($110 million per year) • From $30,000 to $50,000 for couples who purchase 4-room or smaller resale flats, and from $30,000 to $40,000 for couples who purchase 5-room or bigger resale flats.
(B8)	**Enhancements to the Pre-school Sector** • Increase the capacity of centre-based infant care to over 8,000 places by 2020.
(B9)	**Enhancements to Bursaries for Post-Secondary Education Institutions (PSEIs)** (increase of around $50 million per year) • Increase in annual bursaries for students in publicly-funded PSEIs (up to $400 more for undergraduate students, $350 more for diploma students, $200 more for ITE students).

(B10)	**Community Mental Health** (additional $160 million over the next five years) • Resource Voluntary Welfare Organisations (VWOs) to set up more community-based teams. • Improve delivery of care within the community. • Increase the number of Dementia Friendly Communities. • Integrate people with mental health issues at the workplace and society.
(B11)	**Cultural Matching Fund** • Top up $150 million to continue 1:1 matching for donations to cultural institutions.
(B12)	**VWOs-Charities Capability Fund** (up to $100 million over next five years)
(B13)	**Grants to Self-Help Groups** ($6 million over next two years)
(B14)	**Enabling Masterplan 3** ($400 million per year, including existing initiatives) • Stronger support for persons with disabilities. • Extend training programmes to Special Education students with moderate intellectual and multiple disabilities to prepare them for employment. • Set up a Disability Caregiver Support Centre to provide caregiver training and peer support.
(B15)	**Community Sports and Sports Excellence** • Community sports — expand the Sports-In-Precinct Programme, and scale up SportCares to empower disadvantaged youths (over $50 million). • High performance sports — direct grants to support aspiring athletes and 1:1 matching of sports donations (direct grants of $50 million over five years, and up to $50 million over five years for matching of sports donations).
(C)	**Vehicle Owners**
(C1)	**Vehicular Emissions Scheme** • Extend the Carbon Emissions-based Vehicle Scheme (CEVS) until 31 December 2017. • Replace with new Vehicular Emissions Scheme starting from 1 January 2018, for two years.
(C2)	**Tiered Additional Registration Fees (ARF) for Motorcycles**
(D)	**Fiscal Sustainability**
(D1)	**Prudent and Effective Public Spending** • Permanent 2% downward adjustment to the budget caps of all Ministries and Organs of State from FY2017 onwards. • Some of these funds will be used to implement cross-agency projects that deliver value to citizens and businesses.

Source: MOF

A small overall surplus is projected for FY2017.

An overall budget surplus of $1.9 billion or 0.4% of GDP is projected for FY2017, smaller than the $5.2 billion surplus in FY2016. (Chart 4.12 and Table 4.2) This is predominantly due to a larger primary deficit of $5.6 billion arising mainly from an increase in operating expenditure. Accordingly, the deficit in the basic balance, which is the primary balance less special transfers excluding top-ups to endowment and trust funds, is also estimated to be larger in FY2017, despite the projected decline in special transfers arising from smaller pay-outs for Productivity and Innovation Credit and Temporary Employment Credit. Meanwhile, top-ups to endowment and trust funds are budgeted to rise from $3.6 billion to $4.0 billion this financial year.

Chart 4.12
Components of the Budget

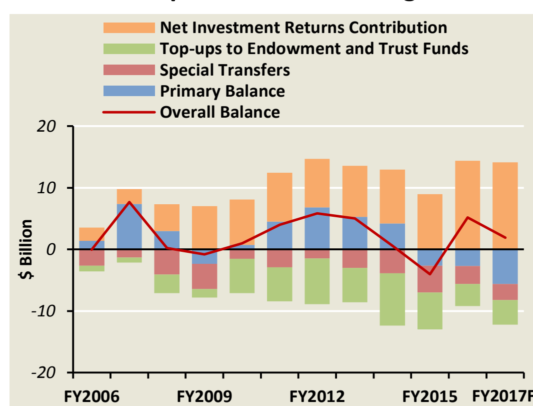


Table 4.2
Budget Summary

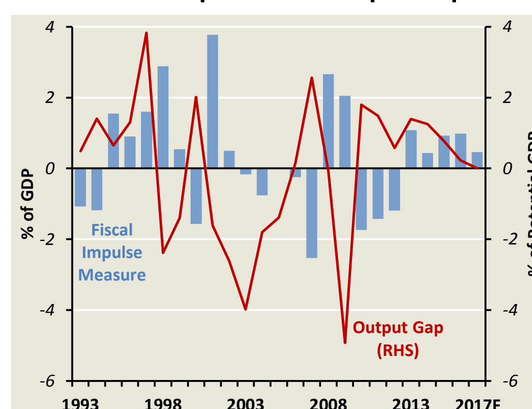
	FY2016 Revised		FY2017 Budgeted	
	$ Billion	**% of GDP**	**$ Billion**	**% of GDP**
Operating Revenue	68.7	16.6	69.5	16.3
Total Expenditure	71.4	17.3	75.1	17.7
Operating Expenditure	52.7	12.8	56.3	13.3
Development Expenditure	18.7	4.5	18.8	4.4
Primary Surplus/Deficit (–)	**(2.7)**	**(0.7)**	**(5.6)**	**(1.3)**
Less: Special Transfers (excluding top-ups to endowment/trust funds)	2.9	0.7	2.6	0.6
Basic Surplus/Deficit (–)	**(5.6)**	**(1.4)**	**(8.2)**	**(1.9)**
Less: Special Transfers (top-ups to endowment/trust funds)	3.6	0.9	4.0	0.9
Add: Net Investment Returns Contribution	14.4	3.5	14.1	3.3
Budget Surplus/Deficit (–)	**5.2**	**1.3**	**1.9**	**0.4**

The fiscal policy stance will be mildly expansionary in 2017.

In line with the slightly larger deficit in the basic balance, the fiscal impulse (FI) is estimated to be mildly expansionary at around 0.5% of GDP in CY2017. (Chart 4.13) This positive stance is appropriate given the relatively modest GDP growth projected this year. Together with the expansionary Budgets over the past four years and the cumulative effects of the monetary policy easing moves undertaken since January 2015, Budget 2017 will also keep the economy's output closer to potential, while supporting the continued restructuring of the economy over the longer term.

While the FI measure provides an indication of the short-term stimulus to aggregate demand arising from Budget 2017, the actual impact of selected budget measures on the economy was quantified using the Monetary Model of Singapore (MMS). Table 4.3 shows the macroeconomic impact of some of the Budget's key initiatives in 2017 and 2018. The personal income tax rebate, GST Voucher–Cash and one-off GST Voucher–Cash Special Payment, as well as other grants and bursary enhancements, will increase disposable incomes and, in turn, stimulate private consumption this year. At the same time, the budget measures targeted at firms should provide some near-term cash flow relief, in addition to supporting segments of the economy facing persistent cyclical headwinds. Accordingly, although many of the business measures in Budget 2017 have a medium-term orientation, the level of real GDP in 2017

Chart 4.13
Fiscal Impulse and Output Gap



Source: EPG, MAS estimates

Table 4.3
Impact of Selected Budget 2017 Measures on Real GDP and CPI-All Items Inflation

	2017	2018
Real GDP (% deviation)	0.10	0.00
CPI-All Items Inflation (% point deviation)	0.13	0.22

Note: The total value of the measures simulated is $996 million and $623 million in 2017 and 2018, respectively. The simulations include the deferment of foreign worker levies and the water price and diesel tax changes.

will be boosted by 0.1% from the baseline, with this effect fading in 2018.

The impact of the budget measures on CPI inflation will mainly be felt in 2018, primarily due to lags in the price transmission mechanism, and in view of the fact that some administrative price adjustments will only be fully phased in next year.

It is important to assess the macroeconomic impact of Budget 2017 in the context of the continued fiscal support from past as well as ongoing budget measures undertaken since 2013. These include the measures previously announced that will take effect in 2017, such as extending the SEC; the multi-year nature of some budget initiatives, including the Workfare Income Supplement Scheme and Silver Support Scheme; as well as the typical lags associated with government spending multiplier effects. EPG thus separately simulated the impact of these measures on the Singapore economy. The results show that the continued pass-through of fiscal stimulus since 2013 will boost the level of GDP by about 0.6% in 2017, and continue to provide some support in 2018. The stimulus from Budget 2017 is thus appropriately calibrated in this broader context.

Review of Government's CY2016 Basic Balance

Government operating revenue rose modestly in CY2016 …

This section compares the government's budgetary outturn in CY2016 with that in CY2015.

In 2016, operating revenue increased by $4.4 billion to $68 billion (16.6% of GDP) on the back of higher revenues from fees & charges, personal income taxes, GST and stamp duty. These increases more than offset the decline in revenues from corporate income taxes and property taxes. (Chart 4.14)

Fees & charges were boosted by a rise in vehicle quota premium collections as new vehicle registrations increased in 2016, even as the weighted average COE premium fell. (Chart 4.15) Overall, revenues from vehicle quota premiums rose by $1.3 billion to $6.3 billion for the year.

At the same time, receipts from personal income taxes (PIT), including withholding taxes, rose by $1.1 billion due in part to the cessation of the one-off PIT rebate that was in place for YA2015. Meanwhile, revenues from GST rose by $0.6 billion amid moderate growth in consumption and stamp duties increased by $0.4 billion likely on account of a modest rise in property transactions in 2016 as a whole. (Chart 4.16)

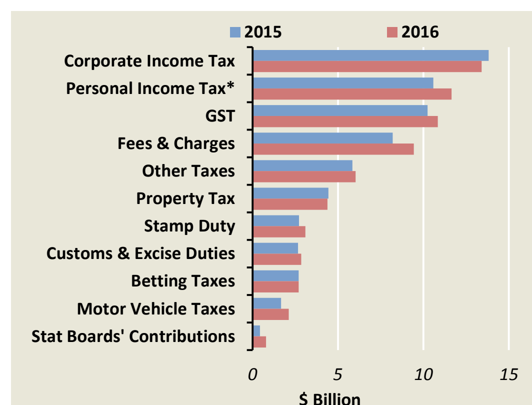
In comparison, corporate income tax receipts declined by $0.4 billion in 2016 compared to a year ago.

… while operating and development expenditures increased by more.

Total government expenditure rose by $11.8 billion to $72.9 billion (17.8% of GDP) in 2016 on account of higher spending on both operating and development items. (Chart 4.17) In terms of sectors, the bulk of the increase in total expenditure can be attributed to higher spending on economic[4] and social development. (Chart 4.18)

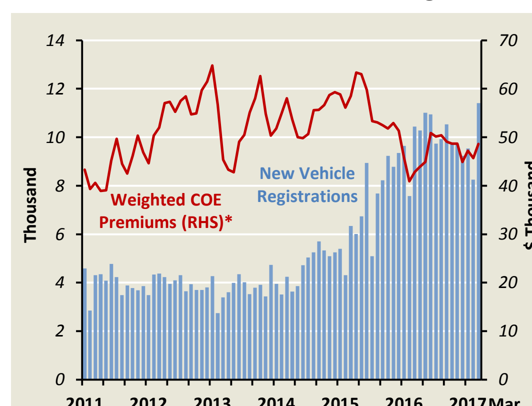
Operating expenditure, which includes expenses on manpower, and operating grants to statutory boards

Chart 4.14
Components of Operating Revenue



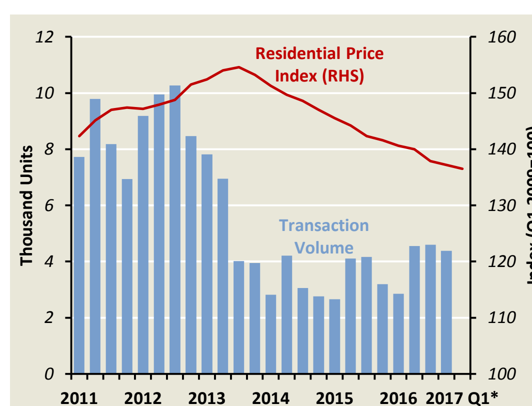
* Includes withholding tax.

Chart 4.15
COE Premiums and New Vehicle Registrations



* Weighted by the COE quota of each category.

Chart 4.16
Residential Price Index and Property Transaction Volumes



* Flash estimate.

[4] The economic development category comprises Transport, Trade and Industry, Manpower (excluding Financial Security) and Info-Communications and Media Development. The social development category comprises Education, National Development, Health, Environment and Water Resources, Culture, Community and Youth, Social and Family Development, Communications and Information and Manpower (Financial Security).

and other organisations, rose by $5.7 billion to $51.1 billion (12.5% of GDP) in 2016. The Ministry of Health recorded an increase in operating expenditure of $2.0 billion to cater for higher subventions to Public Healthcare Institutions and VWOs, and to implement national policies to improve healthcare affordability, such as subsidies for MediShield Life. At the same time, operating expenditure by the Ministry of National Development increased by $1.0 billion due to higher expenditure on public housing and an increase in housing grants to support home ownership. The Ministry of Education also saw a rise in operating expenditure, mainly due to a provision for the SkillsFuture Singapore Agency (SSG) established in October 2016, as well as a one-off provision of seed endowment grants to SIM University, which was recently granted the status of an Autonomous University.

Development expenditure, which comprises longer-term investment in capitalisable assets, such as roads and buildings, rose by $6.0 billion to $21.8 billion (5.3% of GDP) in 2016. The bulk of the increase accrued to the Ministry of Transport, for ongoing expansion of Changi Airport and the development of the Thomson-East Coast rail network.

The deficit in the basic balance widened in CY2016.

As the increase in total expenditure exceeded that of operating revenue, the government recorded a primary deficit of $4.9 billion (1.2% of GDP) in 2016, compared to the surplus of $2.4 billion in 2015. Together with slightly higher special transfers to businesses under the Transition Support Package, the government's basic deficit widened to $9.1 billion (2.2% of GDP), from $1.6 billion in the preceding year.

Chart 4.17
Government Operating and Development Expenditure

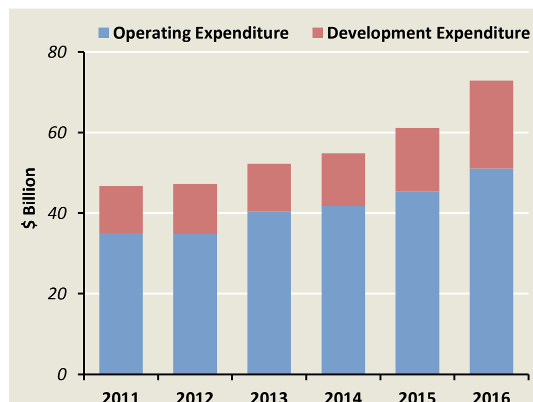
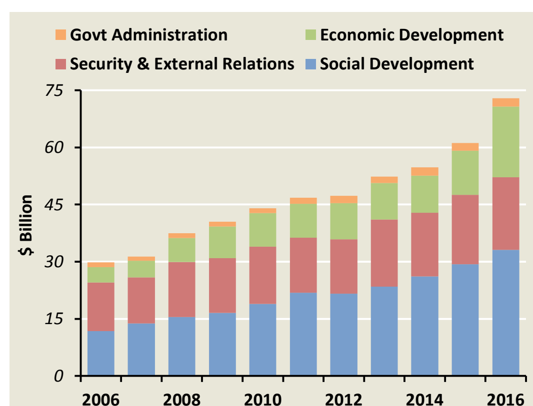


Chart 4.18
Components of Total Expenditure



Box C
The Currency Interchangeability Agreement: Fifty Years On[1/]

Introduction

On 12 June 1967, Malaysia, Singapore, and Brunei Darussalam (Brunei) began issuing their own currencies—the Malaysian dollar[2/], Singapore dollar, and Brunei dollar—in place of the Malaya and British Borneo dollar that previously circulated in these territories. At the same time, each country signed a Currency Interchangeability Agreement with the other two, undertaking to accept each other's currency and to exchange it at par, without charge, into its own currency. In other words, the three currencies would not be legal tender when circulating in the other participating countries but they would be "customary tender" and would be repatriated to the issuing country periodically.

This Box reviews the historical background to the Agreement and the subsequent developments that led to Singapore and Brunei maintaining interchangeability to the present day. It also explores how the Agreement has remained relevant for both countries over the years despite significant economic challenges as well as changes to each country's institutional arrangements for currency issuance.

From Straits Dollarisation to Malayan Currency Area (1897–1967)

The historical roots of the Currency Interchangeability Agreement can be traced to the turn of the last century, when the Board of Commissioners of Currency for the Straits Settlements (comprising Singapore, Penang and Malacca) was established in 1897. By the early 20th century, the Board was issuing Straits Settlements currency notes and minting Straits Settlements silver dollars. Singapore and the other Straits ports had, therefore, acquired a uniform and unified domestic currency, as well as a unit of account.

In actual fact, however, the currency of the Straits Settlements also circulated widely in the rest of the Malay Peninsula, British North Borneo (Sabah), Sarawak and Brunei, alongside the British North Borneo dollar and the Sarawak dollar, which were exchangeable at par with the Straits dollar. Brunei had become a British Protectorate in 1888, and its colonial and economic links with the Straits Settlements led to the Straits dollar becoming the currency of choice. There was thus *de facto* "Straits dollarisation" in Brunei by virtue of the latter's use of the Straits dollar.

In 1933, the Blackett Report recommended the creation of a common currency encompassing the Straits Settlements, the Malay States, and Brunei through joint participation in a pan-Malayan currency board. This recommendation was motivated by the desire for the Malay states, which had hitherto utilised the Straits dollar for free, to bear the costs of note issuance as well as share in the profits[3/] from the operation of a currency board (Drake, 1981). The Currency Ordinance of 1938 put into effect these recommendations, and Singapore and Brunei were thus formally linked through a common currency—the Malayan dollar—with the Malay states. These arrangements were disrupted by the outbreak of World War II, but subsequently revived and expanded to include North Borneo and Sarawak in 1950. The Malayan Currency Board was renamed the Board of Commissioners of Currency Malaya and British Borneo, and it began to issue the Malaya and British Borneo dollar from 1953. With this development, Singapore and Brunei had moved from sharing a "Pan-Malayan Currency" to being officially part of a wider "Malayan Currency Area" (Lee, 1990).

1/ This Box is written in collaboration with the Autoriti Monetari Brunei Darussalam. It has benefited from comments by Mr Freddy Orchard and Associate Professor Peter Wilson.

2/ The Malaysian dollar was renamed the Malaysian ringgit in August 1975.

3/ The Straits Settlements would receive, and bear, 37% of the profits and liabilities associated with currency issuance. Brunei's share was 0.75% (Straits Settlements Legislative Council Proceedings, 1934, as cited in Lee, 1990).

The Currency Interchangeability Agreements of 1967

In 1957, Malaya obtained independence and following that, a central bank, Bank Negara Tanah Melayu (Central Bank of Malaya), was established in 1959. Bank Negara's statutes included a provision for the Bank to extend its operations to Singapore, Sabah and Sarawak, since these states were expected to eventually merge with Malaya. In the event, the union of the four territories in the new political entity of Malaysia was completed in September 1963.

However, as currency issuance still resided with the Currency Board, the renamed Bank Negara Malaysia's (BNM) autonomy in the conduct of monetary policy through discretionary changes in the money supply was circumscribed. Malaysia lodged a "notice of replacement" to the Currency Board in 1964 to inform the latter that it would issue its own currency beginning from December 1966. Accordingly, Malaysia worked towards dismantling the Currency Board and allowing BNM to take on the sole responsibility of issuing a new Malaysian dollar. Brunei, which had remained under British administration, was still reconsidering the currency issuance arrangements.

On 9 August 1965, Singapore became a sovereign nation, but initially worked towards sharing a common currency with Malaysia. After all, the extensive business and trade linkages between the two economies, as well as their complementary economic relationship, meant that there was a compelling case to be made for a currency union to reduce the frictions and transactions costs associated with foreign exchange and payments. Despite multiple discussions between the two governments involving technical inputs from the IMF, negotiations for a common currency collapsed and each of the parties decided to take the route of monetary separation.

It was in this context that on 12 June 1967, the BNM, as well as the newly-formed Board of Commissioners of Currency, Singapore (BCCS) and Brunei Currency Board (BCB), issued three separate currencies to replace the Malaya and British Borneo dollar: the Malaysian dollar, the Singapore dollar, and the Brunei dollar. These new currencies were *de facto* pegged through their link to the pound sterling, which helped to minimise disruptions in the commercial and banking sectors in these countries following the issuance of the new currencies. In addition, Malaysia, Singapore and Brunei signed Currency Interchangeability Agreements with each other, undertaking to accept one another's currency and to exchange it at par, and without charge, with its own currency. These arrangements could be considered a pragmatic approach that acknowledged the depth of the economic links between their economies. They passed their first test when all three countries decided not to follow Britain's move to devalue the pound sterling in November 1967.

Continued Currency Cooperation between Singapore and Brunei

The interchangeability agreements faced another major challenge with the tumultuous events that shook the international monetary system in the early 1970s. In August 1971, US President Nixon closed the gold window and devalued the US dollar against gold, which automatically meant a revaluation of these currencies against the US dollar. Two years later, the post-war Bretton Woods system of fixed exchange rates broke down when all the major currencies decided to float against the US dollar. Against this external backdrop, and given its domestic development imperatives, the Malaysian government terminated its agreement with Singapore on 8 May 1973 and two weeks later, the interchangeability agreement between Brunei and Malaysia also ceased.

Singapore and Brunei have continued with the Agreement ever since, despite significant structural changes to their economies as well as domestic monetary institutions and arrangements. Indeed, the Currency Interchangeability Arrangement has stood the test of time, having been resilient in the face of economic challenges such as the Asian Financial Crisis and Global Financial Crisis. There are several reasons why the Agreement has worked well for Singapore and Brunei over the years.

First, the Agreement initially operated within the traditional currency board system, with the BCCS and BCB taking on the responsibility of currency issuance. This boosted investor confidence in both the Singapore and Brunei dollars. Subsequently, the BCCS retained the currency issuance function even after the Monetary Authority of Singapore (MAS) was established in 1971. Such an institutional configuration was novel, with the

IMF's 1971 mission to Singapore noting that "the combination of a monetary authority together with an autonomous currency board is an interesting innovation which marks a departure from the conventional wisdom of central banking in the emergent countries."[4/] This sent a further signal to financial markets that the fledging monetary authority would not be able to print money to finance government deficits, thus helping to maintain confidence in the value of the Singapore dollar.

While the institutional framework behind currency issuance in Singapore and Brunei continued to evolve over the latter half of the 20th century, the credibility and discipline necessary for the smooth functioning of the Agreement was preserved. Strictly speaking, Singapore had ceased to operate a currency board system from 1973 as the Singapore dollar was allowed to float against the US dollar, and could no longer be exchanged on demand for foreign currency at a fixed rate. However, the spirit of the currency board system remained. Thus, in 2002 when the BCCS was merged with MAS, Singapore continued to back currency issuance with external assets in the Currency Fund. Similarly, the Brunei Currency Board continued to manage currency issuance, even as it was renamed the Brunei Currency and Monetary Board in 2004, and reconstituted as the Autoriti Monetari Brunei Darussalam (AMBD) in 2011. Today, Brunei still operates a currency board system with the Brunei dollar anchored to the Singapore dollar at par.

Second, the Currency Interchangeability Agreement is supported by Singapore and Brunei's underlying economic fundamentals such as their strong external balance positions, including their foreign reserve holdings. The flexibility in both domestic economies have negated the need for asymmetric monetary policy, while Singapore and Brunei's current account surpluses have accorded long-run support to their real effective exchange rates.

Third, the Agreement has been compatible with macroeconomic stability in both Singapore and Brunei. In 1981, Singapore adopted an exchange rate-centred monetary policy framework, aimed at achieving low and stable inflation. From Singapore's perspective, the nominal exchange rate was a relatively more effective anti-inflation instrument in the context of the small and very open Singapore economy (MAS, 1981/82). An appreciation of the trade-weighted Singapore dollar could be used, where necessary, to directly offset imported inflation and indirectly dampen demand for Singapore's exports, and hence, factor inputs and costs. At the same time, the framework has also served as a credible nominal anchor (MAS, 2016). The exchange rate-centred monetary policy framework has undoubtedly been successful, since Singapore's average CPI inflation rate moderated from 6.1% in 1970–80 to 1.9% over 1981–2016, well below a weighted average for OECD countries.

Insofar as Brunei is also a small, open economy with a significant pass-through from import prices to domestic prices, it would benefit from the exchange rate-centred monetary policy framework. At the same time, it could be challenging for small, open economies with relatively less deep forex markets to adopt freely floating exchange rates. Singapore and Brunei's cooperation on currency and exchange rates resolved this issue through a *de facto* peg of the Brunei dollar to the Singapore dollar. This has allowed both countries to share in the benefits of the strong nominal anchorage provided by an exchange rate-centred monetary policy framework. Indeed, CPI inflation in Brunei has been low and stable, averaging 1.6% over 1981–2016. It is noteworthy that the IMF has lauded the currency board arrangement with the Singapore dollar as having served Brunei well by providing a credible nominal anchor (IMF, 2016).

Fourth, the Agreement has contributed to preserving and deepening the existing economic and financial linkages between Singapore and Brunei. The peg effectively eliminates foreign exchange rate risks between the two currencies while minimising transaction costs, thereby facilitating tourism, trade and investment between the countries. To the extent that Singapore is a major FX trading centre, these arrangements have also facilitated the convertibility of the Brunei dollar into other currencies. Indeed, in the years since the signing of the agreement, trade between the two countries has grown steadily from under US$20 million in 1968 to US$822 million in 2016. Despite the rapid growth in each country's total trade with the rest of the

[4/] Source: Orchard (2016), quoting the concluding statement of the IMF Article VIII Consultation, 1971.

world, Singapore has remained one of Brunei's top 10 trading partners. In 2000–16, Singapore accounted for approximately 18% of Brunei's total imports on average, up from 16% in 1967–80. Over the two time periods, Singapore's share in Brunei's total exports has remained stable at around 3%. Singapore's trade in services with Brunei has risen from US$76 million in 2000 to US$400 million in 2015, and has expanded more rapidly than Singapore's trade in services with the world.

Conclusion

Over the last fifty years, the Currency Interchangeability Agreement has been mutually beneficial for both Singapore and Brunei, and it has remained intact despite significant economic challenges faced by both countries over the years. The monetary arrangements prevailing in the two economies have evolved, but the essential spirit of cooperation has stayed the same. The domestic and international purchasing power of the Singapore dollar is anchored by the credibility of MAS' exchange rate-centred monetary policy in keeping inflation low and stable, and this has been extended to Brunei via the Agreement and the Brunei dollar's peg to the Singapore dollar. These arrangements have also enabled both countries to benefit from stronger trade and investment flows, and the Agreement remains as relevant and valuable today as it did fifty years ago. At the same time, it stands as a solid testament to the strong historical links between the two countries and the close relationship enjoyed by AMBD and MAS.

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