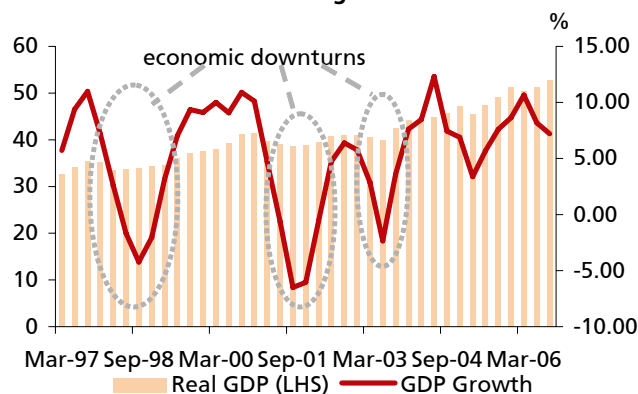


# Singapore Budget: Something for Everyone

## A Budget to enhance growth

- Over the past decade, Singapore has managed to reinvent itself and emerge from difficult times with more robust economic growth (**Chart 1**). After a respectable expansion of 6.4% in 2005, the economy went on to clock in robust growth of 7.7% in 2006. Growth consistently came in above expectations last year, with the government having raised its 2006 real growth forecast three times, from 4.0-6.0% in February, to 5.0-7.0% in May, and finally to 6.5-7.5% in August.
- This is again the time of the year when the financial markets as well as the Everyman eagerly await the goodies that may be dished out by the Government on Budget Day. The current good-going presents an ideal opportunity for policy-makers to introduce adjustments this Thursday, with the aim of enhancing Singapore's competitiveness, sharing the fruits of growth, creating more economic opportunities and providing a more extensive social safety net.

Chart 1 : Real GDP and GDP growth

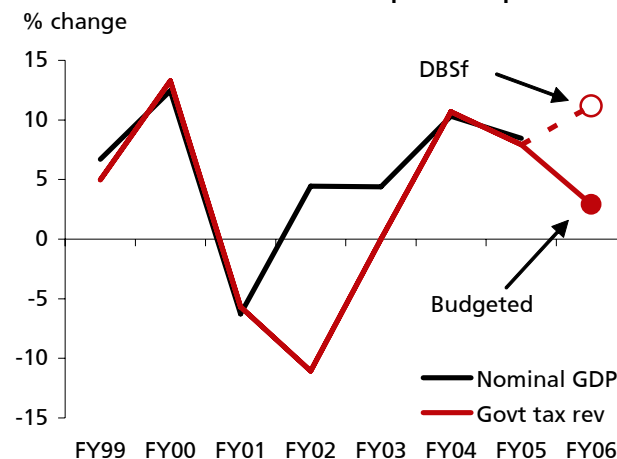


Source: CEIC, DBS

## Smaller than expected deficit for FY06

- Before delving into expectations for Budget 2007, let us take a look at the state of finances so far this fiscal year. As of Sep06, or the end of the first fiscal half, tax collections have already reached 54.0% of the full year target. Given the momentum of growth and the tendency for tax collections in the second half to remain quite stable, we estimate that total operating revenues (which also includes fees and charges) for FY06 could surprise on the upside at SGD 31.1bn, versus the projected SGD 28.96bn (**Chart 2**). Meanwhile total expenditure appears on track to achieve the targeted SGD 30.62bn – spending in 1HFY06 totalled SGD 9.27bn, and given the usual surge in second-half spending, expenditure targets should be met.
- This will bring the primary balance to a small surplus of around SGD 460mn - a first since FY01. Nevertheless the overall budget position will still likely be one of a deficit, given that significant special transfers comprising of Growth Dividends, the Workfare Bonus, top-ups to CPF accounts and so on were made last year. Our calculations point to a deficit in the region of SGD 741.2mn to SGD 1.22bn, versus a budgeted shortfall of SGD 2.86bn. The swing factor will be whether Net Investment Income (NII) delivers as projected.

Chart 2: FY06 revenues could surprise on upside



Source: Ministry of Finance, CEIC, DBS

## FY07: Tax changes a moderate net positive for revenues

- As has already been well flagged by the government, the GST will be raised by 2.0% to 7.0%, probably all in one hit. At the same time corporate/personal income tax will also be lowered. This rebalancing is aimed at enabling Singapore to sustain crucial investment flows into the country and ensure fiscal sustainability as the population ages.
- According to DBS' estimates, a one-time GST hike could raise collections by SGD 1.5-2.0bn. This makes a reduction in corporate/personal income tax rates to 17.0-18.0% viable. However, since the income cut would subtract from revenues, an initial 1.0% reduction in corporate/personal taxes with perhaps a pre-commitment of another 1.0% in FY08 could be

the preferred approach. Moreover, the authorities are also likely to implement both the GST hike and income tax cuts simultaneously, to placate employers, who will also be hit with higher contributions to their employees' CPF accounts (we elaborate more on this in the following sections).

- The timing of the GST hike and income tax cut affects our revenue calculations, though not by much. We note that when the GST was first introduced in 1994, firms had over a year's notice. During the staggered hikes in 2003 and 2004 businesses had ten months to adjust to the first hike. The substantial lead time is to allow business and accounting systems to be adjusted. We reckon that this time round, firms would probably need at least six months to adjust to the hike. Despite the possibility of learning-curve effects, one should not underestimate the complexities involved, particularly for the SMEs - which means implementation in the Dec07 quarter at the earliest. This would raise the government's operating revenues by SGD 162mn for FY2007; assuming more 'prep' time, say till 1Q08, then the tax changes would result in a SGD 81mn rise in FY2007 operating revenues, with the rest of the incremental revenue being deferred to the following fiscal year.
- The real wild cards for the overall budget position will not lie in the timing or degree of tax changes, but rather special transfers and the NII contribution. Policy makers have touted this Budget as one that will offer something for everyone. However, given plans to put in place sustainable social safety nets, we would be surprised to see special transfers surpassing the SGD 2.0bn mark. Government officials have also previously said that the additional revenue from the GST hike will be ploughed back into special transfers, and as we mentioned earlier SGD 2.0bn is about right.
- Meanwhile PM Lee has said that NII would include realised capital gains. Currently, NII only includes dividends and interest income from the investment of reserves, but having averaged a whopping SGD 2.5bn in the past five years, it has already been a significant boon to the budget. It is not clear what proportion of the realised capital gains will accrue towards the NII. However, even assuming an extremely modest 1.0% annual capital gain on Singapore's official reserves of over SGD 200bn, we could ostensibly looking at a near-doubling of the NII contribution. Again, the boost to overall budget position is contingent on timing - the sooner Parliament passes this change in the NII definition, the sooner the boost to the budget.

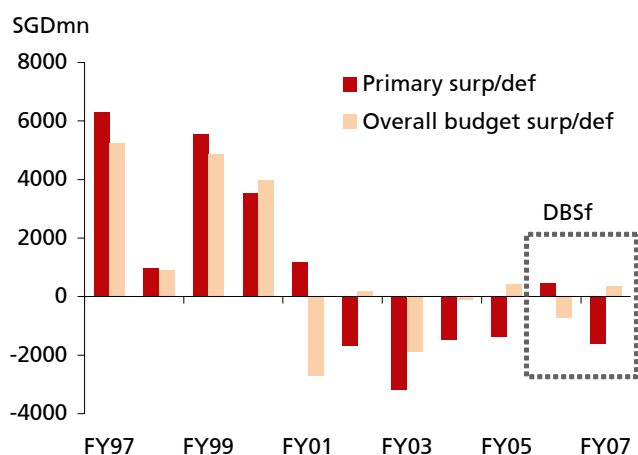
### Small deficit/moderate surplus for FY07

- In summary, despite significant changes to Singapore's tax structure in the coming financial year, the overall budget position is not likely to be extreme, and is likely to range anywhere between a small shortfall of SGD 130mn to a modest surplus of up to SGD 550mn (**Chart 3**).
- As has been the case since FY2002, the primary balance is likely to be in deficit, to the tune of around SGD 1.6bn. We expect slower real economic activity this year of around 5.2%, and this will cool the pace of revenue collection, with operating revenues likely to be in the SGD 32.4bn region. This will be slightly surpassed by total expenditure of around SGD 34bn.

### As for the goodies...

- On the expenditure side, do not expect the government to drop any bombshell policy-wise. The budget and the initiatives/policies that go along with it are unlikely to deviate much from previous years, except that it may not be in the same flavour as the "Relief Package" seen during the recession years. Rather, it will more likely taste like the Progress Package seen in the last budget. **Table 1** shows a breakdown of special transfers in previous years' Budgets, which provides us some guidance on what may be in store for the forthcoming one.

**Chart 3: Overall budget headed for a surplus in FY07**



Source: Ministry of Finance, DBS

**Table 1: List of Special Transfers**

Cost of Govt Special Transfers, FY 2001-06	SGD bn
New Singapore Shares	2.5
Economic Restructuring Shares	2.7
S&CC and Rental Rebates	0.5
U-Save Rebates	0.6
CPF Top-ups	1.09
Medisave Top-ups	0.45
Edusave Top-ups	0.05
<b>Budget 2006 Measures (Estimates)</b>	
Growth Dividends	1.43
Workfare Bonus	0.4
CPF Special/Retirement Account Top-ups	0.25
Medisave Top-ups	0.25
40th Anniversary NS Bonus	0.2
U-Save Rebates	0.06
<b>Total Cost of Special Transfers</b>	<b>10.45</b>

Source: Ministry of Finance

### Developing human capital

- As has been the case in previous years, there will continue to be significant emphasis on investing in human capital. This is necessary for sustaining the transition of the economy towards a knowledge-based economy. For example, of the 450 new investment projects (worth SGD 13bn) attracted to Singapore by the Economic Development Board in 2006, the bulk of them are involved in high-tech, high value-added activities which require workers with a sophisticated skill set. As it stands, there is still evidence of a mis-match between job requirements and skill-sets despite on-going efforts at developing human capital, with the resident unemployment rate having stagnated at 3.6% since 2Q06, despite a record number of new jobs being created. To this end, a significant Budget allocation may be made for training and education initiatives, such a top-up to the Lifelong Learning Fund (currently at SGD 2.1bn) and an increase in funding for the Job Re-creation programme.
- The government may also give more attention to the white-collared workforce, ie. professionals, engineers, technicians and mid-level managers, by providing funding for the training and further education of this group. For Singapore to compete effectively in the global economy, the country not only needs a liberal foreign labour policy, but must also ensure that the full spectrum of its labour force stays in pace with the developments in the external environment.

### Promoting new growth engines and upgrading infrastructure

- Promoting new growth sectors is a critical part of the Government's economic strategy. As with past budgets, it is likely that government would provide funding for jump-starting new industries as well as incentives to incumbents in existing sectors. Targeted areas are expected to include tourism-related activities, ahead of the opening of the "Integrated Resorts", creative services, such as the IT media and design industry, educational services as well as R & D in areas such as life sciences, nanotechnology and biofuels.
- Infrastructure upgrading has been a regular feature in previous budgets. Budget 2007 will be no exception, despite the recent debacle over sand imports.

### Softening the impact and sharing the fruits of growth

- For Singaporeans who pay income tax, the reduction in income tax will offset, fully or partially, the increase in GST. However, many Singaporeans pay no income tax. To alleviate the possible negative impact of the GST on this group, the offset package would likely be substantial. Items such as rebates on service and conservancy charges and rental, workfare bonus, utilities rebate, top up of the Comcare Fund and perhaps a second round of Growth Dividends are likely to be featured. In addition, to maximize educational opportunities for young Singaporeans, particularly those from the lower income families, the government is expected to increase its funding for the Edusave Fund and other education related initiatives.
- Currently, there are approximately 263,500 Singaporeans aged 65 or above, and this figure is likely to increase to about 795,900 by 2030. Faced with an aging population, the government would most probably continue its policy of helping the elderly Singaporeans, especially those without financial support, to cope with their healthcare needs. Expect a top up in the Eldercare Fund, Medifund, CPF Special or Retirement and Medisave accounts for the aged.

### Some changes to CPF contributions

- The employer's CPF contribution rate has gone through several changes over the years, from as high as 20% back in the pre-crisis years to the current 13%. This is likely to change again with recent comments from the political leadership, suggesting that there will be an increase in the employer's CPF contribution rate. Meanwhile, there have also been suggestions for a cut in employee's contribution (currently at 20%) instead, to put cash into the hands of the lower income workers. Judging from official rhetoric, however, the latter will probably be left out of the table this Thursday. Instead, we expect the employer's CPF contribution rate to be raised by 2% to 15%, with the additional 1% each allocated to the Ordinary Account and the Special Account.

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