Singapore Budget 2016

Restructuring the economy for the future

MACRO | ECONOMY | SINGAPORE

31 March 2016

Interesting Facts

- This is the first budget since the new government was elected in 2015, the Singapore Constitution prevents every new term of Government from drawing on the accumulated fiscal surpluses of the previous term, thus limiting the room for large expenditure early on in a fresh term.
- Singapore had maintained a positive output gap (actual output is more than the full-capacity output) since 2010 but is expected to have a slightly negative output gap in FY2016 as growth moderates.
- Temasek Holdings will be added into the calculation of Net Investment Returns Contribution (NIRC). This will increase NIRC for FY2016 budget by 48.6% from the revised FY2015 budget. This is a huge contributing factor to an overall budget surplus.
- Statutory Boards' Contributions are expected to increase by $1.4bn (or 333%) to $1.9bn mainly due to contributions coming in from MAS, which had not made contributions over the past 5 years

Our take on the budget

1. **This is the second consecutive year that the government is running a structural Primary Deficit**. The saving grace for an Overall Budget Surplus was the significant reduction in **Special Transfers** (-40.5%) and the inclusion of Temasek Holding for NIRC. It will not be healthy for the government to continue running a primary deficit especially when it is expecting further increase in social expenditure due to an aging population. We can take a cue from the past to understand the future action of the government. After the 2001 General Election, GST rate was hiked, not once, but twice in 2003 from 3% to 4% and ultimately to 5% in 2004. The same scenario repeated itself in 2007 after the 2006 General Election when the GST rate was further increased to 7% from 5%. If history is to repeat itself, a GST rate hike seems to be ever more plausible in the near further.
2. **We are not sure if the S$5bn (7.3% increase from prior year) addition expenditure will be enough** to counter the cyclical economic headwind. With the global economic in a less than rosy state, U.S., Europe and Japan are fighting their own battles against recession and deflation. China's transition from a manufacturing-based economy to a consumption and service-led economy is creating unexpected ripples in their equity markets and their currency. This was rightly pointed out in the budget as externally-oriented sectors such as manufacturing will continue to face subdued demand. Even in such dire external macroeconomic environment, the government is expecting a positive fiscal impulse of c%1.1 of GDP from it's spending.
3. **This budget refocused on businesses especially for SMEs**. The following initiatives such as ***Enhancing Corporate Income Tax Rebate*** with the higher percentage of Corporate Income Tax (CIT) Rebate. Under the ***SME Loan Assistance*** the government will co-share 50% of the default risk of such loans with participating financial institutions, to encourage lending to SMEs. ***SME Centres*** were established to help SMEs access schemes administered by various government agencies., Under the **Automotive Support Package**, government will enhance the risk-share with participating financial institutions from 50% to 70% so as to improve SMEs' access to loans for qualifying projects***. SME Mezzanine Growth Fund*** has also expanded from current fund size of $100mn to a total fund size of up to $150mn. To support SMEs internationalisation, the government has also extended the ***Double Tax Deduction for Internationalisation scheme***, till 31 March 2020.

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Key Measures for Businesses

Beside the enhancement and extension of a few ongoing initiatives, the biggest key initiative this year, was the $4.5bn budgeted ***Industry Transformation Programme***. The programme is further sub-divided into three key thrust. Mainly,

- Transforming Enterprises
- Transforming Industries
- Transforming through innovation

Under the Industry Transformation Programme, a huge emphasis has been placed on automation and increasing productivity.

a) The ***Automation Support Package*** will include over $400mn to be spent on support for firms in scaling up automation project. Such support include grant to scale-up automation project by up to 50% of cost, capped at $1mn. Net Investment Allowance of 100% of automation equipment.

b) As part of the effort to increase productivity through automation, the government is making a huge push into robotics by setting aside $450mn, for the next 3 years, to scale up development and adoption of robots under the ***National Robotics Programme***.

Other Business Measures of interests

a) **Enhancing Corporate Income Tax Rebate**
The existing Corporate Income Tax (CIT) Rebate will be raised from 30% of tax payable to 50% of tax payable, with a cap of $20,000 rebate each year for Year of Assessment (YA) 2016 and YA 2017.

b) **Loan Assistance for SMEs**
To support viable SMEs that may have cash flow concerns or wish to continue growing their business, the Government will introduce a new ***SME Working Capital Loan scheme***, for loans of up to $300,000 per SME. Under this scheme, the Government will co-share 50% of the default risk of these loans with participating financial institutions, to encourage lending to SMEs. The SME Working Capital Loan will be available for three years, starting from 2016.

c) **Foreign Worker Levy Changes**
A dismal for most, the foreign worker levy will remain unchanged for the underperformance manufacturing sector as the government put the foot down on doing away with cheap foreign labours and forcing firms to look into increase productivity via automation. The Government will proceed with levy increases for Services and Construction Work Permit holders, as well as S Pass holders in every sector, as announced in Budget 2015. In view of challenging business conditions in the Marine and Process sectors and the reduction in the number of Work Permit holders in these sectors, the Government will defer levy increases for Work Permit holders in these sectors for one year.

d) **Cooling Measures for Property Market**
In view of keeping a stable and sustainable property market, it is assessed to be too premature to relax the measures that were set in place since 2010 to stabilise the property market.

e) **Production and Innovative Credit (PIC)**
In a shift to more targeted measures under the Industry Transformation Programme, board-based measures such as the PIC will continue to be tapered. The cash payout rate under the PIC will be reduced from 60% to 40% for expenditure incurred on or after 1st August 2016. The 400% tax deductions under the scheme remain unchanged. The scheme will expire after YA2018.

These are just a few of the measures we felt would relevant to point out the trend of Budget 2016. To find out more measures and to get a holistic view of the budget, do kindly access the budget homepage for more information. We have also not commented on the budget affecting household. Next, we follow up on the budget with our thoughts on how certain sectors will be affect by this year's budget.

Impact on Sectors

Construction & Infrastructure

The government intends to spend $2.5bn into funding smaller scale construction projects, and this is expected to benefit smaller construction companies on hindsight. However, due to the impending levy increase to be imposed on construction work permit holders which was announced in Budget 2015, gross margins on construction projects are likely to wane even more despite cost savings from falling material prices.

At the same time, reiterating on Building and Construction Authority's projection, where it expects the total value of construction contracts to be awarded in 2016 to range between $27bn and $34bn, compared to $27.2bn last year. The demand from the private sector is likely to falter amid the weaker economic environment along with higher completions of private housing projects and offices. However, construction contracts from public sector demand should cushion the impact from a slowdown in the private sector, as higher public spending is expected to be channelled into civil engineering projects.

Notable initiatives in 2016 will include the ramping up of Home Improvement Programme for HDB flats, JTC's Integrated Logistics Hub, improvement works to the Kranji and Pan-Island Expressways, as well as the remaining contracts for the Thomson-East Coast MRT line.

Telecom & Manufacturing

We view that the telecommunications and manufacturing sectors will be beneficiaries from the Industry Transformation Programme. The Government intends to set aside a total of S$4.5bn under the programme to support enterprises and industries, on top of the amounts allocated for R&D and National Productivity Fund. This includes the new tranches of funding that will be allocated to support economic development under the Enterprise Development Fund (EDF) and the Economic Development Assistance Scheme (EDAS).

Even though this is not the first budget that the Singapore government has introduced to boost innovation level of Singapore SMEs, the 2016 budget also serves to further strengthen firms and the relevant industries to create more value.

In addition, the government is extending higher amount of grants and incentives to support these firms on their transformation through innovation. These measures include,

1) expanding the existing SME Mezzanine Growth Fund from S$100m to S$150m,
2) introducing a Merger & Acquisition allowance for up to S$40m and
3) upfront certainty of tax exemptions on corporate profits made through equity investments.

We believe the pace of consolidation between SME manufacturers will be accelerating. Large companies with strong balance sheets such as Venture, SingTel and Starhub could benefit from new acquisitions.

Property and REITs

Finance Minister Heng reiterated that it is still premature to relax property cooling measures, echoing what National Development Minister Lawrence Wong said late last year and again in Parliament sitting last month.

Private property prices have fallen c.8.4% since their peak in 2013, after recovering c.49% (central region) and 75% (outside central region) from the Global Financial Crisis (GFC) trough to 2013. We expect private property prices to fall further, to close to the 15%-20% correction from the peak, before any possibility of the cooling measures being lifted. For property related counters, we prefer those operating within more resilient sectors or with bigger discount buffers, such as GLP (BUY, TP $2.43) and Ho Bee Land (ACCUMULATE, TP S$2.27).

The government's decision to further develop Jurong with the Jurong Innovation District (JID) comes after earlier announced development plans for Jurong. Dubbed the second CBD of Singapore, vibrancy in the area is expected to increase further with the new high-speed rail link to Malaysia, new Science Centre, and the JID. Although there is still some time away for these developments to come to fruition, we expect retail malls in the Jurong area to benefit immensely and CapitaLand Mall Trust (Non-Rated) should benefit with a stronghold of malls in the Jurong area (JCube, IMM, Westgate).

Bank & Finance

We view the introduction of the SME Working Capital Loan Scheme, for loans of up to $300,000 per SME could be a significant impact to overall banking industry. The SME Working Capital Loan will be available for 3 years, starting from 2016. The government expects that during this 3 years, the scheme could catalyse more than $2bn worth of loans. According to MAS, outstanding SME loans as of Q215 is approximately $84bn so the expected S$2bn figure only represents 2.4% of the loans outstanding.

However, we believe that the government estimate of $2bn worth of loans catalysed from the SME Working Capital Loan Scheme is conservative because it implies only c. 6,700 SMEs would participate in this scheme over 3 years ($2bn dividend by loan cap of S$300k per SME). Singstat's "Profile of Enterprises in Singapore 2014" indicates there are 157,000 locally owned SMEs which means the estimate assumes only 4.3% of the local SMEs taking up this scheme during the period. Though we do not expect such heady numbers to materialise in 3 years, we have become more optimistic that the budget has set a higher growth trajectory for SME loans growth.

From the NPL perspective, the 50% co share of risk would be most helpful now. NPL ratio for SME loans have hit 1.3% in Q215, a higher level since end of 2011. As banks have begun to eschew a loans with higher risk profile, the co-share scheme is an avenue for the participating banks to support viable SMEs that may have cash flow concerns or wish to continue growing their business.

Budget Figures

Table 1: Overview of Fiscal Position FY 2014 to 2016 (S$'Mil)

	FY2014	FY2015 (Revised)	% change from FY2014	FY2016 (Budgeted)	% change from Revised FY2015
Operating Revenue	**60,838**	**64,163**	**5.5%**	**68,445**	**6.7%**
Corporate Income Tax	13,371	13,846	3.6%	13,412	-3.1%
Personal Income Tax	8,927	9,130	2.3%	10,128	10.9%
Withholding Tax	1,126	1,309	16.3%	1,327	1.4%
Statutory Boards' Contributions	516	434	-15.9%	1,881	333.4%
Assets Taxes	4,341	4,391	1.2%	4,396	0.1%
Customs and Excise Taxes	2,540	2,558	0.7%	2,907	13.6%
Goods and Services Tax	10,215	10,326	1.1%	10,615	2.8%
Motor Vehicle Taxes	1,603	1,797	12.1%	2,935	63.3%
Vehicle Quota Premiums	3,394	5,406	59.3%	5,655	4.6%
Betting Taxes	2,591	2,709	4.6%	2,721	0.4%
Stamp Duty	2,784	2,730	-1.9%	2,523	-7.6%
Other Taxes[1]	6,097	5,882	-3.5%	6,329	7.6%
Other Fees and Charges[2]	3,010	3,294	9.4%	3,317	0.7%
Others	324	350	8.0%	300	-14.3%
Total Expenditure	**56,648**	**68,409**	**20.8%**	**73,431**	**7.3%**
Operating Expenditure	42,685	48,726	14%	54,427	11.7%
Development Expenditure[3]	13,963	19,682	41%	19,003	-3.4%
Primary Surplus / Deficit	**4,190**	**(4,246)**		**(4,986)**	
Less:					
SPECIAL TRANSFERS[4]	**12,356**	**10,537**	**-15%**	**6,270**	**-40.5%**
Special Transfers Excluding Top-ups to Endowment and Trust Funds	**3,856**	**4,537**	18%	2,670	-41.2%
Wage Credit Scheme		1,910		790	
Temporay Employment Credit		716		725	
GST Voucher - Seniors' Bonus		315		280	
Top-ups to Child Development Accounts		129		-	
CPF Medisave Top-ups		100		100	
Productivity and Innovation Credit		985		660	
Productivity and Innovation Credit Bonus		200		20	
Service and Conservancy Charges Rebates		85		86	
Top-ups to Post-Secondary Education Accounts		80		-	
Others Transfers[5]		18		7	
Basic Surplus / Deficit[6]	**334**	**(8,783)**		**(7,655)**	
Less:					
Top-ups to Endowment and Trust Funds	8,500	6,000		3,600	-40.0%
Changi Airport Development Fund		3,000		1,000	
National Productiviy Fund		1,500		-	
National Research Fund		1,000		1,500	
Special Emplpoyment Credit Fund		500		1,100	
Add:					
Net Investment Returns Contribution[7]	**8,738**	**9,898**	**13%**	**14,705**	**48.6%**
Overall Budget Surplus / Deficit	**571**	**(4,884)**		**3,450**	

Note: Figures may not add up due to rounding.

[1] Includes Foreign Worker Levy, Development Charge, Annual Tonnage Tax and Water Conservation Tax.

[2] Includes revenue from Licenses, Permits, Service Fees, Sales of Goods, Rental of Premises, Fines and Forfeitures and Reimbursements.

[3] Development Expenditure excludes land-related expenditure.

[4] Special Transfers include Top-ups to Endowment and Trust Funds.

[5] Consists of SME Cash Grant, Growth Dividends, GST Credits, SG50 Giving, and funding for Self-Help Groups and VoluntaryWelfare Organisations.

[6] Surplus / Deficit before Top-ups to Endowment and Trust Funds, and Net Investment Returns Contribution.

[7] Net Investment Returns Contribution (NIRC) is the sum of: (1) up to 50% of the expected long-term real return on the relevant assets specified in the Constitution; and (2) up to 50% of the net investment income on the remaining assets.

Source: Ministry of Finance

Chart A: Breakdown of Total Expenditure by Sector (FY2015 and FY2016)

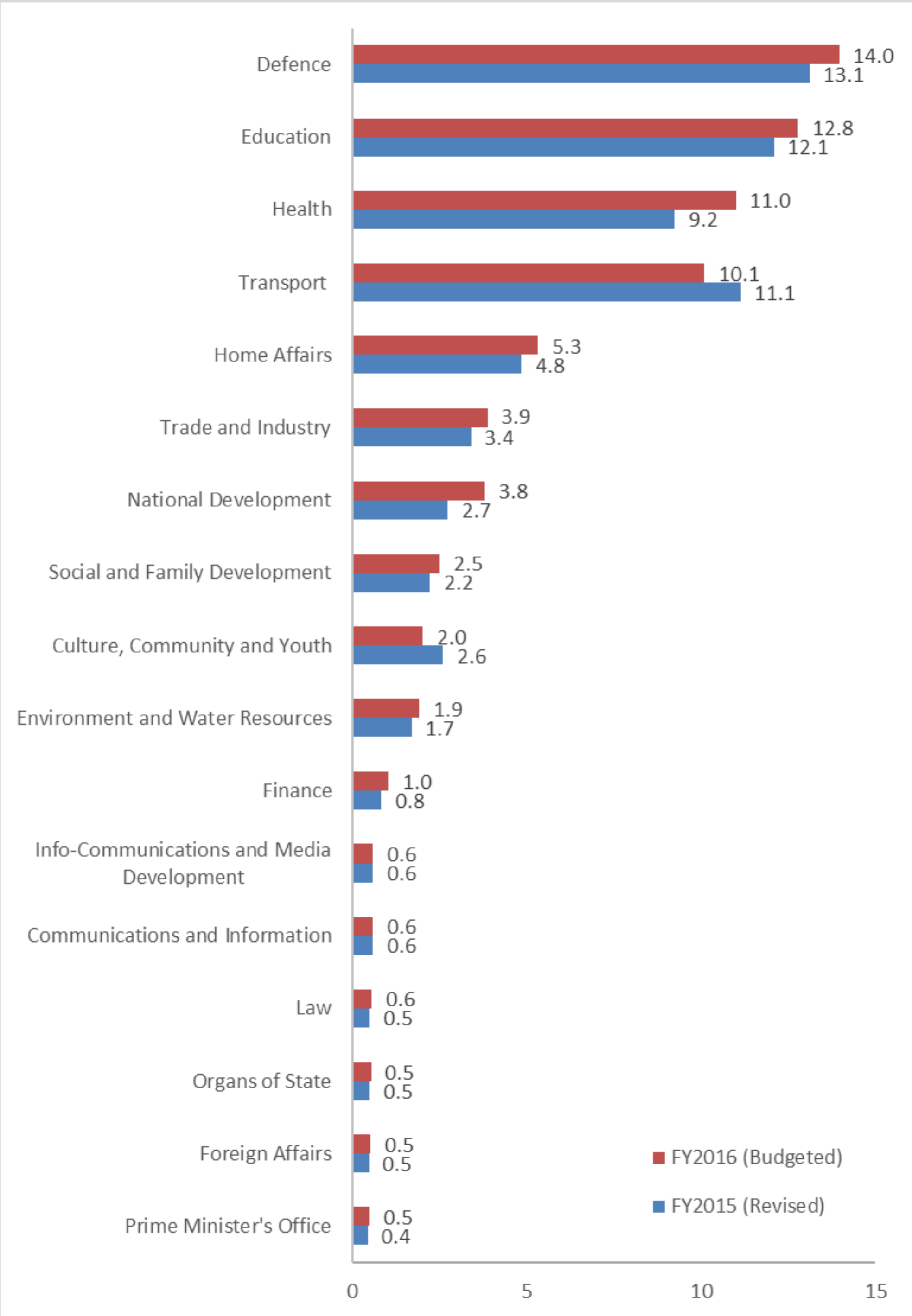

Table 2: Total Expenditure by Sector for FY2015 to FY2016 (% of GDP)[1]

	FY2015 (Revised)	FY2016 (Budgeted)
Total[2]	**17.0%**	**17.9%**
Social Development	**7.9%**	**8.7%**
Education	3.0%	3.1%
National Development	0.7%	0.9%
Health	2.3%	2.7%
Environment and Water Resources	0.4%	0.5%
Culture, Community and Youth[3]	0.6%	0.5%
Social and Family Development[3]	0.6%	0.6%
Communications and Information[3]	0.1%	0.1%
Manpower (Financial Security)	0.2%	0.3%
Security and External Relations	**4.6%**	**4.8%**
Defence	3.3%	3.4%
Home Affairs	1.2%	1.3%
Foreign Affairs	0.1%	0.1%
Economic Development	**3.9%**	**3.7%**
Transport	2.8%	2.5%
Trade and Industry	0.8%	0.9%
Manpower (excluding Financial Security)	0.2%	0.2%
Info-Communications and Media Development[3]	0.1%	0.1%
Government Administration	**0.6%**	**0.6%**
Finance	0.2%	0.3%
Law	0.1%	0.1%
Organs of State	0.1%	0.1%
Prime Minister's Office	0.1%	0.1%

Note: Figures may not add up due to rounding.

[1] Data may differ from previous years due to revisions to GDP estimates.

[2] The expenditure estimates do not include Special Transfers and spending from Government Endowment and Trust Funds.

[3] With effect from 1 November 2012, the Ministry of Community Development, Youth and Sports (MCYS) and the Ministry of Information, Communications and the Arts (MICA) were restructured to form three Ministries: (i) MCYS was re-named as the Ministry of Social and Family Development (MSF), (ii) MICA was re-named as the Ministry of Communications and Information (MCI) and (iii) the new Ministry of Culture, Community and Youth (MCCY) was formed to undertake functions transferred from MCYS and MICA.

Source: Ministry of Finance

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