



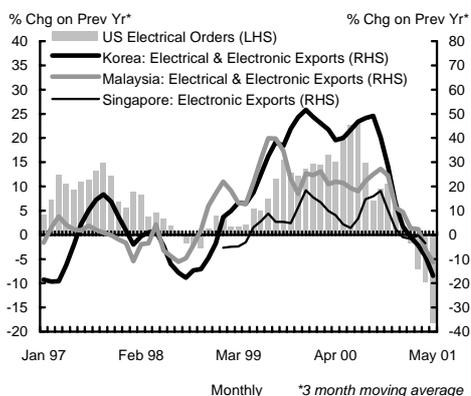
Monday, 16 July 2001

**Singapore: Q2 GDP Advance Estimate  
(% Chg on Prev Yr)**

Industry	Q4	Q1	Q2
	2000	2001	2001
Goods	13.7	2.1	-6.6
Services	8.7	5.5	2.1
<b>Overall</b>	<b>11.0</b>	<b>4.6</b>	<b>-0.8</b>

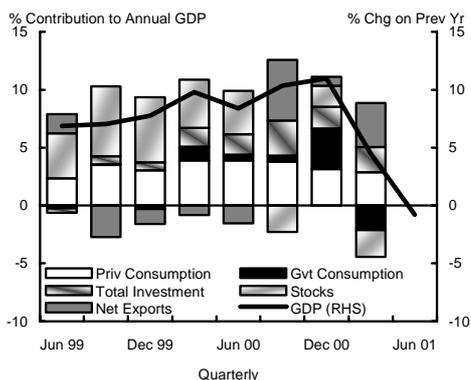
Source: MTI

**US Electrical Orders and Regional Exports**



Source: CEIC & Datastream

**Singapore: Contributions to Growth**



Source: CEIC

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**THIS WEEK IN ASIA**

**A POSTCARD FROM SINGAPORE - WHEN THE CHIPS ARE DOWN**

**Event and Impact**

*"It's obviously raining and the rain will get heavier. This is not a passing shower. But we should not assume that it's going to be a full-blown thunderstorm. It may not be.  
"So, we should get our umbrellas ready and try to stay as dry as possible but keep watch on the weather, and if it gets worse then we may have got to do more, but respond in a measured way...and look even in the darkest clouds for silver linings which may open up new opportunities for US.  
"Which means not slowing down our restructuring because of the problems we are facing, but pressing on so that when the weather clears up again, we will be well-positioned and we will be ahead."*

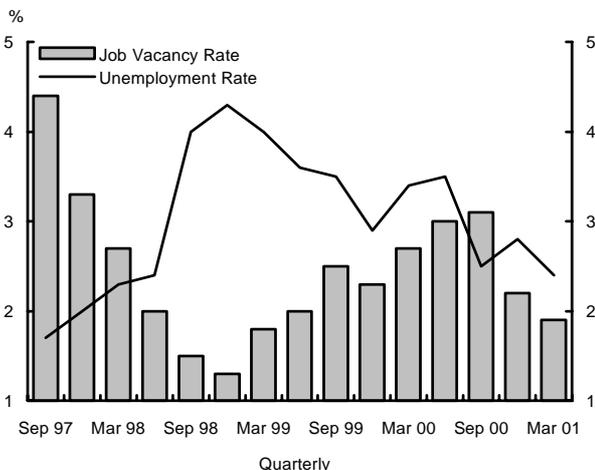
George Yeo, Trade and Industry Minister, 11 July 2001 following the release of Singapore's advance GDP estimate for Q2

**The US slump is causing significant pain to the domestic economy...**

- The sharp slowdown in the US economy this year, and the contraction in demand for electronics components have clearly been very damaging for the Singapore economy, given its high trade exposure to the US.
- The Government's GDP advance estimate for Q2 2001 suggests that the economy contracted by 0.8% in year-on-year terms. This is attributed to the sharp slowdown in the major OECD and Asian economies, as well as the deterioration in global demand for electronics.
- **This indicates that the Singapore economy is now in 'technical recession', defined as two consecutive quarters of on-quarter GDP.** The seasonally adjusted, annualised quarter-on-quarter growth estimate for Q2 2001 points to a contraction of 10.1%, following a decline of 11.3% in Q1.
- A 'full-blown recession' is defined as two consecutive quarters of year-on-year contraction, and could yet happen if the current weak economic trends continue, as largely anticipated.
- The latest official estimates suggest that growth in the second-half of the year will be between -1% and 1%. **The official growth forecast for 2001 has been revised to 0.5-1.5%, down from the previous forecast 3.5-5.5%.**
- Clearly, the recovery in the domestic economy will hinge on developments in the US, and any subsequent flow-through to Singapore's major trade partners. At this stage, however, the outlook for the US remains murky, with corporate earnings on Wall Street still looking bleak.

- While private consumption in the US has remained relatively resilient to date, the demand for electronics goods – the main driver of industrial production and exports in Singapore, and several other Asian economies – has plunged sharply this year (see top chart on previous page).
- US electrical orders have fallen by 13% in the first five months of this year, compared to the same period last year. In contrast, orders rose by a year-on-year 16% during the first five months of 2000.
- **The biggest concerns revolve around the high levels of inventory and the excess capacity in the US, which may take some time to unwind.** Our discussions with private sector analysts in Singapore show that opinion as to the timing of the pick-up in domestic growth is mixed, with expectations ranging from Q4 2001 to Q2 2002, due to the uncertainty surrounding the US.
- Although the more optimistic analysts are anticipating a rebound in US demand for 'hi tech' goods as early as Q3 2001, with the help of obsolescence and US corporates quickly running down inventories, the pessimists are expecting the 'hi tech' sector to be a drag on growth for at least another 2 quarters.
- Singapore's balanced growth profile to date is clearly unsustainable, with both business investment and private consumption increasingly threatened (see bottom chart on previous page).
- A major concern is the expected 'fallout' in the labour market, with some 20,000 job losses estimated for this year. While this is less than the 29,000 jobs lost in 1998 during the Asian financial crisis, it is nearly twice that of last year (see chart below).
- Additionally, the outlook for the property sector, which has been a significant growth driver in the past, remains gloomy (see panel following).

### Singapore : Unemployment & Job Vacancies

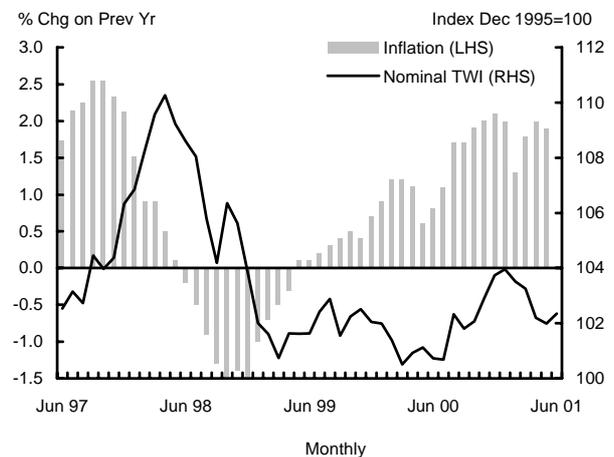


Source: CEIC

### ...and monetary policy has become more accommodative

- As we had anticipated, the Monetary Authority of Singapore (MAS) formally announced during the week that its stance on monetary policy has shifted to neutral, from the previous tightening bias.
- The MAS uses the S\$ exchange rate as its main monetary policy tool, allowing the S\$ to fluctuate within a certain 'policy band' of values in relation to a trade-weighted basket of currencies. Consequently, interest rates are determined by the market.
- Clearly, MAS' previous concerns over the incipient rise in inflationary pressures have now shifted to the increasingly bleak outlook for growth, with its recent statement:
  - ~ "Against the backdrop of a weaker external economic environment and a more protracted global electronics downturn, near-term growth prospects for the Singapore economy have turned significantly weaker, while inflationary pressures are subsiding."
- Indeed, *Macquarie Research Economics'* trade-weighted index (TWI) for Singapore suggests that the effective exchange rate has been 'neutral' for several weeks now (see chart below).
- Additionally, the MAS has announced that its 'policy band' will be centred on a zero percent appreciation of the trade-weighted value of the S\$.

### Singapore: Inflation and the Trade-Weighted Index



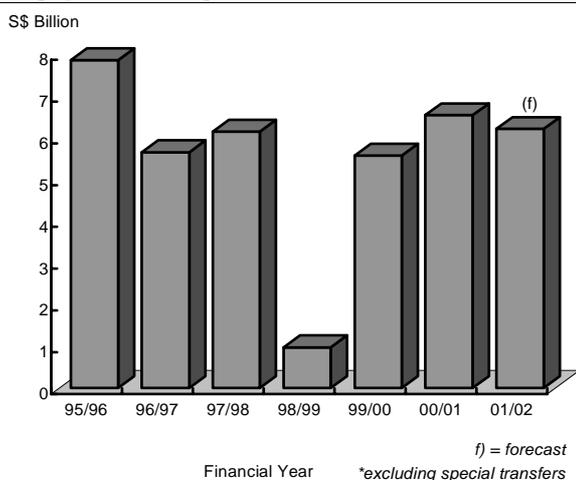
Source: CEIC, Datastream & Macquarie Research Economics

- The S\$ fell to 11-year lows against the US\$, following the announcement of the GDP flash forecast and the shift in monetary policy. Since the beginning of the year, the nominal exchange rate has depreciated by 5.5% against the US\$.
- Given the neutral stance in monetary policy, this suggests that the S\$ will move in line with the currencies of its major trading partners in the months ahead. **In our view, the exchange rate may well**

reach US\$/S\$1.85 this year, on the back of a weakening yen and other depreciating Asian currencies.

- The Government has said that it is also planning a 'relief package' – to be announced on 25 July – aimed at alleviating the effects of the downturn felt by businesses and workers "while we await the recovery of the US economy and the global electronics industry."
- In this regard, the latest off-Budget measures are expected to differ somewhat in scope and scale from the two packages totalling S\$12.5 billion, implemented in 1998 during the worst of the Asian financial crisis.
- The general consensus amongst the private sector this time is that the Government should introduce a package that will have a quick and direct impact on disposable income, rather than pump-priming projects that may take a while to flow through into the economy.
- Indeed, the authorities have acknowledged that "...such pump-priming would only be of marginal benefit. It would not be able to offset the drastic fall in external demand."
- In other words, income tax cuts, property tax rebates and reduction in government fees, charges and levies are likely to be preferred to new infrastructure projects.
- Most importantly, the Government will have significant latitude to implement the stimulus measures required, given its healthy fiscal position.
- As we had foreshadowed in our **This Week in Asia** of 15 March, the Government has accumulated a significant 'war chest' from previous budget surpluses, which can be used to stimulate the economy in the event of a sharp slowdown in growth (see chart below).

### Singapore: Budget Balances\*

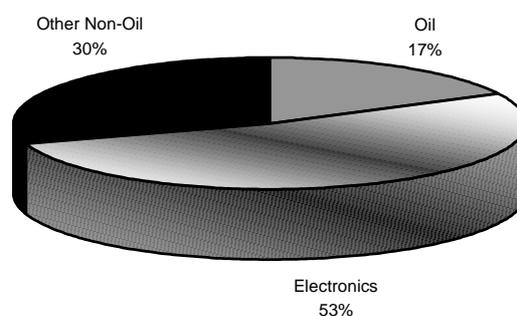


Source: CEIC & MoF

### ... liberalisation and 'restructuring' will continue

- While the currently difficulties faced by the Singapore economy are partly a result of a global slowdown, the domestic economy is also vulnerable structurally, that is, its high dependence on the electronics sector and the US economy (see chart below). Singapore exports to the US amounts to around 25% of GDP, one of the highest in Asia.
- Where the development of the 'hi tech' industry – notably, the manufacture and export of 'hi tech' goods – has been a major driving force for growth in recent years, it has now left the economy very exposed to the global electronics cycle.
- Although the authorities are well aware of the need to move towards a higher-value added, knowledge based service economy, any significant result from the attempt to 're-engineer' the economy is more a medium-term prospect (see our November 1999 **Macquarie Irregular, Regaining Confidence in South-East Asia**).
- Indeed, the services sector proved to be the one bright spot in the Q2 growth figures, expanding by a modest 2.1% in year-on-year terms. In contrast, the goods-producing industries contracted by 6.6% during the same period.
- Similarly, the objective of market diversification via the establishment of free-trade agreements is unlikely have a significant impact in the short-term.

### Singapore: Composition of Exports



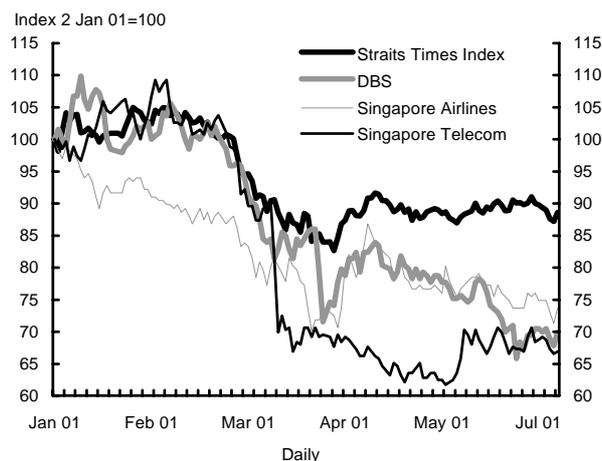
Source: CEIC

- **Encouragingly, our discussions with policymakers suggest that the current trend of mergers and acquisitions (M&A) in both the corporate and financial sectors should continue, despite the uncertainties in the outlook.**
- Further 'restructuring' is largely seen as unavoidable if domestic corporates are to expand and diversify their earnings base to other markets, and enhance their competitiveness internationally.

## ...causing further uncertainty in financial markets

- Given the economy's significant exposure to the US slowdown and the global electronics downturn, it is not surprising that the Straits Times Index has been one of the worst performers in the region this year, down by 14% since the beginning of the year.
- Additionally, the stockmarket has also been weighed down by 'blue chip' companies going 'ex-monopoly' as a result of industry deregulation, in areas such as banking and telecommunications (see chart opposite).
- Moreover, international acquisitions by the major domestic corporates have raised questions about the appropriateness of valuations placed on 'target' companies.
- Interestingly, there has been a shift to smaller capitalisation stocks, which have operations mainly in China.** This appears to mirror the 'plays' seen in China and Hong Kong, underpinned by the optimism surrounding China's impending entry into the World Trade Organisation (WTO).
- Meanwhile, in the foreign exchange market, any expectation of increased demand for US\$ funding for M&A activities by Singapore companies in the months ahead could introduce some volatility in the currency, as seen in H1 this year.

## Singapore : Stock Prices



- Our discussions with private sector analysts suggest that investors are, by and large, cashed-up at the present time, waiting for signs of a turnaround in the economy.**
- At that point, the stocks in the 'hi tech' industry and petrochemicals cluster are expected to have significant upside, given the recent foreign direct investment in wafer fabrication and petrochemical plants, which would be ready for any pick-up in demand.

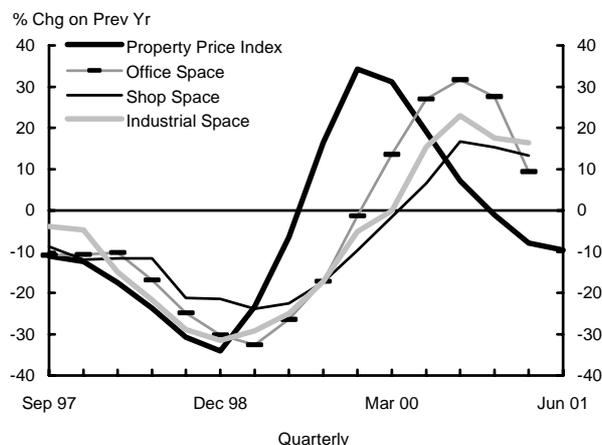
## The Outlook for the Property Sector

- The strong turnaround in the property sector, following the bursting of the 'bubble' during the Asian financial crisis, has clearly moderated in H1 this year (see chart opposite).
- Indeed, private residential property prices have actually fallen in recent quarters, on average.** Our recent discussions in Singapore point to a gloomy outlook for the **residential sector** as a whole.
- Currently, some 13,500 new private residential units are ready to be 'launched', while another 24,500 units are in the planning stage. In other words, a total of around 38,000 new units are in the pipeline. Given that average annual take-up is between 5,000-6,000 units, this suggests a considerable 'overhang' in the medium-term.
- Although sentiment in the **retail sector** has turned cautious, with the deterioration in the general economic outlook, rentals have increased slightly on average, driven by healthy demand for prime shop space and the limited supply of high quality retail space over the next two years.
- Meanwhile, the outlook for **office sector** is increasingly bleak, as the economic downturn has

led companies to reassess their space requirements.

- Additionally, the consolidation of the banking sector – and the potential closure of some retail branches – could increase the availability of office space in the months ahead.

## Singapore : Property Prices



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