Rising interest rates worrying for Singapore economy: economists

Amid slowing economy, space for monetary policy response is limited due to high levels of indebtness, they say

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THE expected rise in interest rates will further weaken Singapore's already slowing economy, said economists at a high level discussion last week.

But manoeuvring space for further monetary policy response in order to stoke inflation and growth remains tight, as Singapore remains highly indebted, they added.

Over a three hour session on Wednesday, attendees of the 25th Singapore Economic Roundtable talked of a Singapore economy that faces stresses on multiple levels.

Even as the economy tries to shake off these woes, they foresee another looming on the horizon, and one that may just make it worse for Singapore: rising interest rates.

Last month, the US central bank said that it will look to raise interest rates in June should economic data point towards stronger growth.

This will result in Singapore's economy entering into a second straight year where real interest rates exceed real growth, making debt unsustainable, said Taimur Baig, chief economist at Deutsche Bank who presented at Wednesday's discussion.

This differential was at -1.6 per cent in 2015, and is expected to be at -0.8 per cent this year, he said.

Dr Baig pointed out that when the financial crisis hit in 2008, growth rates were negative. But Singapore kept interest rates substantially low, which cushioned the economy.

But now, deflationary pressures make it hard for Singapore's highly indebted economy to respond to rising interest rates.

"It is really, really bad right now," he said.

The roundtable is a twice yearly meeting of a small group of policymakers, private sector economists and business leaders. It is intended to generate discussion of major issues facing the Singapore economy, and is co-organised by the Institute of Policy Studies and The Business Times.

Dr Baig's presentation on Wednesday, in sketching a "sobering outlook" - as stated in its title - for Singapore, set the tone for the discussion.

"Low growth and high interest rates are a poor combination for a highly leveraged economy like Singapore," said Dr Baig. Deutsche Bank puts Singapore's total debt at about 300 per cent of GDP.

The Monetary Authority of Singapore (MAS) previously put aggregate corporate debt-to-gross domestic product (GDP) ratio in 2014 at 145 per cent. Household debt-to-GDP ratio is at about 75 per cent, while household debt-to-income ratio is at about 2.2 in 2014.

Yet, the roundtable discussants see dwindling array of policy responses left to maintain economic stability here even as rates rise.

For one thing, the central bank will find it harder to stoke inflation.

Core inflation - a key consideration for monetary policy - will come in at "the lower half of the 0.5 to 1.5 per cent forecast range" this year, and at slightly below 2 per cent in the medium-term.

Credit Suisse is decidedly more bearish. It sees core inflation at just 0.4 per cent over 2016 and 2017, said discussant Ray Farris, the bank's head of Asia macro strategy, quoting from a May 10 note that he co-authored.

But Singapore's high levels of indebtness means that easing the Singapore dollar nominal effective exchange rate (S$NEER) policy band will result in a larger negative impact.

Said Dr Baig: "A corollary of weaker NEER is higher interest rates domestically, which is not quite tenable under the current condition of high debt. Consequently, the cost of Singapore dollar devaluation has gone up."

Yet, low prices are not good for growth, and in fact raises the stakes for an economy trying to shake off a slowdown.

"A prolonged period of deflation and disinflation that pushes down nominal GDP growth rate can have far reaching impact on the economy, hurting revenues, margins and debt sustainability," said Dr Baig.

Already, there is talk that Singapore's slowdown will worsen.

Credit Suisse has revised its forecast to see next year's growth coming in slower than this year's. It previously saw growth at 1.7 per cent in 2016 and 1.8 per cent in 2017. It has since cut them to 1.4 per cent and 1.2 per cent respectively.

Economists at the roundtable now see a heavier expectation on the government to promote growth.

While Credit Suisse still expects MAS to re-centre the S$NEER band downwards, it predicts this will only happen in April next year, as the government leans on fiscal measures to combat economic slowdown in the meantime.

Some measures include additional stimulus, removal of some property cooling measures, and administrative measures, said the bank.

Attracting investments and encouraging firms to expand overseas are also good approaches, said UBS senior Asean economist Edward Teather, who was at the roundtable.

"The authorities' efforts to support productive investment, open international markets and allow the economy to adjust should help the Singapore economy cope with externally induced adverse surprises," he said.