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ASK: NUS ECONOMISTS

Whither Singapore's trade surplus?

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■ *Why has Singapore been experiencing large trade surpluses in recent years? Will it continue to do so in the near future?*

In any given year, an economy's trade balance is in surplus when the value of the goods and services that it exports exceeds that of its imports.

In 2011, Singapore's trade surplus was 26.7 per cent of gross domestic product (GDP), far higher than that of major non-oil exporters such as China (2.8 per cent), Germany (5.1 per cent) and Hong Kong (4.0 per cent).

Interestingly, Singapore has been running a trade surplus exceeding 20 per cent of GDP every year from 2003 to 2011.

It is tempting to explain strong export performance by examining key export sectors that have done well, such as electronics and mineral fuels. But the overall trade balance is better explained by examining the economy's aggregate levels of saving and investment.

This is because the economy's trade balance is intimately tied to its level of saving and investment.

Singapore saves a far greater portion of its GDP than is required to finance domestic capital formation and inventory accumulation. The excess savings are hence channelled overseas for investment in other countries.

Singapore's massive trade surplus provides its main source of foreign exchange which enables it to finance these overseas investments. In other words, being a net exporter allows Singapore to become a net investor in the rest of the world.

Thus, to explain saving and investment is to explain the trade surplus.

Regarding saving, Singapore has longstanding institutional features (such as the Central Provident Fund, or CPF, scheme of compulsory savings for workers; and a long tradition of emphasising cost-recovery in public service provision) that encourage thriftiness on the part of households, businesses and the Government.

The domestic savings rate in the last decade has been high even by Singapore standards, routinely exceeding 50 per cent of GDP.

On the household front, demographics play a key role. The last decade saw working-age adults peak as a proportion of the total population. As these save far more than the young and the elderly, the overall savings rate is high.

Households are also likely to have boosted savings rates so as to afford larger down payments that accompanied the run-up of property prices in recent years.

Rising income inequality may also have played a role; higher-income households tend to have higher savings rates than lower-income households, and thus a greater concentration of income in the former will tend to raise overall savings rates.

Government saving has also contributed to high savings rates. For the past decade, the average surplus in general government finances exceeded 7 per cent of GDP. Even in the 2009 fiscal year, when tax revenues fell and the Government conducted a fiscal stimulus to fight the effects of a world recession, general government finances still recorded a modest budget surplus when land sales are included in revenues.

That the Government chose to boost its reserves in this period may be a result of a conscious effort to save in preparation for greater future spending as the population ages. Still, it is now apparent that government spending on housing and other infrastructure in the last decade was too low, given rapid population growth from immigration.

In contrast, investment expenditure averaged 23 per cent of GDP over the last decade, considerably below that of previous decades, though comparable to Hong Kong's (23.4 per cent in 2011). Deploying 50 per cent of GDP into domestic investment in a mature economy like Singapore's is bound to depress returns.

With high capital mobility, businesses and households have elected to seek better returns and greater diversification of risk by making overseas investments. The Government has done the same with the management of its reserves by Temasek Holdings and the Government of Singapore Investment Corporation.

Exchange rate policy provides a last piece of the trade surplus picture. Exports form part of the demand for Singapore dollars in currency markets, while imports form part of the supply.

A trade surplus thus tends to exert upward pressure on the value of the Singapore dollar. With appreciation, the trade surplus tends to shrink as exports become more expensive for foreigners and imports become cheaper for Singapore residents.

In Singapore's case, the Monetary Authority of Singapore has slowed down the Singapore dollar's appreciation by selling it in currency markets to accumulate foreign exchange reserves. In the last decade, the balance of payments shows over $200 billion in such accumulated reserves.

With low fertility rates and with the population ageing, the elderly will soon become a much larger proportion of the total population, which drives down the overall savings rate.

Immigration may slow down this effect but is likely to fall well short of eliminating it. The Government is also set to raise social and infrastructure spending in the near future, including the provision for more public housing. This is likely to involve reversing the flow of government reserves from overseas back into Singapore.

These factors suggest that Singapore's savings rate is set to fall by several percentage points in the next decade, even as investment rates rise. Thus, it is likely the era of massive trade surpluses will end within the next decade.

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This is a monthly series by the NUS Economics Department. Each month, a panel will address a topical issue.

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