Higher SG$ interest rates will incentivise a more efficient use of capital

When the debt party ends

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Will Singapore's debt binge over the last five years lead to a hangover once rates begin to rise? That is the question being asked by economists as the interest rate cycle begins to swing up. It may come as a surprise to some that Singapore holds the largest amount of non-financial private debt in the world amongst advanced economies – ahead of Japan, the US, and even China. And a large part of this has been run up over the last five years, whereas the US, Japan, and the UK have seen prudent private borrowers cut their debt loads. Since 2011, Singapore has added an equivalent of almost 40% of GDP – over $150b – in debt. It is unparalleled, but is it also dangerous? The first thing to look at is the forecasts for interest rates.

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Currently, Singapore SIBOR – the benchmark interest rate – is sitting below 1%, making all that borrowing very inexpensive. But that is about to change. As CLSA's Chuanyao Lu notes, the Fed's 25bp hike in Dec '16 is a harbinger of more to come with expected US rate increases flowing onto Singapore, bringing the 3-month SIBOR to 1.7% by end-2017. But the interest rate for corporate borrowers would likely be higher still.

"The 10-year SG government bond spread over the 3-month SIBOR has now moved slightly above its long-term average spread of 135bps as the market starts to price in the risk of further rate hikes. Assuming the spread at the long-term average as the SIBOR climbs to 1.7%, it would imply a 10-year SG bond yield of ~3.0% by end-2017," adds Lu.

Indebted companies will be stretched further to repay loans, and as we have seen in the oil & gas industry with Swiber and Ezra, there has been a fair amount of bad loans made. UBS economist Edward Teather notes that the most obvious areas of capital misallocation are in the offshore oil & gas supply sectors and the property market, evidenced by falling prices and rentals.

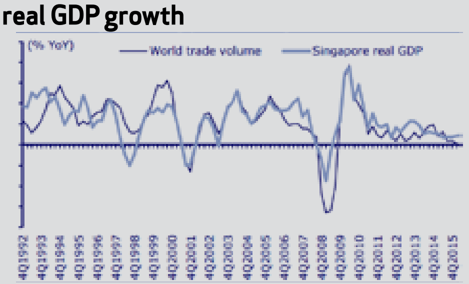
"The decline in the profit share of GDP and slackening of the labour market suggests the scale of economic adjustment needed probably goes beyond those sectors. We expect this adjustment to become more obvious in 2017, not least because higher SG$ interest rates will incentivise a more efficient use of capital. That adjustment process should keep growth weak and push unemployment higher but, absent a significant external shock, not tip the economy into recession for full year 2017," says Teather.

Trade conundrum

The other big unknown for Singapore is trade. 2016 was one of the toughest for Singapore with real GDP expected to come in at 1.4%, or the lowest since the Global Financial Crisis in 2008, and the third consecutive year of falling GDP growth for the country. This impacted not just Singapore's export-oriented manufacturing and services industries, but domestic demand as well as the decline in overall sentiment weighed on the propensity to spend. In fact world trade volumes are highly correlated with GDP growth, 75% to be exact. So any pickup in world trade flows through to Singapore's GDP.

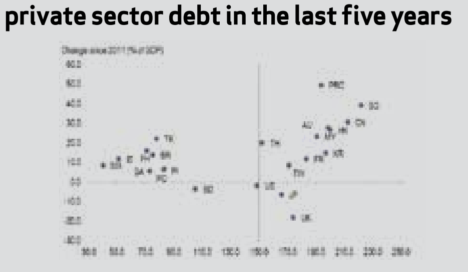
CLSA has a positive view on world trade, Trump protectionism notwithstanding, and forecasts GDP growth of 2.5% in 17CL. "We do note that we are much more positive compared to the current consensus forecast of 1.5% for 2017, and this is primarily driven by our view of global trade recovery. We expect trade recovery to further pick up into 2018, and hence drive GDP growth to 3.5% in 18CL." UBS is less sanguine, arguing Singapore's growth momentum is likely to remain weak.

World trade volume growth vs Singapore's real GDP growth



Sources: CLSA, CEIC

Asia has seen the biggest build-up in private sector debt in the last five years



Sources: Haver, BIS, CEIC, and UBS calculations