20 February 2018

Strategy | Strategy - Singapore

2018 Singapore Budget

Expecting a Positive "Post Budget" Market Reaction

With the exception of the BSD increase for residential property transactions, Budget 2018 was positive for all business sectors. The carbon tax implementation should translate into higher capex for the corporates and support strong loans growth for domestic banks. The tax removal on the distribution of specified income by REIT ETFs is likely to be positive for the REITs sector. And, with concerns of an impending GST hike now behind us, we expect consumer sentiment to remain buoyant in 2018. We remain upbeat on Singapore's growth outlook, and continue to prefer exposure to the consumer, real estate, REITs and banking sectors.

Consumer sentiment to remain positive. With the GST hike implementation deferred to the "earlier part of 2021-2025", we expect consumer sentiment – which is witnessing early signs of recovery – to remain upbeat in 2018. This should be supported by the SGD100.00-300.00/person "SG Bonus" to be paid out of the FY17 budget surplus to every adult citizen. We assess that the wage credit scheme extension till 2020 would be positive for consumer companies like Sheng Siong Group (SSG SP, NEUTRAL, TP: SGD0.99), BreadTalk (BREAD SP, BUY, TP: SGD2.09) and Neo Group (NGL SP, NEUTRAL, TP: SGD0.64).

Property developers may see some knee-jerk share price reactions. The introduction of a top marginal buyers stamp duty (BSD) of 1% for residential property, although unexpected, should not significantly dampen the housing market. We assess that any weakness in share price for property developers would offer a good buying opportunity. We recommend investors to buy CapitaLand. APAC Realty should also benefit from the expected rise in Housing Development Board (HDB) resale transactions following the Government's announcement of higher Proximity Housing Grants (PHGs).

REITs to benefit from tax transparency on REIT exchange-traded funds (ETFs). REIT ETFs, which are now subject to the prevailing corporate tax rate of 17%, would no longer be subjected to tax on the specified income that is distributed to unit holders. Thus, we anticipate more REIT ETF-based products to hit the market in the near term, which would help widen the investor base and boost the liquidity for SREITs. Our REIT Top Picks are Ascendas REIT, OUE Hospitality Trust and Manulife US REIT.

Announcement of strategic national projects under the Smart Nation initiative. Under Smart Nation, the Government is to introduce strategic national projects. These include a sensor platform for Internet of Things (IoT) devices, a National Digital Identity system to enable citizens to authenticate identities for online transactions, an adoption of e-payment island-wide system, and the opening up of digital platforms for the private sector. We expect ST Engineering (STE SP, BUY, TP: SGD4.04) to be the key beneficiary of these initiatives.

Continued support for small and medium enterprises (SMEs) and offshore & marine (O&M). We view the extension of the wage credit scheme, enhancement to the Corporate Income Tax (CIT) rebate, and higher tax deductions for using and registering intellectual property as key measures to support the SME sector. Deferment of the earlier-announced increase for foreign workers levy in the O&M sector should be positive for Keppel Corp and Sembcorp Marine.

Company Name	Rating	Price	Target	% Upside (Downside)	P/E (x) Dec-18F	P/B (x) Dec-18F	Yield (%) Dec-18F
APAC Realty	BUY	SGD1.06	SGD1.20	13.2	13.5	2.6	3.7
Ascendas REIT	BUY	SGD2.62	SGD2.90	10.7	12.7	1.2	6.2
Avi-Tech Electronics	BUY	SGD0.49	SGD0.59	20.4	9.8	1.6	7.2
Cache Logistics Trust	BUY	SGD0.86	SGD0.98	14.0	11.7	1.0	7.5
CapitaLand	BUY	SGD3.63	SGD4.20	15.7	14.7	0.8	3.6
Dairy Farm	BUY	USD8.38	USD9.53	13.8	20.4	5.7	2.9
Food Empire Holdings	BUY	SGD0.67	SGD1.00	49.9	12.4	1.4	1.4
HRnetgroup	BUY	SGD0.83	SGD1.14	38.2	17.4	2.5	2.9
Manulife US REIT	BUY	USD0.92	USD0.98	7.1	14.0	1.1	6.5
Moya Holdings Asia	BUY	SGD0.09	SGD0.17	82.8	9.3	1.6	-
OUE Hospitality Trust	BUY	SGD0.85	SGD0.95	12.4	11.2	1.1	6.3
Singapore Medical Group	BUY	SGD0.57	SGD0.79	38.6	19.3	4.1	-
United Overseas Bank Ltd	BUY	SGD27.30	SGD30.00	9.9	11.9	1.2	3.3
Venture Corp Ltd	BUY	SGD23.53	SGD24.10	2.4	17.5	2.7	3.4

Source: Company data, RHB

Singapore sector ratings:

Overweight	Consumer, real estate, REITs
Neutral	Banks (with a slight overweight bias) healthcare, plantations, technology, telecommunications
Not Rated	Materials, offshore & marine

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Key Highlights Of Budget 2018

An expansionary budget. Finance Minister Mr Heng Swee Keat announced an expansionary budget for FY18, pencilling in a slight overall budget deficit of SGD0.6bn, or 0.1% of GDP. Government expenditure is envisaged to expand sharply this year, mostly on development and social expenses. However, revenue collected is expected to retreat from a high base, which would result in a primary budget deficit of SGD7.3bn or 1.7% of GDP.

Figure 1: Overall fiscal position (FY16-18F)

	FY16	FY17F	FY18F	FY16	FY17F	FY18F
	SGDbn			% GDP		
Operating Revenue	68.7	75.2	72.7	*16.1*	*16.8*	*17.3*
% YoY	*5.9*	*9.5*	*-3.3*			
Total Expenditure	71	73.9	80	*16.6*	*16.5*	*19*
% YoY	*5.3*	*4.1*	*8.4*			
Primary Surplus/Deficit	**-2.3**	**1.2**	**-7.3**	***-0.5***	***0.3***	***-1.7***
Special Transfers	-6.5	-6.2	-9.1	*-1.5*	*-1.4*	*-2.2*
Net Investment Returns	14.4	14.6	15.9	*3.4*	*3.3*	*3.8*
Overall Budget Surplus/Deficit	**5.6**	**9.6**	**-0.6**	***1.3***	***2.1***	***-0.1***

Source: Ministry of Finance (MoF), RHB

Tenants of key government policies remain largely unchanged. The key tenants of the Government's overall policies remain unchanged from earlier budgets, as seen in the extension of CIT rebates and the Wage Credit Scheme (WCS), which subsidises pay increases for employees.

There were also a series of measures announced to assist SMEs with the modernisation and internationalisation of their operations. Some of these measures include:

i. Higher tax deductions for using and registering intellectual property;

ii. The raising of the Double Tax Deduction for Internationalisation (DTDi) cap;

iii. Setting aside an additional SGD145m for the Tech Skills Accelerator, which is to be scaled up into new sectors like manufacturing and professional services.

Delays in GST hike should continue to support revival in private consumption. A GST hike to 9% (from 7%) was pushed back to the "earlier part of 2021-2025" period. We believe this is the right move, as any rise in private consumption would be offset by a declining labour force, an as-yet-uneven economic growth, and higher interest rates in the near term. The delay in the GST hike, coupled with the deferment of a foreign workers' levy increases for the marine shipyard and process sectors, indicate that the Government still has a bias on the dovish side as we enter the 10th year of the current growth cycle;

E-commerce tax on services. The Government announced that buyers of imported services from overseas suppliers, which have no establishments in Singapore, would attract GST from the start of 2020. This does not affect the imports of goods as yet.

Implementation of a carbon tax from 2019. The carbon tax that was announced during last the budget was set at SGD5.00 per tonne of greenhouse gas emissions from 2019 to 2023, with plans to increase it to between SGD10.00-15.00 per tonne by 2030. With the details confirmed, we expect companies in the industrial sectors – eg the refinery and logistics sectors – to invest higher capex in order to go green and reduce their carbon footprints. The tax is expected to collect almost SGD1bn in taxes over the five years, starting from 2020, and may deliver a bump in private investments starting from 2018.

Budget surplus to be reinvested in infrastructure, healthcare and partially shared with citizens. The Government announced an expected overall budget surplus of SGD9.6bn (2.1% GDP) for FY17, much higher than the earlier estimated SGD1.9bn budget surplus. The additional surplus of SGD7.7bn was deemed to be a one-off and would be expensed as such:

i. SGD5bn to be set aside to offset future railway infrastructure spending;

ii. SGD2bn to be reserved to support the aging population;

iii. The remaining SGD700m to be dispersed as a one-off bonus for citizens aged 21 and above.

The property sector could see a knee jerk reaction

HDB resale demand to receive a boost, slight negative for private housing demand. The higher PHG, combined with a larger radius, is likely to attract more buyers to the HDB resale market. This would be due to more choices, as well as being able to benefit from the grants.

On the other hand, the slight increase in the BSD for unit values of more than SGD1m was unexpected, as the recovery in the residential property market has only recently started. We expect this move to be slightly negative on demand for larger-sized units and high-end residential projects.

Nonetheless as the additional quantum is still small when compared with overall property prices, we believe the market should be able to absorb the additional stamp duty. Moreover, there is ample liquidity in the market from recent en-bloc sales, coupled with positive sentiments surrounding bullish land bids by developers. This should sustain the uptick in near-term property sales momentum.

We believe developers could counter the move by building more compact residential units and maximise the units with absolute quantum of less than SGD1m. We continue to maintain our expectation of 3-7% increases in residential property prices for 2018.

The increase in HDB resale demand should benefit our Top Pick, APAC Realty, which has a 26% market share of the total transaction value. This would, however, be partially offset by slightly lower-than-expected near-term demand for larger private residential units.

For developers, we expect a slight knee-jerk reaction of a 3-5% price correction following the announced increase in the BSD. However, we would use this price correction as a buying opportunity. Our Top Pick in developer space is CapitaLand.

Below is the summary of announced policy changes on residential sector:

i. **Increase in PHG.** The PHG for families buying a resale flat to live with their parents or children is to be increased to SGD30,000.00 (from SGD20,000.00). For singles who buy a resale flat to live with their parents, they would now receive a PHG of SGD15,000.00 (up from SGD10,000.00). Additionally, singles who buy a resale flat near their parents would also now receive a PHG of SGD10,000.00 (nil before). The Government is also increasing the radius of what is considered as “near” – this is now “within 4km” from the same town or within 2km previously;

ii. **Higher BSD charges.** The Government is raising the top marginal BSD rate for residential properties to 4% from 3% previously. The new top marginal rate of 4% would apply to the portion of residential property value that is in excess of SGD1m (Figure 2). This change would apply to all residential properties acquired on or after 20 Feb. There are no changes in the BSD for non-residential properties.

Figure 2: Changes in BSD for residential properties

Purchase Price or Market Value of the property	Exisiting BSD rates	BSD rates for residential properties from Feb 20th
First SGD 180,000	1%	1%
Next SGD 180,000	2%	2%
Next SGD 640,000	3%	3%
Remaining Amount	3%	4%

Source: Inland Revenue Authority of Singapore (IRAS), RHB

REITs to see benefits from tax transparency for REIT ETFs

The tax transparency treatment that was applicable for SREITs would now apply to SREIT ETFs as well. This means that REIT ETF’s, which are now subject to the prevailing corporate tax rate of 17%, would no longer be subjected to tax on the specified income that is distributed to the unit holders. The tax concession for REIT ETFs is to take effect on or after 1 Jul, with a review date set for 31 Mar 2020. The review date coincides with the date for review for other tax concessions for SREITs.

This much lobbied move is positive for REIT sector growth and ought to strengthen Singapore’s status as an emerging REIT hub. We anticipate more REIT ETF-based products to hit the market in the near term. The move would also help widen the investor base for REITs and aid in boosting the liquidity for underlying SREITs. Our REIT Top Picks are Ascendas REIT, OUE Hospitality Trust and Manulife US REIT.

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