

Redefining reserve returns

The Singapore government wants to give itself the ability to recognise Temasek Holdings' unrealised capital gains as investment returns that may be spent. Is that a sustainable way to address the government's growing bills?

— KENNETH LIM

Who manages Singapore's reserves?

RISK PROFILE

MORE CONSERVATIVE

MORE AGGRESSIVE

MAS

The Monetary Authority of Singapore manages the Official Foreign Reserves, which must be readily available for balance of payments and exchange intervention needs.

Size of official foreign reserves
(January 2015 estimate)

US\$251b

GIC

Created in 1981, GIC invests Singapore's reserves in a globally diversified portfolio of mostly public investments. Funds from Singapore's social security system, the CPF, are indirectly invested by GIC.

The size of GIC's assets are a state secret

More than US\$100b

Temasek

Temasek is an active investment company tasked to deliver sustainable long-term returns on commercial principles. Its original portfolio in 1974 comprised S\$354 million of shares in businesses owned by the government during the first decade of independence.

Size of Temasek's portfolio
(As at March 2014)

S\$223b

The proposal

The constitution allows the government to spend up to half of what MAS, GIC and Temasek make from investing the country's reserves. But how does one figure out how much they made? Temasek's contribution is currently based on a framework known as Net Investment Income (NII). The government wants to switch to the Net Investment Returns (NIR) formula, which is already used for MAS and GIC and which includes unrealised capital gains.

Net Investment Income

vs

Net Investment Returns

Dividends
+
Interest
+
Other income
+
Net interest from loans

Actual

Dividends
+
Interest
+
Other income
+
Net interest from loans
+
Capital gains
-
Inflation

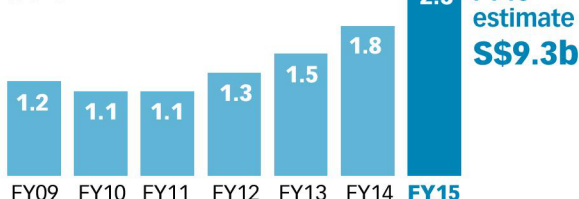
Expected long-term rate

Why the change?

In essence the move to the Returns framework is meant to address expectations that demand for public spending will grow in the coming years. Beyond newly announced schemes such as the Silver Support payouts to less privileged elderly and the SkillsFuture credits for lifelong learning that place ongoing obligations for future governments, costs in specific areas such as healthcare have also been climbing in recent years.

Budget healthcare spending over the years

% of GDP



How NIR helps

Larger pool

Counting capital gains will give a sharp boost to the returns recognised by the government.

NII/NIR contribution to Budget (\$b)

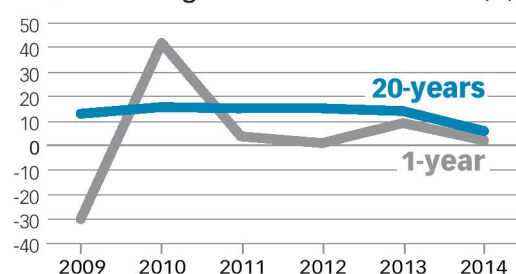


* Based on figures given in Budget speech and 2014 GDP estimates.

Smoother inflows

A long-term average return rate smooths out short-term volatility, especially with capital gains now in the picture. That gives the government a more predictable source of income from year to year.

Temasek's rolling total shareholder returns (%)

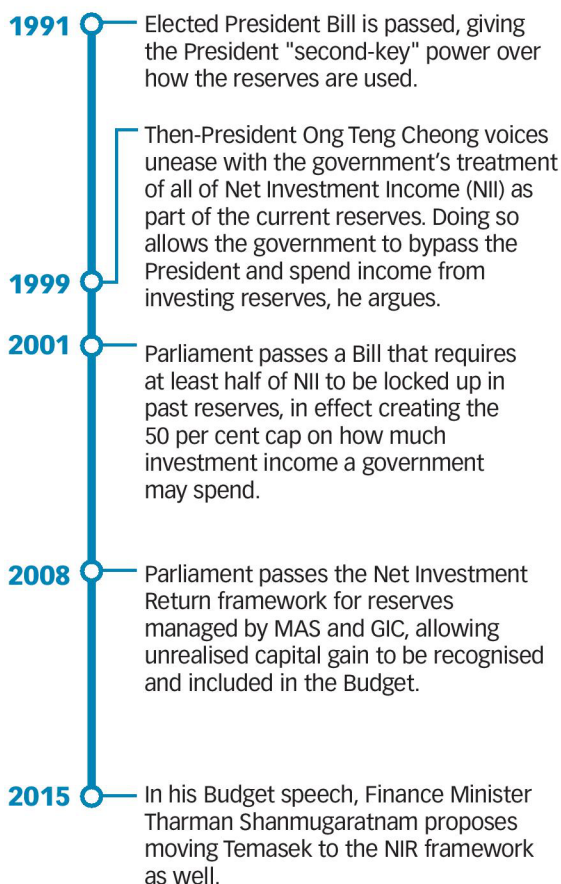


Inflation adjustment

The expected rate of return is adjusted for the cost of living, helping to ensure that the Returns framework is fiscally prudent.

From income to returns

The current treatment of invested reserves' returns has its roots in Singapore's move towards an elected Presidency.



How 'Expected Long-Term' returns might be calculated

Temasek uses its Temasek Geometric Expected Return (T-Gem) model to figure out its likely annualised returns over 20 years. While the exact expected returns are not disclosed, Temasek believes its portfolio is more likely to give higher returns and less likely to give negative returns than model global equity and thematic portfolios.

Temasek's T-Gem model of likely 20-year returns

