ARTICLE FOR THE EDGE

SINGAPORE: 2018 LOOKS GOOD BUT WHAT OF THE LONGER TERM?

The past 12 months have been mostly kind to Singapore. The economy has regained some traction, and that has lifted the mood somewhat. Looking forward, we can say two things. First, the economic prospects in 2018 appear encouraging: next year may well be even rosier than this year's better than expected outcome. Second, this economic rebound helps Singapore buy time to address its structural challenges. It is crucial that the respite Singapore has gained from the global economic recovery be put to good use in crafting bold responses to these challenges.

The economic cycle: 2018 will be better than 2017

First, global demand is likely to surprise on the upside. We challenge the view that after a stronger than expected 2017, 2018 must inevitably see a tapering off:

- Virtually all countries in the world except those in crises are growing for the first time in a decade. That lends resilience to this global rebound. It also means that demand in one economy translates into export demand for others, which can produce a nice positive feedback loop – the kind that delivers upside surprises to forecasters. The lead indicators show the United States, Japan and Europe likely to grow at close to or just above trend rates. The tax cuts in the United States should add even more juice to the American economy. Encouragingly, the prospects for large emerging economies such as India, Brazil, Russia and Turkey, are also brightening – that will help offset the small deceleration likely in China.

- Recent data has reinforced our view that a recovery in capital spending seems underway in advanced economies. Even better still, we now have indicators suggesting that a rising investment cycle is taking shape in developing Asian economies where imports of capital goods are rising again. As the uncertainty of the past few years ebbs, business confidence everywhere is improving, helping to release pent-up demand for new productive capacity. In addition, so many new technologies – artificial intelligence and other digital technologies, renewable energy, advanced manufacturing processes such as 3D printing and new bio-medical therapies and drugs – are taking off simultaneously. That means huge new business opportunities promising higher returns are emerging that companies will have no choice but to invest more aggressively in. Failure to invest could mean a loss of competitive edge vis-à-vis competitors.

- Oil prices are now in a sweet spot, high enough to provide respite to oil producers but low enough to support oil consumers. The outlook for supply and demand suggests that oil prices will remain in this range for some time. That spells better news for Singapore's beleaguered offshore and marine sector, which should begin a modest recovery.

Second, in the past few months, global trade volumes have started growing faster than world economic output. This revival of trade is hugely positive for Singapore, which is one of the most open economies in the world. If the revival in capital spending does indeed materialise, global imports will accelerate as capital goods demand tends to be import-intensive. Singapore's manufacturing sector will go from strength to strength, as a result, pulling allied activities such as transportation, storage, trade finance along.

Third, Singapore's regional hinterland will have one of its best years in a long while. Malaysia, like Singapore is trade-dependent and a big winner from the global upcycle. Domestic demand is also likely to strengthen in the coming year as the government ramps up spending in an election year and as the infrastructure projects are implemented. Similarly, Thailand's diversified export base in terms of both export products as well as export markets means that Thai exports tend to outperform when there is a broadly-based global upturn. Vietnam's export-driven economy should also see another year of acceleration. Indonesia appears to be shaking off the lacklustre demand of recent years – consumer confidence is improving and the lagged effects of interest rate cuts should help. With the passing of tax reforms and the implementation of the "Build, Build, Build" infrastructure programme, the Philippines' economy is likely to be the fastest in Southeast Asia.

Greater vigour in the regional hinterland should help Singapore's services such as finance, entrepot trade, transportation and logistics. This is important because these are activities where local enterprises are more present than in the case of manufacturing, and that will spread the benefits of headline growth to Singaporeans.

What does that mean for policy?

In short, the economy will surprise on the upside. Higher growth will soon remove the remaining slack in the economy: the labour market will tighten and wages are set to pick up. As resource utilisation improves, companies' pricing power will grow and there will be more price increases. So, yes, inflation could well surprise on the upside. Most analysts believe that the Monetary Authority of Singapore (MAS) will tighten policy in October next year – basically by guiding the Singapore Dollar up. However, if economic growth does indeed out-pace expectations, there could be a case for the MAS to move earlier, to pre-empt any rise in inflation.

As economic prospects improve, we are seeing more positive sentiment in the real estate sector. This is evident in the en-bloc redevelopment frenzy in recent months. Consequently, we do not see the authorities relaxing the macro prudential policies introduced to restrain real estate froth.

Given that the economy has substantially out-performed the government's assumptions in the budget, the current fiscal year will almost certainly end with a massive budget surplus. The government will have the fiscal space therefore to increase social spending as well as to accelerate infrastructure construction if it wants to. There is certainly no hurry to raise the Goods & Services Tax rate any time soon. However, there might be some adjustments to sin

taxes while new taxes on carbon and sugar might be introduced, not for revenue reasons but to achieve health and climate change goals.

So far, so good – but do we need to fear the longer term?

As we look forward to better prospects in 2018, we also need to be mindful about the longer term. Indeed, there are troubling trends in the global environment that Singaporeans should study carefully.

The first concern is geo-politics. The coming year could well be one where political developments go from being just interesting items on the news to having material effects on Singapore.

- **Populism puts the global trade regime at risk**: The World Trade Organisation (WTO) is critical for small, highly open economies such as Singapore as it protects us from being intimidated by more powerful nations. The WTO's dispute settlement processes are key to this, providing a neutral place to settle disputes so that trade frictions do not escalate into trade wars which everyone loses out from. Unfortunately, the Trump Administration has been obstructing the renewal of terms for the judges to the WTO's appellate tribunal. By the end of 2018 or early the year after, the appellate tribunal will not have enough judges to form a quorum and that will be the end of this neutral arbitrator of trade disputes.

- **More election risks**: The coming two years will see a series of major elections around the region. Malaysia will hold its 14th general election by around the middle of the year. While Prime Minister Najib Razak's Barisan Nasional coalition seems to be in a good position to retain power, concerns over the cost of living and governance could throw up surprises. Thailand's military government has promised a general election to restore civilian rule by the end of this year. However, if the election date keeps getting postponed, we could see a backlash against the government. In Indonesia, President Joko Widodo will be gearing up for his re-election campaign for the 2019 elections. The polls show him in a strong but not unassailable position and we can expect his rivals to try everything possible to undermine him.

- **The Middle East continues to be a source of potential conflict.** Rising tensions between Saudi Arabia and Iran, the increasing sense of injustice and helplessness in the occupied Palestinian territories and the continuing conflicts in Libya, Syria, Iraq and Yemen could add up to a point where the production and transportation of oil are threatened – which could cause oil prices to spike up. Moreover, Singapore and its neighbours have to be alert to the return of Southeast Asian jihadists to the region following the collapse of the so-called Islamic State in Iraq and Syria. If they find safe havens in places such as southern Mindanao, they could pose a security threat to all of us.

- **Beyond that, there are the perennial concerns over the South China Sea and North Korea's nuclear programme.** Both appear to be in a stalemate – little likelihood of imminent

conflict but the underlying trends look worrying. In the South China Sea, China continues construction of quasi-military facilities on the artificial islands it has occupied against the will of its neighbours. North Korea looks determined to pursue its nuclear programme until it possesses a credible capacity to threaten the United States. In the near term, there is no appetite for any party to escalate the tensions into outright conflict. But if the underlying trends continue, there will be a backlash at some point in the longer term.

A second concern is the effects of global monetary tightening. In the United States, the Federal Reserve will be raising rates and contracting its balance sheet. Over time, other central banks will follow. With valuations stretched across virtually every asset class and signs of speculative frenzy, there are bound to be some dislocations as financial conditions tighten. We should expect abrupt asset price corrections, sharp changes to risk appetites and turbulent capital flows.

Another danger is that of disruptions that threaten Singapore's competitive position.

- First is the challenge posed by technological disruptions which are multiplying. Already, large Singapore companies that enjoyed semi-oligopolistic market positions in their respective industries – such as media and taxi companies – have been shaken to the core. There will be even more disruption as time goes on – not only to companies but to workers who might be displaced by automation. The fact is that technological change is accelerating and taking both corporate leaderships as well as policy makers by surprise.

- Second is the complicated outlook for our global hub. So far, Singapore has done well in fending off putative challengers – our port and airport have kept ahead of the competition and the MAS has encouraged judicious investments in the fintech area so that our financial centre is not left behind by that revolution. However, the rise of super-clusters of economic activity around Singapore's main competitors – Hong Kong and Bangkok – could pose a mightier challenge in the long term. Hong Kong will be at the centre of a huge 100-million population mega-urban region which will give it economies of scale and geographic concentration Singapore can only dream of. Bangkok's plans for its Eastern Economic Corridor will also result in a major cluster which will make Bangkok more attractive as a regional hub, particularly when combined with Bangkok's increasing emergence as the capital of the Greater Mekong Sub-Region with its roughly 250 million population and USD1 trillion economic output.

Do we have the capacity to manage these challenges?

The trends above make for a volatile period, one of sudden changes to competitive positioning and where financial or other shocks could be frequent. Singapore needs two things to cope with this challenging environment – resilience to short term shocks and the flexibility to adjust to longer term competitiveness challenges.

As far as economic resilience is concerned, Singapore remains in a good position. As a small, open economy, Singapore is vulnerable – but it also has the capacity to absorb shocks and

rebound quickly. So long as we maintain strong balance sheets and rigorous financial supervision, a diverse economic base and a capacity for swift and effective policy responses, Singapore should remain resilient.

It is the second area where we may have a problem. We are facing quite fundamental challenges that we have been aware of for some time – ageing and low fertility, less than adequate retirement funding for key parts of our population, weak productivity, inadequate innovation capacity and the relatively poor state of locally-owned companies. Yet, our responses to these have been inadequate – they have certainly not overcome these challenges despite years of trying. We need to ask ourselves whether the incrementalist and "safe" approaches that policy makers have favoured have outlived their usefulness, whether it is time to be bolder.

On that could hinge Singapore's capacity to face the future.

Prepared by Manu Bhaskaran, CEO, Centennial Asia Advisors.