ARTICLE FOR THE EDGE

SINGAPORE AT 57: LOOKING AHEAD WITH CONFIDENCE

As it approaches its 57th birthday, Singapore faces a more troubled operating environment. This is the product of a dizzying series of events in the past six months which saw geo-political conflicts, a decisive monetary tightening, high energy prices and growing risks in China. While Singapore's economy starts off from a strong position in 2022, the going will get tougher as we move into 2023 and beyond. Nevertheless, the Republic should adopt a positive approach, taking the more challenging environment as an opportunity to undertake reforms to strengthen its ability to accommodate the changed world.

Singapore must deal with a world that has been decisively transformed

First, worsening tensions among the world's big powers have created a more dangerous world for Singapore.

Russia's "special military operation" in Ukraine has put it in conflict with the US and Europe. All signs point to a protracted war there, which means a long period of tensions between the big powers as the Western allies step up their support for Ukraine and impose more sanctions on Russia. The US, Europe and Japan are now committed to significant increases in defence spending as well. Because China has chosen to side with Russia in this conflict, the Ukraine war has further worsened the already strained ties between the US and China. In recent days, Chinese anger over US House Speaker Nancy Pelosi's visit to Taiwan has made that relationship even more fraught. In coming months, we can expect China to devise more ways to punish Taiwan for the visit. Where these involve military actions (such as air or naval exercises close to Taiwan's territory), there is always the risk of unintentional escalation that could draw the US in.

The risk of conflict in its backyard is disturbing. But even if that risk can be avoided, Singapore has important military and economic interests in Taiwan and is bound to be dragged in. For example, there could be pressure from China for Singapore to downgrade its ties with Taiwan.

In addition, the big powers will now be more concerned over the resilience of their supply chains, which could mean a sustained effort to increase their self-sufficiency by cutting reliance on imports and so undermining growth in the world trade that Singapore thrives on. There will also be a decisive reallocation of resources away from productive uses towards defence, while R&D spending could also be diverted towards security rather than directly useful economic purposes. That could slow global economic growth as well.

Second, the alarm over climate change has grown as a result of the recent heat waves in the US, Europe and China. We should expect more pressure to accelerate decarbonisation efforts. In addition, the recent spike in oil and gas prices while damaging global growth in the near to medium term, will also accelerate the shift to renewables and non-fossil fuels in the long term. But Singapore is constrained by its small land area and its climate from fully exploiting renewables. It needs to find innovative ways to deal with this.

Third, the ongoing inflation shock will have wide consequences for global finance with an impact on Singapore. Central banks in the developed world missed the inflation spike until it was too late. Now they will have to aggressively tighten monetary conditions so as to rebuild their credibility. The years of ultra-low interest rates and quantitative easing are over. The US Federal Reserve Bank will not be backstopping asset prices with well-timed rate cuts each time there is some financial or other shock. This will make for a thorough-going change in the asset pricing regime. As investors become more rigorous about valuations, there will be downward pressures on these valuations. They will be more questioning about business models of companies and so less free with funding

start-ups and others. With interest rates likely rising to levels not seen for more than a decade, we could even see real estate prices coming down. In other words, we should expect more turbulence over time in financial markets and in the property market.

Fourth, China's economy is in trouble. Its rigorous approach to containing covid infections has given its already slowing economy a thumping, bringing economic growth down to near-zero in the second quarter. The real estate sector is deflating, resulting in rising defaults and other financial stresses. Small and medium enterprises have borne the brunt of the slowdown and are also at risk of financial stresses. Since these firms employ the bulk of workers, it is not surprising that unemployment has increased, especially among younger Chinese. China's policy makers have held back from large-scale stimulus programmes because of the imbalances they created in the past. But without a higher pace of stimulus, there is a danger that China's slowdown could deepen severely.

This is the world that Singapore confronts as it enters its 58th year of existence. How it deals with these challenges will determine its prospects in coming years.

Fortunately, Singapore starts from a good position

The Singapore economy is currently in good shape. The cyclical outlook is bolstered by a several supporting factors.

- The rescinding of covid restrictions is allowing sectors such as food & beverage and tourism to regain ground it lost. The re-opening of borders has boosted the aviation sector: passenger throughput at Changi Airport was 2.9 million in June, compared with 5.8 million in June 2019 and a sharp improvement on 2021. It has also allowed foreign workers to return to work in sectors such as construction which are desperately short of workers.

- Domestic demand should receive a boost as well. The job market is tight and wages are rising, which is likely to support healthy consumer spending.

- Singapore's neighbours are also enjoying a post-covid rebound. Tourism is revving up while high commodity prices are boosting rural income and spending. As they recover, the demand for Singapore's regional hub services will improve as well.

- Although the electronics sector may decelerate somewhat from two years of heady growth, it will still enjoy good growth given the strong capital spending in areas which our manufacturing sector services. Manufacturing will also get some help from the pipeline of foreign investments.

- Although hard numbers are difficult to come by, there is considerable anecdotal evidence that the finance sector is benefiting from activity being relocated from Hong Kong. Innovation such as variable capital companies are attracting fund managers and family offices here as well. Singapore's competent management of the pandemic added to its reputation for safety and good governance and that will support the continued expansion of its wealth management hub.

Rising inflation is a problem. However, the Monetary Authority of Singapore's pre-emptive actions will help cool inflation. Property prices are also beginning to gather momentum and will require some corrective measures.

But overall, Singapore's economy is likely to weather 2022 in reasonably good shape. The Singapore economy remains highly competitive, attracting high quality investments in both manufacturing and services that will keep its economy growing in line with its potential in the near term. That being the case, the key issue now are the structural issues for the longer term.

To face the future in good shape, Singapore needs to address its structural issues

The International Monetary Fund's latest report card on Singapore was highly complimentary but the IMF did sound a note of caution in some areas. In our view, there are several areas that merit policy attention. In previous commentaries, we have pointed out our concerns with Singapore's productivity growth and innovation performance. These concerns remain. But there are some additional problems to consider as well.

First, there is a problem with the savings dynamic in the economy.

- Government savings are high due to an overly conservative fiscal position which results in the economy not getting sufficient traction from domestic demand. That leaves it more vulnerable to external turbulence than it should. The excessively conservative approach also means that there is less effort to tackle inequality than needed.

- Worries about the adequacy of retirement funding, health care support in old age and the desire for protection against rising job insecurity in a restructuring economy can lead to excessive household savings.

- An inordinately high profit share of GDP translates into a high corporate savings rate. The proportion of profits that is saved is substantially greater than the share of household income that is saved.

A high savings rate is seen as a good thing. But there can be too much of a good thing. If the high savings rate comes at the expense of tackling key issues such as inequality, then it is not something to crow about. A high savings rate also produces a very large current account surplus and that could expose Singapore to more protectionist pressures over time. After all, the IMF's view is that, in 2021, real effective exchange rate of the Singapore Dollar was undervalued by anything between 6.8% and 14.0%, something that could inspire the US Treasury to place Singapore on the list of currency manipulators.

A second issue raised by the IMF is real estate prices. The IMF observed that "the private residential housing market runs the risk of diverging further from fundamentals". Not only do high and rising property prices hurt the ability of young couples to own homes, but high prices insidiously damage the economy by feeding into a high cost structure. Another issue Singapore confronts is the growing unease over the 99-year lease for HDB homes. A large proportion of Singapore's public housing stock will soon reach the age at which the value of the remaining lease begins to decay more sharply. The recent controversy over the Selective En-bloc Redevelopment Scheme in Ang Mo Kio is a reminder that this will become a more pressing concern with time and that the authorities need to come up with a solution sooner rather than later.

Third, the government's efforts to wean the economy off its excessive dependence on foreign labour are necessary and indeed unavoidable. But such measures can create headaches for the sectors which have become addicted to cheap foreign labour. A shakeout awaits the small and medium enterprise (SME) sector as a result. It may be necessary to complement policies on foreign labour with more expansive measures to support the SMEs.

Conclusion: Forward Singapore exercise is an opportunity for a rethink

Deputy Prime Minister Lawrence Wong launched the Forward Singapore exercise in June, observing that it was an opportunity for him, and the next generation leaders he will soon lead, to "review and refresh our social compact, and chart a roadmap for the next decade and beyond". Given the challenges in the global environment, this will be a good opportunity to rethink some longstanding policies such as our conservative fiscal stance and the way we manage leases for social housing, among others. Our willingness to

embrace such change, even if it can be discomfiting, will be a test of Singapore's capacity to face up to the future.

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