

The View from Singapore: Cautious Optimism about Asian Economic Recovery

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Summary

- The mood in Singapore is one of cautious optimism as Asia's fast and seemingly robust economic recovery continues.
- There is moderate concern about the knock on effects of European economic problems, though this is not seen as posing a substantial threat to Asian exports or fiscal positions given the region's limited exposure to the Eurozone.
- The main worry is about the emergence of asset price bubbles as a result of increased capital flows into Asia encouraged by loose monetary policy. The focus of local concern is the housing market where prices rose sharply after the economy came out of recession and buyers reappeared, initially paying 20-30% below Q1 2008 prices.
- There is also anxiety about the potential geopolitical implications of the Chinese leadership transition as a younger, arguably less experienced generation of leaders come to power.
- Regarding transnational bodies, there appears to be general scepticism among policymakers over the longer-term effectiveness of the G20 with its diverse membership expected to make agreement difficult.

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CII Introduction: Due to its unique vantage point at the heart of Southeast Asia, Singapore is well placed to provide an informed view of global economic developments and their implications for this influential part of the world. This paper discusses the tremendous growth surge underway this year, and notes Singapore's continuing confidence in Asia's ability to generate strong growth in spite of the serious economic problems facing many developed countries. However, due to concerns over Asian specific asset bubbles and volatile capital flows, the mood is one of cautious optimism rather than hubris, with a watchful eye on political developments across the region as well as around the world.

Given its position at the cross-roads of global trade and finance, the view from Singapore provides a glimpse of the key trends driving the world economy. This Asian hub is the fifth largest foreign exchange market by turnover, the busiest container port and, by some measure, busiest port overall. Furthermore, the Singapore government is a major international investor on its own right, with two sovereign wealth funds (Government Investment Corporation of Singapore and Temasek) and a number of companies owned by Temasek. As such, its leaders and businesses are sensitive to the changing winds of international economic growth. Singapore is a bellwether for Asia and the world. For instance, as early as April 2008, Dr Tony Tan, Deputy Chairman and Executive Director of GIC warned of the possibility of a 'deep, prolonged global recession... unless decisive and timely actions are taken by policy makers in the United States and elsewhere.'

In this paper, we examine more closely the current views of key Singapore policymakers and opinion formers. The focus is on three critical issues — the prognosis for the global economic outlook, the rise of China and global economic governance.

1. The global economic recovery: cautious optimism prevails

Despite some concerns about possible contagion from instability in Europe or the US, there is generally an air of cautious optimism in Asia which is reflected in the prevailing mood in Singapore. Much of this optimism is based on the fact that the Asian recovery has been very broad-based rather than dependent on any one particular sector or country. For instance, at the Asian Development Bank's 43rd annual conference in May 2010, Haruhiko Kuroda, the President of ADB opened his address with 'One year ago, we met in crisis. Today we meet in hope.' The ADB Chief economist Jong-Wha Lee pointed out that 'There are financial linkages, but you can decouple a bit... We've initiated our recovery faster than industrial countries and we can maintain our financial system [to be] relatively resilient from the global financial markets.'

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While these Asian leaders are hopeful about a general upturn in the global economy, they point to a multispeed recovery, with Asia leading the way, followed by the US, while prospects in Europe remain relatively subdued. In August 2009, Deputy Chairman of the Government Investment Corporation of Singapore (GIC) Tony Tan noted, 'The worst seems to be behind us in Asia. Asian economies are now expected to see continued improvement through 2010.' And by January 2010, Tony Tan reaffirmed the thrust of his previous assessment, pointing out that, 'Economies at the centre of this crisis – the US and Europe – should continue to grow over the coming year. In the US, growth could be moderately strong in the first half of 2010 before slowing down to a below-average pace. Although prospects for the US economy have improved, it does not look like the US will enjoy the growth spurt that typically follows from a deep contraction. Europe too, should benefit from the pickup in global trade although a muted response in consumption tempers the likelihood of a strong bounce. Growth in Europe is likely to be weak.'

2. Why the European crisis will not affect Asia's recovery

While accepting the possibility that more severe debt problems in Europe could disrupt the global economy, the largest bank in Southeast Asia by assets, DBS Bank is sanguine that these European problems will not derail growth in Asia. The title of the introduction of their quarterly report published in June 2010 succinctly summed up this view -- 'Asia matters more'. They argue that Asia is 'far less dependent on growth in the G3-the US, Japan and Europe', pointing out that US import demand increased **after** Asian industrial production had fully recovered to the pre-crisis level of output – Asia did not depend on this US recovery.

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They effectively dismissed the three possible routes by which European problems could be transmitted to Asia. First, they argued that the European crisis was unlikely to affect Asian exports, pointing to the strong increase in consumption in Asia since September 2007. Asian consumption has grown by 17%, the US by 1%, and Japan by 0.5%, whereas European consumption remains below its pre-crisis level. DBS drew the implication that 'European demand has not contributed to Asia's recovery and a lack of it going forward would not be greatly missed.' They qualified this statement by admitting that a drop in export demand would affect the smaller, more open Asian economies such as Singapore, Hong Kong and

Malaysia more than the larger, domestically-drive economies like China, India and Indonesia.

Secondly, they did not believe that a generalised sell-off of sovereign debt would affect Asia given that most countries in the region are running current account surpluses (Asian countries are generally net creditors in global markets, not net borrowers). DBS Bank also assumed that the exposure of the Asian banks to the European debt problem would be minimal.

The third path through which the European crisis might affect Asia is via a credit crunch, which, DBS Bank argued, was the most significant cause of Asia's downturn in 2008/2009. However, there was only a small likelihood of this given that the 750 billion euro bailout from IMF/EU would give Eurozone governments 2-3 years to sort out the debt problem.

Unlike DBS bank, the Singapore's Ministry of Trade and Industry (MTI) have been more cautious about the downside risks, particularly the sovereign debt crisis in Europe. For instance, in MTI's announcement (made on 20 May) of the first quarter economic results for 2010, they noted with some concern the possibility of adverse spillover effects from the European crisis onto Asia, with mention of 'significant uncertainties [remaining] beyond the immediate horizon'. Minister of Finance Tharman Shanmugaratnam also pointed out, 'I don't think we are back in a 2008 situation. I don't think the situation fundamentally warrants the degree of uncertainty we saw post-Lehman. But there are risks. We will have to be alert and adroit in the way we respond to these risks.'

As a sign of optimism regarding the global economy, MTI upgraded Singapore's 2010 GDP growth forecast in May from 4.5%-6.5% to 7.0%-9.0% although this forecast was still much lower than those of private sector analysts. However, on 14 July, after reporting annualised GDP growth of 26% for the second quarter, MTI substantially revised upwards the 2010 forecast to 13-15%. Even then caution prevailed as they warned of a more subdued outlook for second half of 2010, due to the slowdown in the US labour market and concerns over a possible sovereign debt crisis. MTI concluded that 'The momentum of the global economic recovery has thus moderated, although a double-dip recession remains unlikely at this juncture.'

3. Main concerns: asset price inflation, volatile capital flows and currencies

The main area of concern for Singaporean policymakers is excessive asset price inflation in emerging Asia' and there have been calls for a tightening of monetary policy in other Asian countries. For instance, in June 2010, Tharman Shanmugaratnam, Singapore's Finance Minister, argued that 'Asia cannot delay for too long a return to gradual monetary tightening, and all that implies for currencies as well' and, furthermore, 'monetary

policy will have to focus on the medium-term challenge of inflation, of goods prices and asset price inflation'.

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In contrast to the property market, Singapore deals with consumer inflation by adjusting the trading range of the trade-weighted Singapore dollar, also known as the nominal effective exchange rate (S\$NEER), rather than depending on interest rate setting. This is because of its openness to trade. On 14 April 2010, the Monetary Authority of Singapore (MAS) announced a policy of 'a modest and gradual appreciation of the S\$NEER policy band' and recent news suggests that currency appreciation may be stepped up.

After the Chinese announcement in June that they would revert to a more flexible renminbi policy, the MAS issued a statement that it would not change its policy of managing the Singapore dollar against a basket of currencies of Singapore's major trading partners. However, the rise in Chinese renminbi will foster concern over the possible impact on already escalating property prices elsewhere in the region as Chinese buyers will be encouraged to enter. In Singapore, mainland Chinese buyers currently constitute about 4.5% of private property purchases.

One of the main causes of rising asset prices and inflation is the scale of capital flows into Asia. These capital flows, largely a result of loose monetary policy in the European and American economies, have also added to volatility in exchange rates. Since mid-2009, Asian central banks have publicly raised concern about growing and volatile capital flows and, like Brazil, some countries have adopted measures to discourage inflows. In November 2009, Taiwan introduced some capital controls, banning foreigners from investing in time deposits. In June 2010, Indonesia and South Korea also introduced some constraints on the flow of capital. More recently, in July 2010, Ong Chong Tee, the Deputy Managing Director, MAS reiterated the need for the region to 'deepen and broaden domestic market capabilities to harness the capital flowing coming in [sic] while at the same time manage the risks that these flows may present.'

4. Rebalancing the Global Economy and the Rise of China

Like policymakers around the world, those in Singapore generally believe that there is a structural shift in the global economy – the Asian economies will have to take up the role of driving growth in global demand. However, a common view, as put forward by Finance Minister Shanmugaratnam, is that it will take time to build up the typical Asian consumer's confidence to the point that this can make up for lower demand from Europe and the US. Hence, global growth is expected to be somewhat slower for the next five to eight years than in the pre-crisis period.

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There are also various risks in attempting to rebalance the global economy. The first is the increase in inflationary pressure in the medium and longer term. Shanmugaratnam predicted that a drive to increase the demand for consumer goods in Asia will exert 'an inflationary impulse on the global economy' in the years to come.

The second risk is geopolitical. Singapore's overarching foreign policy is to ensure that there is a balance of power in the East Asian region in general and Southeast Asia in particular. Singaporean leaders have consistently called for greater US engagement in the region and are concerned that the US may retreat politically. In January 2010, Tony Tan warned that, 'the shift in economic power to the emerging world will likely increase geopolitical risks', pointing out that even though the US will remain dominant in military power, it will be 'heavily reliant on foreign countries, including key emerging geopolitical rivals, to finance its large public debt.'

Given its close relations with China, Singapore has a ringside view of political developments there. Both Prime Minister Lee Hsien Loong and Minister Mentor Lee Kuan Yew have consistently expressed concerns over the implications of a new generation of Chinese leaders who have neither experienced the Second World War nor the Cultural Revolution. In an interview conducted on April 2010, Lee Hsien Loong noted that, 'the current generation of leaders experienced the Cultural Revolution. They know what a mess China can be if it is mismanaged and how important it is that China gets its act together, what challenges China faces internally and how important it is for China to grow and improve the lives of its people and to continue to do this for another generation at least. The next group of leaders will be post Cultural Revolution. They will have grown up in 30 years of reform and opening up. They would have live in a China which is connected to the Internet, with people who are much better informed with what is going on in the world, where interests are expressed, where there will be tensions between different parts of China and they have to run this whole system not as a central system but with a market economy and with a coherent political framework on top of that and I think they'll have a big challenge.'

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While the older generation of Chinese leadership is clear about what they want—domestic stability, the newer generation of Chinese public has taken that for granted and is keen on receiving their due recognition on the international stage alongside continuing improvements in living standards. However, unlike Americans, the Chinese do not seem to have made up their minds on the shape of the world. Lee Hsien Loong noted:

'I think they [the Chinese] are trying to calibrate their position because having emerged in the world and become economically much more powerful than before..., Deng Xiaoping's old dictum to hide your light under a bushel and go quietly into the world...still applies. They [the Chinese] are trying to figure out how to apply it.... they can no longer just move as a small country...[they] have to decide how to trade off [Chinese] interests...versus the interests of the whole system and [their] long term requirement to be a constructive player in the world system, which is what America has done since the Second World War...After 60, 70 years in Asia, people still say America plays an indispensable role, please stay...It would be quite something if the Chinese could achieve that kind of acceptance of their place in the world.'

Earlier in 2005, in an interview with *Time* magazine, Lee Kuan Yew expressed concern that the younger generation of Chinese may miscalculate their position, warning that 'somewhere down this road, a generation may believe they have come of age, before they have.' So there are, as ever, some

concerns about the impact of change and what lies ahead.

5. Global economic governance in flux?

Although Singapore is not a member of the G20, it pays close attention to developments at this level. In general, there is scepticism that the G20 will remain the main forum for global economic governance. Lee Hsien Loong pointed out that 'many other such groupings... will emerge.' There seems to be a general scepticism among policymakers over the longer term effectiveness of the forum given the diverse membership. However, it was notable that after Singapore was placed on the grey list of tax havens after the G20 London Summit in April 2009, the city state began to show a greater interest in the institution and the policies that may emerge.

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Singapore appears to have taken a two-pronged approach towards the G20. The first is to lobby for the formal inclusion of regional representatives (particularly ASEAN) in G20 through the Global Governance Group (3G). This 3G was convened by Singapore's Foreign Minister George Yeo together with his Swiss and Qatari counterparts. The 3G currently includes about two dozen small and medium sized states.¹ The 3G has positioned itself at the United Nations level, calling for the UN secretary general to be present at the G20 and for more inclusive consultation between G20 and non-G20 states, as well as greater flexibility for non-G20 states to be involved in specialised issues. The second approach is to participate in some of the G20 processes particularly through the Financial Stability Board. This is a matter of particular concern for Singapore – policymakers are anxious that the global rules for finance may become overly complicated. As Finance Minister Shanmugaratnam pointed out, the focus should be on risk, saying 'Fundamentals matter, try not to get too complex because in finance, if you get too complex, the inmates take over the asylum.'

While the government does not think that the G20 is the only game in town, it takes the view that a 'G2', whereby the US and China decide to steer the global economy, will not materialise soon. Lee Hsien Loong remarked, 'I think it is an extrapolation beyond the facts. We are not there and the Chinese know that, they are not there... I think they will feel much more comfort to be in a less exposed position.' The overall

¹ The members of the 3G are: the Commonwealth of the Bahamas, the Kingdom of Bahrain, Barbados, Botswana, Brunei Darussalam, Chile, Costa Rica, Guatemala, Jamaica, the State of Kuwait, the Principality of Liechtenstein, Malaysia, the Principality of Monaco, New Zealand, Panama, the Republic of the Philippines, the state of Qatar, the Republic of Rwanda, the Republic of San Marino, the Republic of Senegal, the Republic of Singapore, Switzerland, the United Arab Emirates and Uruguay.

sentiment is that there will remain some fluidity in the architecture of global economic governance.

6. Overall: Mood of Cautious Optimism

Overall, the mood in Singapore is cautiously optimistic about Asia's and Singapore's prospects in the medium term. Early this year, Tony Tan spoke of the possibility of Asia entering into a 'golden age' in the next decade, noting that by and large, Asian countries and companies have emerged from the recession in better shape, although not completely unscathed. However, this result will not be inevitable but will depend on the actions of policymakers. He stressed that the global economy will be 'extremely reliant on policymakers in the next couple of years' due to fact that current recovery was sustained by extensive government support for the financial sector as well as loose monetary and fiscal policy. His outlook for the developed economies, however, is more moderate, pointing out that 'I would like to emphasize is the longer than expected time it might take for the developed world to fully heal from this crisis'. The implication of this multi-speed economic recovery and growth is that, 'over the next decade we are going to hit a tipping point where the influence of emerging markets in economic, financial, and geographical issues will be important, if not dominant.'

Notwithstanding Tony Tan's positive views, Shanmugaratnam is unapologetic about preparing for the next crisis, pointing out in May 2010, 'We will have a next crisis. We want to make sure we don't get a blowout the way we have this time. When we do, we want to make sure there's a more orderly and not a destabilizing way of resolving problems with individual institutions'. In Singapore, preparing for the next challenge and the next crisis is a way of life that will continue.

If you have any questions or comments about this thinkpiece, and/or would like to be added to a mailing list to receive new articles by email, please contact: Laurence Baxter, CII Head of Policy & Research: thinkpiece@cii.co.uk or by telephone: +44 (0)20 7417 4783.



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