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Growth Drivers in Asia and Singapore

Good morning.

1 Thank you for inviting me to join you today. There are important issues confronting the global economy. Allow me to share some observations on global and regional economic trends, and what they mean for Singapore. I look forward to hearing your views.

2015 in Retrospect

2 While the G3 appeared to be on the upswing phase of their gradual recovery from the GFC, emerging market economies (EMEs) in 2015 experienced a generalised downturn that was partly a result of policy responses to the crisis. The combination of expansionary fiscal and monetary policies in China post-GFC led to a credit boom, which has largely run its course, accompanied by a significant build-up of debt. Growth in China has slowed since 2014, dragging down global commodity prices with it. This confluence of factors—namely, negative terms-of-trade shocks, supply-side constraints, and a tightening of financial conditions ahead of last month's US interest rate hike—have come together to precipitate a pullback in growth in Emerging Asia. Economic activity in the region was further weighed down by a sharp fall in trade flows.

3 Against these headwinds, the region's performance last year was the slowest since 2001, with GDP growth projected at 6.2%.[1] Growth in the larger ASEAN[2] economies also moderated to an estimated 4.5% last year, the weakest since the GFC, although resilient domestic demand supported economic activity. While Asian growth has slowed, it remains well above that in most other developing parts of the world, including Latin America, where the expansion came to a stand-still last year. Moreover, labour market conditions have remained firm in the region.

What Lies Ahead for Asia?

4 As we enter the new year, the key forces at work in the second half of 2015 will continue to influence global economic prospects. There are a few things we should watch.

[1] EM Asia comprises China, India, Korea, Taiwan, Hong Kong, Singapore, Thailand, Malaysia, Indonesia and the Philippines. GDP growth forecasts are from *Consensus Economics Inc*. The overall growth rate for EM Asia is calculated using 2013 nominal GDP weights, converted at the average exchange rates prevailing in that year.

[2] ASEAN here refers to Indonesia, Malaysia, the Philippines and Thailand.

5 First, will the Chinese economy, and, in relation, commodity prices, stabilise? For now, the latest economic data from China continues to give cause for concern over growth, and recent stock market gyrations add to the uncertainty.

6 Second, as the Fed embarks on monetary normalisation, how will the re-pricing of interest rates and risk premia in the medium term affect financial markets and global growth? The asset purchases and prolonged ultra-low rates have led to a search for yield and a potential misallocation of resources, which a normalisation cycle may expose.

7 Third, how will financial market volatility weigh on confidence, and hence affect business and consumer spending? Since the GFC, global financial markets have reacted more sharply to bad news, reflecting anxiety about the global economy, and the deeper inter-linkages between financial markets and the real economy across the world. Geo-political risks, such as the rise of ISIS and conflicts in the Middle-East, have added to the uncertainty.

8 Forecasters suggest that Asia's growth in 2016 will at best be similar to that of last year. Actual growth will depend heavily on final demand in the advanced economies and how well the region adjusts to the turns in the global commodity and interest rate cycles.

9 My view is that in the short term, investors need to remain vigilant to market volatility, given that asset prices have been supported in part by the period of prolonged low interest rates. But Asia can meet the cyclical challenges from arguably a stronger base compared to the late 1990s, with adequate official reserves, stable banking systems and relatively healthy fiscal positions in many countries. As I have mentioned previously, Asian policy makers have learnt important lessons from the Asian Financial Crisis which took place in 1997-98.

10 Looking at the medium to long term, sustaining growth and returns to investment will depend critically on economic restructuring and innovation. When I was at the MAS several years ago, I cautioned that we must not get carried away by hubris during good times.[3] By the same token, in harder times, we should also not forget the important progress that has been, and that remains to be made, in restructuring the region's economies and building new capabilities to sustain long-term growth. Amid the present doom and gloom, let me share some recent positive developments on this front.

Asia is adapting to the new economic realities

11 First, growth in Asian emerging markets as a whole is projected to average 6.0% from 2015–20[4]. There are demographic and urbanisation dividends to be reaped, and much of Asia is still at a catch-up growth phase. A growing middle-class, who is being encouraged to consume more, will provide the internal impetus for growth. Even though the 6% growth rate is not high by historical standards, Asia is expected to continue outperforming the rest of the world by a significant margin.

3 Keynote Address at the Opening of EDHEC-Risk Institute Asia, 21 January 2011.

4 Projections based on *Consensus Economics*, October and December 2015.

12 Second, governments in the region have embarked on serious efforts to improve their growth potential by pushing ahead with structural reforms and raising productivity. While this will take time to bear fruit, it signals a clear recognition that change is critical.

13 China's 13th Five-Year Plan demonstrates its leaders' commitment to rebalance demand and revive productivity growth, through a market-based allocation of resources and by injecting greater competition into the markets. It is an ambitious endeavour, not made easier by the sporadic bouts of stock market and currency volatility. But I believe the Chinese government is determined to press ahead with structural reforms, even as it takes measures to ease the transitional pains and maintain financial stability.

14 In India, macroeconomic stabilisation has created a conducive climate for Prime Minister Modi's administration to press ahead with reforms aimed at enhancing the business environment, improving public infrastructure and attracting more foreign direct investment.

15 Japan is planning to nearly double its budget allocation for robot-related investment in the coming fiscal year. The move is targeted at expanding the use of robots in both the manufacturing and services sectors to boost productivity in the face of a declining birth rate and shrinking labour force.

16 In ASEAN, there has been a ramping-up of public investment through a roll-out of infrastructure projects, for example to enhance transport networks. Our neighbours Indonesia and Malaysia have also turned adversity into advantage by slashing energy subsidies when oil prices fell.

17 Admittedly, structural reform is an arduous task, requiring sustained commitment on the part of government, as well as buy-in from businesses and the population. Asian economies will have to continue to push ahead to develop physical infrastructure, upgrade education and skills, and strengthen market infrastructure. While there may be a need for policy recalibration from time to time during this transition, the imperative for change is very clear.

Implications for Singapore

18 Let me now touch on the implications for Singapore in view of these developments in the global and Asian economies.

19 In the short term, with the global economy growing only modestly, the performance of Singapore's externally-oriented industries will be subdued. We cannot be fully insulated from the headwinds in the external markets, but the more domestic-oriented sectors including healthcare and education should continue to post steady growth. Still, we must be alert to the medium-term structural changes. As a small economy, we must continue to be outward-oriented. And, as global trade and production reconfigure, we too must adapt and restructure. In that regard, we will explore opportunities in different areas. Let me share three areas where I see opportunities.

Longer-term growth opportunities

20 First, niche production activities. Singapore-based manufacturers have been moving away from land- and labour-intensive to capital-intensive activities. Starting from the mid-nineties, land intensity per unit of output has fallen continuously,[5] as companies scaled up the value chain. Within the domestic IT industry, manufacturers have recast business models and shifted towards niche production as well as services-related activities, such as chip design, delivery of IT services and innovative solutions. Venture Corporation is an example of a home-grown electronic manufacturing services player that has in recent years pivoted its business to focus on high value-creation segments. This includes working with Tier 1 original equipment manufacturers to produce devices, and the accompanying core technology components, for the medical and life-sciences industries. High quality and reliability are very important for such industries. This way, we continue to make ourselves useful to the world by providing services that complement the evolving production networks in the region.

21 The second area is consumption. Consumption spending will likely expand in tandem with rising population and income levels. Consumption patterns are evolving quickly in Singapore amongst a more discerning domestic populace, and a greater willingness and ability to spend on discretionary services such as insurance, air transport and restaurants, beyond the immediate needs provided by essential services. Between 2008 and 2013, growth in discretionary spending significantly outpaced that of essentials, with real expenditure on discretionary services surging by 61%.

22 What we see in Singapore is also apparent in the rest of the region. Asia's rising affluence will translate into growing demand for a wide range of goods and especially services. Consumers value diversity in consumption, and this provides good potential for intra-regional trade in final goods and services, even as trade in intermediate components remain important.

23 Singapore is in a good position to grow with this trend, by shifting our comparative advantage from a production basis to a consumption basis. Let me share with you an example—tourism. Over the last five years (2010–14), China's imports of tourism services have surged by 31%, from 17% in the earlier five-year period (2005–09). In Singapore, with the exception of 2014, Chinese visitor arrivals have increased on average by 25% every year since the GFC. In 2001, which was a rather dismal year, when I was Permanent Secretary in the Ministry of Trade and Industry, we were hoping we would get 500,000 visitors from China. We pushed ourselves to aim higher, for one million visitors. In 2012, we welcomed two million visitors from China. That is the scale of the change.

24 The third opportunity is modern services. Technology improvements have facilitated a worldwide surge in global services trade. Between 2001 and 2013, Singapore's services exports soared by 14% on an annualised basis, surpassing the global average of 10%. Estimates show that the income elasticity of services imports is higher than that of goods, especially in Asia. The demand for modern services increases more than proportionately with income growth, as compared to

[5] As measured by the capitalised value of land and the buildings or structures erected on it.

traditional services. Exporters of modern services in Singapore are well-poised to benefit.

25 In this regard, I would, in particular, like to highlight promising developments in the financial sector, where there is great potential for Singapore to develop niche growth areas in modern services.

26 As a financial centre, Singapore is an attractive regional base for many global financial institutions, due to our stable political and economic environment, robust regulatory and corporate governance framework, and liquid and vibrant capital market. Singapore is a Pan-Asian centre for asset management, offering a broad and diversified range of investment capabilities, spanning traditional and alternative strategies. In 2014, the asset management industry saw significant gains, with total assets under management increasing by 30% to S$2.4 trillion.[6] When I was in MAS looking at these numbers, we were hoping the market could grow to S$1 trillion. We are now the third largest FX centre globally, and are taking further steps to strengthen our position as an FX price discovery and liquidity centre in the Asian time zone. We also have a clear lead in insurance, with a strong cluster of reinsurance and specialty players, many of which have established their regional hubs in Singapore.

27 Two recent developments have given greater impetus to Singapore's development as an international financial centre.

28 First, China's internationalisation of the RMB. Singapore has grown to be the largest offshore RMB hub after Hong Kong and the RMB is now one of the top five traded currencies in Singapore. We are well placed to support the use of RMB in the region, for example, in trade finance, and in providing FX and cash management services to treasury centres of Chinese corporates that invest in the region. Last year, we enhanced cross-border RMB financing channels to Chongqing, beyond Tianjin and Suzhou; and secured a doubling of Singapore's quota under the RMB Qualified Foreign Institutional Investor Scheme to RMB 100 billion. Notwithstanding recent headwinds in China, we remain positive on RMB prospects in the medium term and will continue to put in place measures to strengthen the RMB ecosystem in Singapore.

29 Second, a potential game changer for businesses and finance: technology. MAS formed the FinTech & Innovation Group (FTIG) within its organisation last year. This group is responsible for regulatory policies and development strategies to facilitate the use of technology and innovation to better manage risks, enhance efficiency, and strengthen the competitiveness of Singapore's financial sector. It is forming close collaboration with industry and other government agencies, and addressing softer factors such as fostering good role models in the fields of science and technology and shifting cultural attitudes towards innovation and learning from failure. MAS is encouraging the establishment of innovation labs, such as UBS' Evolve Lab, MetLife's Lumenlab, Aviva's Digital Garage and HSBC's Singapore Innovation Lab. These labs create a new paradigm for collaboration among financial institutions, institutes of higher learning, research institutes and startups to meet the changing demands of clients.

[6] According to MAS' 2014 Asset Management Survey.

30 To be future-ready, it is important to be proactive and think long-term about talent development, and build a financial sector characterised by world-class skills, continuous learning, meaningful careers and a strong core of Singaporeans at all levels. There are ample opportunities for finance professionals to continuously upgrade their skills, and to avail themselves of the good jobs created by the new financial landscape. MAS is embarking on SkillsFuture initiatives to partner with the industry to develop Singaporean talent with deep skills and regional expertise that will sharpen our edge as a key financial centre in the Asian timezone.

Conclusion

31 Let me conclude. Evolving production networks in the region and the world are leading traditional IT manufacturers to recast their business models and shift towards niche production and services-related activities. Rising Asian affluence is reshaping consumption patterns and redefining competitive advantage from a production to a consumption basis. Global services trade is surging on the steam of technology improvements, opening up opportunities in modern services such as FinTech. These examples come from different sources and arise from different forces. But I see one common theme—an innovative agility and an outward orientation combining to transform changes into a basis of strength and a source of growth.

32 The Committee on the Future Economy had our first steering committee meeting yesterday. As we discussed in the Committee, it is not possible to predict the future. Just like how, say, 15 years ago, we would have been hard put to predict in full the developments I've described today. We may not be able to predict it, but we can certainly prepare for it.

33 What is within the realm of possibility—indeed the realm of necessity—is to have the innovative agility and that outward orientation that will carry us through a range of scenarios. We must recognise and make the most of opportunities, even as we stay mindful of risks. The Committee on the Future Economy will look deeply into how to keep being innovative and outwardly-oriented, so that we may create good opportunities for Singaporeans and Singapore companies.

34 Asia today is facing a complex confluence of cyclical and structural forces. These forces are largely beyond our control as Singapore is a small economy and a price taker. What we can, and must, do is to strengthen our robustness against unexpected shocks by keeping the economy flexible and nimble. We must persevere with structural reforms, to reposition ourselves and build new capabilities, especially in innovation, that will secure sustainable and inclusive growth.

35 I look forward to hearing your ideas too. Thank you.

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