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KEYNOTE ADDRESS BY BG GEORGE YEO, MINISTER FOR INFORMATION & THE ARTS AND SECOND MINISTER FOR TRADE & INDUSTRY, AT SICC’S 158TH AGM LUNCHEON ON 21ST MAY 1999 AT THE MARINA MANDARIN HOTEL

STAYING THE COURSE

Improved Prospects

The global economy has improved significantly in the last six months. Led by the continuing climb of the Dow, the recent stockmarket rallies across East Asia have lifted general market sentiments. The economic situation in Latin America, which only last October threatened to send the world into another financial tailspin, has stabilised. The dark scenario of a global recession triggered by the contagion from Latin America spreading to the US has receded. Even the prospect of a Russian default appears less alarming now.

The US economy shows remarkable resilience. Already into its 7th year of economic expansion, the US GDP grew 3.9% last year. First quarter GDP growth this year was a robust 4.5%. The growth momentum remains strong, leading some economists to believe that there is now a New Economy driven by technological innovation.

For the European Union, despite a weak 2.2% growth in the fourth quarter of 1998, with sharp slowdowns in Germany and the UK, analysts expect the EU economy to bottom out in the second half of this year as a result of decisive cuts in interest rates - 25 basis points in December last year and another 50 basis points last month.

Even the Japanese economy is showing flickering hints of possible recovery. Compared to 6 months ago, the mood in Japan has become less pessimistic. While the IMF forecasts 1.4% contraction for this year, the Japanese government is more optimistic.

These positive global developments help the rest of East Asia in its recovery. Last year, several Asian economies contracted sharply: Indonesia by 14%, Thailand by 8%, Malaysia by 7% and Korea by 6%. The first quarter results this year show significant improvement. On a seasonally adjusted quarter-on-quarter basis, economic growth in Malaysia, Thailand and Korea have all turned positive since the fourth quarter of last year. This was also the case for Indonesia: although the Indonesian economy contracted 10% in the first quarter of this year on a year-on-year basis, growth has turned positive quarter-on quarter.

For 1999, it is now expected that Korea would grow by 4%, Malaysia 1% and Thailand also by 1%. For Indonesia, much will depend on the coming elections in June and November, and the return to political stability.

For these four countries, improved current account surpluses have bolstered foreign exchange reserves. Short-term external debt in these four Asian countries has also fallen considerably by between 25-50% from 1997 to 1998. As a result, both the Korean Won and the Thai Baht have risen in value, the Malaysian Ringgit is now undervalued and the Rupiah has stabilised. Domestically, improved consumer sentiment has boosted demand.

Fragile Growth

However, the current recovery in East Asia is barely six months old and remains fragile. The pace of recovery in different countries is also uneven. Things can still go suddenly and terribly wrong. We cannot assume that spring has arrived and the weather can only get better.

One obvious weakness is exports. While export volumes have grown in Korea and Thailand, for example, export values continue to perform poorly, contracting by

5.4% and 3.8% respectively in the first quarter of this year. For Korea, this is the fourth consecutive quarter of contraction; for Thailand, it is the fifth.

A second weakness is domestic credit creation. Although major efforts have been made to clear the bad debt overhang in many of the crisis-hit economies, progress remains slow. Take Thailand, for instance, which has Bt 380 billion of non-performing loans belonging to the 58 closed financial situations. The bids in the latest two auctions were very low, offering 75-80% discount. As financial institutions tighten prudential requirements, many viable companies are not receiving the funding they need to stay afloat. This is one reason why unemployment has continued to remain high in many Asian countries. Continuing high unemployment can in turn lead to political instability.

The current recovery is partly the result of tough measures prescribed by the IMF. As one would expect, the IMF gets blamed for the bitter medicine but little of the credit when things improve. The countries which carry out painful but necessary structural reforms are among the first to recover. Korea's quick recovery is not an accident. President Kim Dae Jung has forced the chaebols to restructure in the face of rising unemployment. He was determined to free up the economy and open the door to foreign direct investment (FDI). Given Korea's long history of economic nationalism, this was not an easy task. Because President Kim persisted, Korea is now in a much better position. Last year, Korea managed to attract US$8.9 bn of FDI. But, even in Korea, there is still much more to be done.

We must take heed of what Dr Stanley Fischer of the IMF said recently in his video conference with Hong Kong and Singapore journalists. He cautioned that the single most important threat to the continued recovery in Asia is a slowing down of the pace of reforms. He was also worried that the rise in regional stockmarkets might again expose Asian economies to the vulnerabilities of the recent past.

We should therefore temper the current optimism and not be lulled into a premature sense of confidence that it will be a smooth ride in East Asia from now on. Financial markets tend to overshoot beyond what the real fundamentals justify. In bad times, we call this the "negative herd-effect". In good times, it is Greenspan's "irrational exuberance". There will be bumps and potholes along the way ahead, some quite nasty ones, and our best strategy is to prepare and allow for them. If we speed on recklessly, accidents are inevitable. In the end, there is no short cut, only hard work. We must keep working on the economic fundamentals and accept that some results will take time to show.

Possible Shocks

Some shocks to the economic system are foreseeable; others are not. Let me discuss three possible shocks, quite obvious ones, that could complicate the Asian recovery in the coming 1-2 years.

First, rapid slowdown of the US economy. Most experts now agree that the underlying non-inflationary growth potential of the US economy is higher than what had been originally assumed. But many also agree that it is quite impossible for the

US economy to continue growing at an annual average of 3.8% which was what it achieved in the last three years. The ballooning US current account deficit, which is expected to reach US$ 270 billion this year, cannot be sustained. The question in 1999 is whether the US economy can slow down gently, say, to 3%. A sharp correction in the US stockmarket can create a huge negative wealth effect which might drag down the entire world economy.

East Asia’s recovery might then be derailed. Of course, the US is not East Asia’s only source of growth. In 1997, intra-East Asian Asean-10, NIE-3, China and Japan trade accounted for about 50% of East Asia’s total trade. This is much more than East Asia’s trade with the US which is 19% of East Asia’s total trade, or with the EU which is 14% of East Asia's total trade.

Accounting for about 17% of total intra-East Asian exports and 28% of imports, the health of the Japanese economy is key. It is therefore crucial that the Obuchi government continues to boost domestic economic growth and complete the cleaning-up of Japanese financial institutions. Continuing growth in China will also provide some cushion. If the US economy slows down gently as the Japanese economy recovers, global demand will be kept up. If the US economy slows down much faster than Japan is able to take up the slack, the East Asian recovery may be aborted.

The second possible shock is Indonesia. It will take many years to restore Indonesia completely to the path of rapid economic development. So many forces have been unleashed, so many factors and factions are now in play, getting Indonesia back into a normal state is a complicated process involving many twists and turns. The general elections in June and the presidential elections in November are two important milestones along this journey. If the elections are widely perceived to be free and fair, and the results are popularly accepted as legitimate, the prospects for Indonesia will be good. Even then, the task of rebuilding political and economic institutions will be a difficult one because of the country’s internal divisions. This is the bright scenario.

If, by some misfortune, the political process in the coming months turns disorderly, then we must be prepared for other outcomes. The Indonesian Army may have to intervene if there is no other way to contain the forces of division. An Indonesia in chaos will spread a thick political haze over large parts of Southeast Asia and make it that much more difficult for the region to attract foreign investments and sustain economic recovery.

The third possible shock is the war in the Balkans. If NATO sends ground forces into Yugoslavia, Russia will willy-nilly be dragged in. Russian politics may then be radicalised with grave and immediate consequences for global stability. A few weeks ago, there was a chance that a Russian-brokered UN solution might be found. Then a tragic accident happened when the Chinese embassy in Belgrade was bombed. A few days later, President Yeltsin, under pressure of impeachment from the Russian Duma, fired Prime Minister Primakov. From whatever angle we look at the Balkans, it is clearly an accident-prone part of the world, which if mishandled, can trigger off a global crisis.

I have listed these three possible shocks as examples of the things that can go badly wrong in a relatively short space of time. In the nature of life, there will always be surprises. In 1997, no one could have foreseen that the devaluation of the Thai Bhat would create such spectacular reverberations in all four corners of the world. What we know is that we are entering a new period of uncertainty after the end of the Cold War. Globalisation of the world's financial markets has resulted in volatilities which the international institutions established at the end of the Second World War, in response to a different set of global problems, are not well-equipped to handle. The IT revolution and the Internet explosion have accelerated the pace of change. Technology is transforming the world faster than many human cultures are able to adapt to.

Pressing On

However, in macro-economic management, the only thing worse than being overly optimistic is being overly pessimistic. While it is still too early to celebrate, we should not pull the brakes. We should instead feed the incipient recovery. Of course we should be aware that many uncertainties remain and brace ourselves for a bumpy ride ahead.

The first quarter results just released show that the economic situation in Singapore is much better now. However, the recovery is still uneven. While electronics has bounced back and the contraction in commerce has moderated, construction and financial services are still in decline. Private consumption expenditure is still weak, with a decline of 1.1% in 1st quarter 1999. This is also reflected in residents' expenditure abroad which shrank by 7.7%, a second consecutive quarter of decline. Despite an increase in public investment, overall investment fell by 16% in 1st quarter 1999. Although retrenchments have dropped, total employment continued to decline, reflecting weakness in the labour market. The current seasonally-adjusted unemployment rate of 3.9% is significantly higher than the pre-crisis level of 2%.

As a small country, Singapore is unable to influence global events in any major way. But we must be good at defensive driving and always take care to give ourselves a margin for error. By cutting costs drastically and implementing many of the recommendations put forward by the Committee on Singapore's Competitiveness, we have put ourselves in a good position for future growth. We must search out new areas of growth and find creative ways to stay globally competitive.

For manufacturing and exportable services, EDB has launched the Industry 21 Blueprint, first, to enhance our strengths in electronics and petrochemicals and, second, to grow new clusters in the life sciences, biotechnology, communications, multimedia, healthcare and education. You would have heard or read of the recent tie-ups we have made with key companies in these clusters Examples include Silicon Manufacturing Partners wafer fabrication plant joint venture with Lucent (US) and CSM (Singapore); CSM and Bell Labs (US) collaboration in wafer fabrication process technology; and ST Microelectronics Asia Pacific (Italy) collaboration with the Centre for Wireless Communications on the development of Wideband Code Division Multiple Access (W-CDMA). .

We are also giving strong emphasis to the financial sector which already constitutes 13% of our economy. Despite the economic crisis, we have pushed ahead with the liberalisation of our financial markets and regulatory structure. In fact, the economic crisis has focussed international attention on the strengths of Singapore, especially the strengths of our financial institutions.

A new area we are giving particular attention to is technopreneurship. The Technopreneurship 21 Initiative launched by DPM Dr Tony Tan early last month will open up a whole new field for young Singaporeans. Opportunities to create new enterprises based on technological innovations will add strength and diversity to our economy. The T21 initiative will create a conducive environment for this to happen. We need technopreneurship to maximise the returns on the massive investments we have made in higher education, R&D and Singapore ONE.

However the competitive landscape changes, our efforts in Industry 21, the financial sector and Technopreneurship 21 will serve us well. If the Asian economic recovery is sustained, we will pull ahead quickly. If the ride stays bumpy for a few more years, we will still make progress albeit at a slower speed. So long as we stay united, keep open our links to the world and stay the course, we will be all right.

I wish SICC every success in the coming year. It will still be a challenging year.