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Singapore apprehensive about economic downturn in China

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"All Quiet on the Eastern Front" was the title of a report by the Konrad-Adenauer Foundation on the elections in Singapore, which saw the ruling People's Action Party (PAP) emerge victorious in September 2015 by a wide margin (T. Stephan, P. Rüppel, "Im Osten nichts Neues", Singapore country report, Konrad-Adenauer-Stiftung, October 2015). In terms of political relations in the city state, the title is accurate; but as the PAP has reigned without interruption since 1959, its dominance is not expected to come under threat any time soon.

In terms of the economy, however, there is a lot going on in the East that will have significant consequences for Singapore and its function as the most important economic, business and finance centre of South-East Asia. The burning question is how to proceed with China in the coming years. High growth rates in China have long been a thing of the past and the shift in the country's development model from labour-intensive manufacturing and investment towards industrial innovation, consumerism and services will affect the overall flow of goods and services to the Middle Kingdom. There are other changes on the horizon owing to various free trade agreements, in particular the ASEAN Economic Community (AEC) and the Trans-Pacific Partnership (TPP), but also due to Chinese initiatives such as the Asian Infrastructure Investment Bank (AIIB) and the Silk Road Strategy (One Belt, One Road).

However, Singapore has more than just new external conditions to adapt to – there are also problems from within the country to be dealt with. One such problem is unfavourable demographic development, which will need to be solved in order for Singapore to maintain its high economic levels in the future.

Inconsistent development in 2015

The global economic crisis, as well as the economic downturn in China and South-East Asia, made its mark in 2015, including on Singapore. Although growth in the fourth quarter began to increase again, price-adjusted growth for the full year only reached +2.0 per cent. This is 1.3 percentage points less than in the previous year, and the lowest increase since the international financial crisis in 2008/2009 (Monetary Authority of Singapore, Recent Economic Developments in Singapore, 4 March 2016, www.mas.gov.sg).

The primary growth drivers were services, and in particular, the wholesale, retail, finance and insurance sectors. The construction industry experienced growth of just 2.5 per cent due to significantly fewer private contracts for residential and industrial buildings, compared to 3.5 per cent the previous year. Manufacturing also fared poorly, with output declining by more than 5 per cent. One reason for this was that export demand for offshore equipment suffered as a result of low oil prices. The semiconductor industry, which is one of Singapore's strongest industries, also produced significantly less than in 2014 because of poor PC sales, among other reasons. The medical industry provided one ray of hope, even managing double-figure growth (Ministry of Trade and Industry Singapore, Economic Survey of Singapore 2015, 24 February 2016, www.mti.gov.sg).

In terms of gross domestic product (GDP), consumer spending increased, particularly in the private sector, by 4.9 per cent. Investment decreased overall by 1.0 per cent. Government expenditure of 3.8 per cent, which primarily went on machinery and equipment, stood in stark contrast to the low level of investment made in the private sector (-2.2 per cent). Net exports climbed by almost two points to 26.8 per cent of GDP, making it one of the highest rates in the world (E. Arbati, G.H. Hong, "Singapore's Export Elasticities: A Disaggregated Look into the Role of Global Value Chains and Economic Complexity", IMF Working Paper, WP 16/52, 7 March 2016, www.imf.org).

Singapore's imports and exports suffered as a result of a weak global economy and low oil prices. Trade in goods dropped in comparison to 2014 by 9.5 per cent to 884 billion Singapore dollars (576.1 billion euros). Business in oil and related products took a particularly bad hit, falling by over 30 per cent. This is because the city state is one of the most important locations in the world for oil refining. Trade of goods unrelated to petroleum barely moved in comparison to 2014. Exported and imported services were worth a total of 389 billion Singapore dollars (+0.3 per cent). Financial services performed best in the sector with the highest growth in terms of exports (+8 per cent) and imports (+12 per cent) (Economic Survey, loc. cit., chapter 4).

2016: Only slight improvements on the horizon

In the short term, Singapore's economy is not set to recover. When consulted in March 2016, economic experts from the Monetary Authority of Singapore, the country's central bank, estimated an average growth of 1.9 per cent of GDP in real terms. Three months before, the organisation had forecast an increase of 2.2 per cent (Monetary Authority of Singapore, Economy Policy Group, Survey of Professional Forecasters, March 2016).

According to the Ministry of Trade and Industry (MTI), growth of "between one and three per cent" is possible in 2016. However, Singapore faces numerous risks. With this in mind, officials have pointed out that this result can only be achieved if various risks do not "fully materialise" (barring the full materialisation of downside risks) (MTI, "MTI maintains 2016 GDP Forecast at 1.0 to 3.0 Per Cent", press report, 24 February 2016).

Minister of Finance, Heng Swee Keat, summarised the situation even more clearly at the presentation on 24 March 2016 of the budget for the fiscal year 2016 (1 April 2016 to 31 March 2017): Business conditions are unclear and the new year will bring with it strong headwinds for Singapore, he said. In any case, he added that there is no need to be "overly pessimistic" ("No need for pessimism despite strong headwinds", Today Online, 25 March 2016, www.Todayonline.com).

Renewed consumerism is expected to be among the country's assets for 2016. The state is providing more for social welfare, health and education (among other things) and, in doing so, is stimulating demand for services in these fields. Moreover, private consumption will profit from a very low inflation rate (forecast for consumer price index: -0.2 per cent) and from a moderate rise in wages and salaries. However, private households are being encumbered with significant debts due to high property prices and a high home ownership rate; in 2015 this was more than 220 per cent of household incomes (ADB, "Asian Development Outlook 2016", Singapore section, March 2016, www.adb.org).

Singapore's economic relations with China: A combination of risk and opportunity

On all accounts, the greatest danger in 2016 comes from China's economic downturn. "When China sneezes, the whole world catches a cold. But Singapore will probably catch it worse because of its small, open economy," says one economist from Singapore's DBS Bank of the situation ("Singapore exports to China suffer biggest hit in seven years", Straits Times, 18 February 2016, www.straitstimes.com). According to calculations from Australia's ANZ Bank, a drop by one percentage point in China's economic growth will drag Singapore's GDP down by a corresponding 1.4 percentage points ("China's slowdown will hit Singapore hardest: ANZ warns", The Straits Times, 12 January 2016, www.straitstimes.com).

Since 2013, China has been Singapore's most important trading partner. In 2014, exports to the Middle Kingdom reached 51.5 billion US dollars, accounting for 12.6 per cent of total exports (www.worldsrichestcountries.com). Electronic equipment and components, such as storage devices or parts for smartphones, constitute almost 45 per cent of the total export value (ibid). In 2015, shipments to China in this sector fell, sometimes by more than 20 per cent (Department of Statistics Singapore, "Singapore's External Trade", various months), and this trend is likely to continue. Alongside economic causes, one reason for this could be that Chinese high-tech companies want to cover more and more of the value chain for their products in order to become less dependent on other countries for primary and intermediate products. Taiwan is suffering from the same problem (D. Rehn, "Taiwan muss sich neu erfinden" [Taiwan must find itself again], Konrad-Adenauer-Stiftung, Regionalprogramm Soziale Ordnungspolitik Asien/Auslandsbüro Japan, 22 February 2016).

Against this backdrop, the city-state's manufacturing sector must prepare itself or another difficult year. Experts form the central bank forecast a decline in output of 2.7 per cent (MAS, Survey of Professional Forecasters, loc. cit.). Aside from the electronics industry, the marine technology industry is also at risk, as the demand for oil rigs and oil rig equipment has fallen sharply due to low oil prices.

Service sectors geared toward foreign markets – particularly China – can also expect less business. This applies, for example, to transport and storage of goods, given that Singapore is one of the most important transshipment hubs in the world (Department of Statistics Singapore, "Business Expectations (Services Sector), First Quarter 2016, 29 January 2016). According to the most recent full-year figures for 2014, the city state exported transport services worth 65.2 billion Singapore dollars, ten per cent of which went to China (Department of Statistics Singapore, "Singapore's International Trade in Services 2014", January 2016, www.singstat.gov.sg).

The hotel and accommodation services sectors will also suffer if the number of Chinese tourists declines (MAS, Recent Economic Developments, loc. cit., p. 11). Furthermore, banks are now threatening trouble. Some experts believe that financial institutions are at risk as a result of China's downturn, since they are heavily involved with loans in Greater China's economic area. Although Singapore's central bank recognises the growing risk, they also point out that large domestic banks have more than enough capital to cope with non-performing loans ("Is Singapore Headed for a Recession?", The Diplomat, 29 February 2016).

Free trade agreements and China initiatives positive steps for Singapore

But even though Singapore is being affected in the short term by the global economy's very uncertain development and changes in China, foreign trade prospects are positive in the medium term. The country benefits from a strong service sector, for example (share of GDP in 2014: approx. 75 per cent) and, in particular, from the shift in China's development model to consumerism and services, which Singapore has responded to accordingly with investment. According to International Enterprise Singapore, the public foreign export company, the country ranked third in 2014 in China's tertiary sector behind the USA and Japan ("S'pore is China's largest investor", Business Times, 25 November 2015). In total, Singapore had invested almost 112 billion Singapore dollars – i.e. 18.5 per cent of its foreign direct investments – in China by the end of 2014 (Department of Statistics Singapore, FAQ on Foreign Direct Investment, www.singstat.gov.sg).

By the same token, China is also very active in Singapore. According to the Business Times, Singapore is an important Asian location for investment for the Middle Kingdom ("S'pore is China's largest investor", loc. cit.). By the end of 2014, China had invested 16.2 billion Singapore dollars into Singapore, while in 2008 this figure was only around 4 billion Singapore dollars. Almost 60 per cent of this investment went into financial and insurance services in 2014, with almost a further quarter going into wholesale and retail (Department of Statistics Singapore, Foreign Direct Investment in Singapore by Country/Region and Major Industry, www.singstat.gov.sg).

In the coming years, China and other countries are likely to increase their presence in Singapore. The reasons for this are primarily free trade agreements (FTA) such as the ASEAN Economic Community and the Trans-Pacific Partnership (TPP). As a result of these agreements, Singapore's status as an important economic, business and financial centre for South-East Asia is likely to increase even more. The city state is already a regional hub for more than 7000 multinational companies (HSBC, "Singapore firms should ramp up now to leverage TPP", press report, 13 November 2015).

The AEC came into effect on 1 January 2016 and is set to transform the ASEAN area into a large, common market with a free flow of goods, services, investment and labour by 2025. In the short term, the AEC is likely to only have a gradual effect on Singapore, according to Glenn Maguire, head economist for South Asia at the ANZ Bank. The agreement is expected to mostly affect goods with a lower added value, since one potential consequence of integration throughout the large region and the alignment of customs procedures is that production of these will move away from Singapore into cheaper neighbouring countries. For clothing, this might be Vietnam or Thailand, and for electronics, it will probably be Malaysia ("New ASEAN Economic Community could give Singapore's GDP a 9.5% boost by 2030: HSBC", The Straits Times, 23 November 2015, www.straitstimes.com).

In the long term, however, Singapore can expect substantial growth stimulus from the AEC. HSBC Bank have forecast a best-case scenario of a 9.5 per cent increase in GDP by 2030 (G. Harvey-Samuel, "AEC will be a welcome economic catalyst", HSBC Global Connections, 4. January 2016, https://globalconnections.hsbc.com/singapore/).

There is likely to be a lot of emphasis on services, which is a sector with a lot of potential for more interregional trading. In 2013, less than a fifth of exports and only 14 to 15 per cent of imports took place within the group of states (The ASEAN Secretariat Jakarta, "ASEAN Integration in Services", December 2015, www.asean.org).

The Silk Road Strategy and the New Asian Infrastructure Investment Bank (AIIB) – both launched by China – should be highly advantageous for Singapore (BDO Singapore, "One Belt One Road", November 2015, www.bdo.com.sg). Singapore will be able to help other states involved in the initiative with the construction of commercial and logistical infrastructure. There are also many possibilities in the field of project finance. In this case, the fact that Singapore is the largest foreign hub for trade in Chinese renminbi Yuan after Hong Kong is certainly helpful.

Manufacturing sector to become more productive and innovative

Singapore's manufacturing sector is under strain. Competition from China is increasing, labour is scarce and costs are rising, while the population is ageing. To top it off, the industry is not making enough. Between the end of 2014 and the end of 2015, productivity declined for five quarters in a row, with most recent figures at around -3.0 per cent (Department of Statistics, Labour, Employment, Wages and Productivity, www.singstat.gov.sg).

This is a "dangerous problem" according to Prime Minister Lee Hsien Loong. "We are doing all the things which the economists say ought to be done in order to fix it. We haven't seen the results yet but we are doing what we believe are the right things." ("S'pore must persist, keep faith with economic restructuring: PM Lee", Today Online, 2 April 2016, www.todayonline.com).

Following the government's attempts in recent years to increase productivity with projects and financial aid yielding seemingly little success, the new buzzword is "restructuring". To make industry and the economy more innovative and productive and to "future-proof" businesses, the government has set aside 4.5 billion Singapore dollars in the budget for the fiscal year 2016 (1 April 2016 to 31 March 2017) for the Industry Transformation Programme (ITP). Specific development plans (roadmaps) are set to be made for more than 20 industries representing around 80 per cent of all economic sectors of the city state. The aim is to ensure greater cooperation among companies in the same industry but also to better coordinate the work of companies, government agencies, industry associations and chambers of commerce ("Bespoke roadmaps for over 20 economic sectors in the works: Heng", The Business Times, 29 March 2016, http://www.businesstimes.com.sg). Small and medium-sized business will be the main focus, as it is precisely these sorts of companies that are suffering the most at the moment from a lack of labour supply. Accordingly, part of the ITP funds are intended for the automation and robotisation of production processes.

Opinion varies wildly on whether or not the plans will be a success. Some experts see these measures as the expression of a "quietly powerful revolution" ("ST Budget roundtable: Quietly powerful evolution, says panel", AsiaOne Business News, 27 March 2016, http://news.asiaone.com). Others see the budget as "old wine in new bottles" (T. Ho, "Why Budget 2016 means nothing to us", AsiaOne Business News, 29 March 2016, http://news.asiaone.com).

Demographic problems a cause for concern

Unfavourable demographic development has called the growth forecast into question. The population is ageing rapidly, as women in Singapore are having fewer children, despite government support measures intended to encourage an increase in birth rates. According to UN calculations, by 2026 a fifth of the population will be 65 years or older. Demographically speaking, Singapore therefore has a disproportionate number of older people ("A super-aged Singapore: Policy implications for a Smart Nation", TodayOnline, 13 October 2015, www.todayonline.com).

This has substantial consequences: The social and health systems are under significant strain and the lack of workers is already becoming noticeable on the labour market. More immigration could ease the problem, but the general public have reservations about a high influx ("China slowdown is biting Singapore economy amid demographic crunch", CNBC, 19 January 2016, www.cnbc.com), leading the government to handle the issue very cautiously. If nothing changes, however, efforts to significantly increase productivity will become even more essential.

In order to solve its various economic and social problems, Singapore is placing a lot of faith in the "Smart Nation" initiative. A large-scale project that started in 2014, the initiative aims to bring the use of information and communication technology into all areas of everyday life on a large scale. The Prime Minister's office will be the coordination centre for this new project (more information can be found at www.pmo.gov.sg/smartnation).

The transformation of Singapore into a "smart" society would go a long way to providing the radical restructuring that the government is aiming for. However, it will be important that promises are followed by clear, convincing results. Even if the transformation does not always run smoothly in some areas, it could be the only way for Prime Minister Lee to secure public confidence in the actions of his government ("S'pore must persist, keep faith with economic restructuring: PM Lee", loc. cit.).

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