

Singapore – and other small advanced economies – in a changing global economic environment

Singapore's growth rates are slowing, with a range of forecasters marking down their growth estimates. The Ministry of Trade & Industry recently narrowed its forecast 2015 growth rate to 2-2.5%, and this week the Asian Development Bank forecast a growth rate for Singapore of 2.1% for 2015. There is increasing talk of a technical recession – two consecutive quarters of negative growth – in 2015 after a quarterly GDP growth reading of -4.0% in the June quarter.

To understand some of the key drivers of this performance and the Singapore economic outlook, it is useful to look at the recent experience of the group of small advanced economies (selected IMF advanced economies with populations of less than 10 million).

It is striking that after a sustained period of strong performance by small advanced economies relative to their larger economy peers, and a generally effective small economy response to the global financial crisis, small advanced economy growth rates over the past few years have been distinctly sluggish. From an average growth rate of about 4% in the 15 years between 1993 and 2007, growth in a 13-strong group of small advanced economies was about 2.5% to the June 2015 quarter. With few exceptions, growth rates in each small advanced economy are lower in 2015 than in 2011. And in many of these economies, there has been a loss of growth momentum over the past several quarters.

In each small country, there are specific factors that can explain part of this slowdown: reduced external demand from Asia and economic restructuring in Singapore; lower commodity prices in New Zealand; the effect of Nokia and Russian sanctions in Finland; or the high Swiss franc in Switzerland. But an interesting aspect of small advanced economy performance since 2011 is how little performance variation there is across small countries despite these different specific exposures.

My interpretation is that the consistently weaker small country performance reflects a more challenging global economic environment for small advanced economies. Perhaps most obviously, the global export growth on which many small advanced economies are reliant has weakened significantly over the past several years. Indeed, world trade growth was negative for the first half of 2015. Lower external demand is exerting a drag on GDP growth across the small advanced economy group. This is clearly apparent in Singapore, with very weak external demand from key export markets reported over the past year.

In addition, global macro conditions have been challenging for many small advanced economies. Loose monetary policy in the US, Europe and Japan, has placed upward pressure on small country exchange rates – and has also made it challenging to run monetary policy in a way that fits domestic conditions. And labour productivity growth seems to have weakened across many small advanced economies in the past several years – perhaps partly as a consequence of weaker export growth.

Because small advanced economies are acutely exposed to global economic developments, this weak performance suggests problems with the underlying strength of the global economy. The key message

from small advanced economies is that the global economy is soft, and that recovery is still a way off. This is consistent with the recent downward revisions of global growth forecasts. For example, the IMF revised their 2015 global growth forecast down in July to 3.3% (from the 3.4% forecast in April), and recently suggested that this forecast will be revised lower again.

Overall, small advanced economies have struggled to return to pre-crisis growth rates. Singapore's recent growth experience is in line with other small advanced economies. It is a much tougher global economic environment in which to generate growth.

In addition, I believe that this weaker small advanced economy performance is also saying something about the medium-term outlook for the global economy. In particular, the weak small advanced economy performance over the past few years may be the first indications of a different global economic regime, with lower, more volatile growth and weaker cross-border flows. Small advanced economies are again functioning as the canaries in the mine of the global economy.

Throughout history, there has been a strong relationship between the performance of small countries and the strength of the global economy. Small countries perform much better in periods of strong global growth and globalisation. Indeed, small countries – with Singapore in the vanguard – have out-performed larger countries over the past 25 years. But the outlook for small advanced economies over the next several years looks to be much less positive.

As one measure of this, it is useful to consider the growth rate differential between small and large advanced economies. Between 1990 and 2007, average growth rates in small advanced economies were higher by about 0.9% a year. But the size of this differential has been markedly lower since 2011, by about half a percentage point. And IMF forecasts suggest that the small advanced economy growth premium will remain at this lower level for the next several years. Such a low growth differential has not been observed on a sustained basis for a few decades, before the start of the process of intense globalisation.

The historical relationship between small country performance and the state of the global economy means that the erosion of small advanced economy over-performance can be taken as a negative signal on the global economic outlook. Indeed, previous periods of poor small advanced economy performance relative to larger countries have coincided with weak global economic conditions. The signal from the small country experience is for weak global growth rates, and with significant downside risk (including the possibility of a global growth recession).

My sense is that small advanced economies are picking up the effects of a turning tide in the underlying dynamics of the global economy. Governments, firms and investors should not expect a return to the economic conditions that prevailed prior to the crisis.

This will be a much more demanding environment for small advanced economies to generate growth in. Small advanced economies will need to act to create growth potential in a low global growth environment – as well as acting to manage risk exposures in what will likely be a more turbulent economic environment.

Small countries that do not do this are likely to experience sustained poor performance. There will be limited margin for error.

Singapore, as a highly open economy, is very exposed to these global dynamics and should expect growth headwinds. But Singapore has many things in place to cope with this environment (substantial reserves, a competitive economy, and so on) and has responded effectively to previous global economic changes. Even so, Singapore will need to be on its toes.

Overall, this recent small advanced economy experience suggests that structural changes are underway in the global economy. And because seas can become choppy in a turning tide, governments, firms and investors need to brace for economic turbulence. To an even greater extent than previously, strategic foresight, resilience and agility will be needed for small country success.

This op-ed was published in the Opinion pages of Singapore's Straits Times on 26 September 2015

About the author

Dr David Skilling is the founding Director of Landfall Strategy Group, which was established in 2011. David advises governments, companies, and financial institutions in several small countries, and writes regularly on global macro, globalisation and geopolitics from a small country perspective. David has recently served as Senior Advisor to the Secretary of Foreign Affairs & Trade in New Zealand, and as a Fellow at Singapore's Civil Service College. Previously, David was an Associate Principal with McKinsey & Company in Singapore, as well as being a Senior Fellow with the McKinsey Global Institute. Before joining McKinsey, David was the founding Chief Executive of the New Zealand Institute, a privately-funded, non-partisan think-tank. Until 2003, David was a Principal Advisor at the New Zealand Treasury. David has a Ph.D. in Public Policy, and a Master in Public Policy degree, from Harvard University, as well as a Master of Commerce degree in Economics from the University of Auckland. David was named as a Young Global Leader by the World Economic Forum in 2008.

About Landfall Strategy Group

Landfall Strategy Group is a Singapore-based research and advisory firm that provides advice on strategic issues to governments, firms, and financial institutions, particularly in small advanced economies. We provide distinctive perspectives on emerging global trends, working with decision-makers to understand key global changes and how governments, firms, and institutions should respond and position themselves in the emerging global economic and political environment.

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