Economics & Strategy

Singapore: Opportunity from the trade war

Group Research

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Irvin Seah
Senior Economist

Please direct distribution queries to
Violet Lee +65 68785281
violetleeyh@dbs.com

- *The ongoing trade disputes between the US and China will likely disrupt trade and investment dynamics in Asia, thus affecting trade dependent economies such as Singapore*
- *But beyond trade dilution, ASEAN countries, including Singapore, could benefit from the corresponding trade diversion, as well as the reshuffling of supply chains by global companies in the medium term*
- *Singapore is in a favorable position to mitigate against the risks, and to capitalize on the opportunities.*
- *Companies would have to re-orientate their business strategies by leveraging on FTAs, technologies and diversify to the ASEAN region*

Trade war

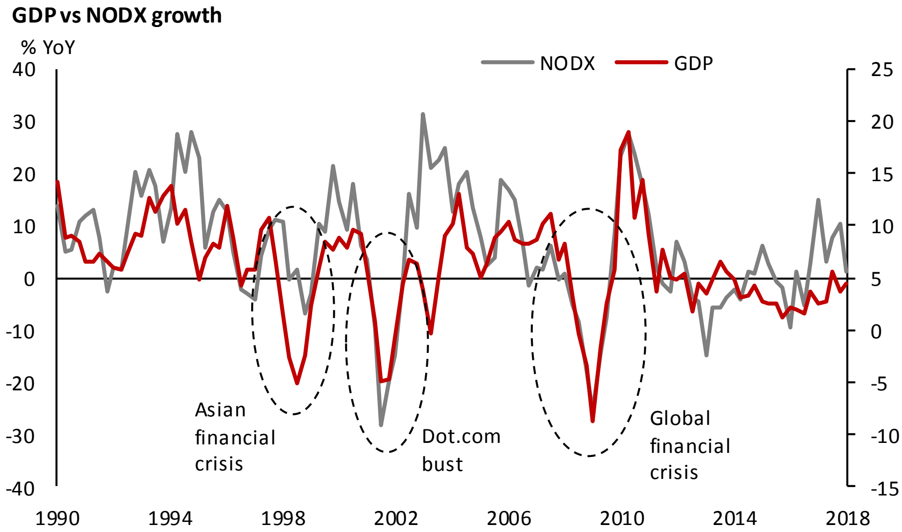
The ongoing trade war is not just about trade but rather, a power struggle between the two biggest economies in the world. Such tit-for-tat trade disputes has already sent the global financial markets into tailspins. The risk is that further escalation could potentially disrupt global trade flows and cast a shadow over longer term economic prospects. This will have a profound effect on the global landscape and ultimately impact trade dependent economies such as Singapore.

The trade war is not just about trade

The latest: the Trump administration has recently announced another round of tariff hikes on Chinese goods. The tariffs on USD 200bn worth of products came on top of an earlier round of tariff hikes on USD 50bn of China's exports. The most recent wave of tariffs will start at 10% before rising to 25% on 1 Jan19. In return, China retaliated with another round of tariff hikes on USD 60bn of products at 5% and 10%, after an earlier round of tariff hikes on USD 50bn of imports from the US.

Singapore's vulnerability to trade cycles

Singapore, with total trade to nominal GDP at 216%, is highly exposed to external environment dynamics. Consequently, Singapore is highly sensitive to global business cycles. It was hit by various shocks such as the Asian financial crisis in 1997/98 and the global financial crisis of 2008, just as it benefited from strong global growth over much of the past few decades. In fact, whenever the non-oil domestic exports (NODX) tanks, Singapore dips into a recession (chart next page).



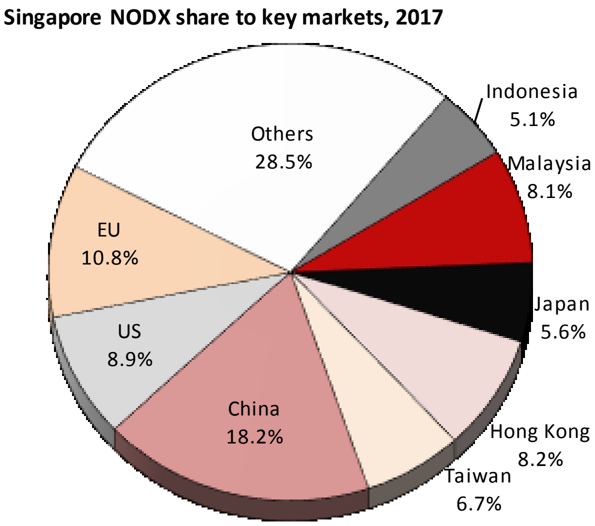
Source: Department of Statistics

So, amid the backdrop of the ongoing trade war between the US and China, the natural assumption is that **Singapore could be more badly hit than most economies in the region due to the high dependency on trade**.

Trade dilution versus trade diversion

However, apart from the tariff hikes on steel and aluminium products, the trade action by the US is specifically targeted at China. It is largely bilateral and other trade partners with the US could be less affected compared to a scenario whereby a blanket tariff hike is applied across the board on all exporters of a particular product class. Such scenario will only benefit local US suppliers due to the import substitution effect. In this current situation, the import substitution effect is relatively less.

The trade war has been largely bilateral



Source: Department of Statistics

Yet, the tariff actions by both the US and China could dilute trade flows between these countries. China's exports to the US could be adversely affected given the lop-sided trade dynamics between these two countries. China shipped about USD 505bn worth of goods to the US in 2017. In contrast, exports from US to China registered only USD 130bn, resulting in a deficit of USD 375bn.

Singapore's manufacturing base is largely focused on high value-added intermediate products, and a large proportion is shipped to China for subsequent processing. As a result, a decline in US's demand for Chinese goods could indirectly hit Singapore's exports. Note China is Singapore's largest export market, accounting for 18.2% of total non-oil domestic exports (NODX) (chart in previous page). In this regard, trade war could impact Singapore's growth and export performance adversely.

ASEAN could benefit from trade diversion

However, as the trade war is largely bilateral in nature, **there could be some degree of trade diversion, which could benefit Southeast Asia economies, including Singapore** (see DBS article "Another perspective of the trade war" dated 23 Mar18). Import tariffs imposed on certain products from China could benefit exporters of similar products from other countries. Essentially, the trade flows could be "diverted" from China to other competing suppliers. That is, if US importers find it too expensive to source from China, they could switch their procurement sources to countries like Vietnam, Cambodia, Thailand, Malaysia and even Singapore (diagram below).

Beyond the obvious better trade terms for their exports to the US, these countries could potentially see more inflows of foreign investment as companies reassess their global supply chains in the medium term. Specifically, countries such as Vietnam, Cambodia and Thailand, with manufacturing cost structure similar to China could see more demand for their exports, as well as investments by Chinese companies looking to circumvent the US tariff wall. Being a regional shipping and financial hub, Singapore could see positive spinoffs in terms of demand for its re-exports, logistics and financial intermediation services.

While the trade war will bring about a lose-lose outcome for both the US and China - exports performance for China and tax / inflation on US consumers - countries in **Southeast Asia could be the main beneficiaries given the trade diversion effects**. Specifically, **the impact of the trade war on Singapore could well be positive from such a perspective**.

Overcoming trade barrier via FTAs

Countries with existing trade agreements with the US and China whereby the trade terms are more favourable could even see added advantages. To safeguard its trade interests, Singapore has invested significant amount of resources over the past two decades in securing bilateral FTAs and participating actively on several regional trade agreements. To date, it has a comprehensive network of more than twenty high quality FTAs with many of its trading partners (table below). Amid the ongoing uncertainties in the global trade environment, these legally binding agreements will be useful in enhancing Singapore's overall value proposition.

FTAs will give some economies added advantages

Implemented FTAs

- China-Singapore FTA (CSFTA)
- India-Singapore Comprehensive Economic Cooperation Agreement (CECA)
- Japan-Singapore Economic Partnership Agreement (JSEPA)
- Korea-Singapore FTA (KSFTA)
- NZ-Singapore Comprehensive Economic Partnership (ANZCEP)
- Panama-Singapore FTA (PSFTA)
- Peru-Singapore FTA (PeSFTA)
- Singapore-Australia FTA (SAFTA)
- Singapore-Costa Rica FTA (SCRFTA)
- Singapore-Jordan FTA (SJFTA)
- Sri Lanka-Singapore (SLSFTA)
- Turkey-Singapore FTA (TRSFTA)
- US-Singapore FTA (USSFTA)

Regional FTAs

- ASEAN-Australia-NZ FTA (AANZFTA)
- ASEAN-China FTA (ACFTA)
- ASEAN-India FTA (AIFTA)
- ASEAN-Korea FTA (AKFTA)
- ASEAN FTA (AFTA)
- EFTA-Singapore FTA (ESFTA)
- GCC-Singapore FTA (GSFTA)
- Trans-Pacific Strategic Economic Partnership (TPSEP)

Concluded/signed FTAs

- EU-Singapore FTA (EUSFTA)
- Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)

FTAs undergoing negotiation

- ASEAN-India (Services & Investment)
- ASEAN-Japan (Services & Investment)
- Eurasian Economic Union-Singapore FTA (EAEU)
- Pacific Alliance – Singapore FTA
- Regional Comprehensive Economic Partnership (RCEP)

Against the backdrop of the trade war, Singapore companies must familiarize themselves with these FTAs, as well as pitch this advantage to customers in the US or China. As such unique comparative advantage will not be easy to replicate in the near term, the FTAs will provide local companies the opportunities to gain further foothold in the two key markets.

The element of certainty that these FTAs provide, particularly against the backdrop of an increasingly challenging trade landscape, **will also enhance Singapore's appeal as a strategic investment destination for multinational companies** hoping to diversify their operations to Southeast Asia. However, companies would have to familiarize themselves on the technical aspects of the FTAs, particularly the Rules of Origins (ROO) within the various FTAs to enjoy the preferential treatments under the trade arrangements [1].

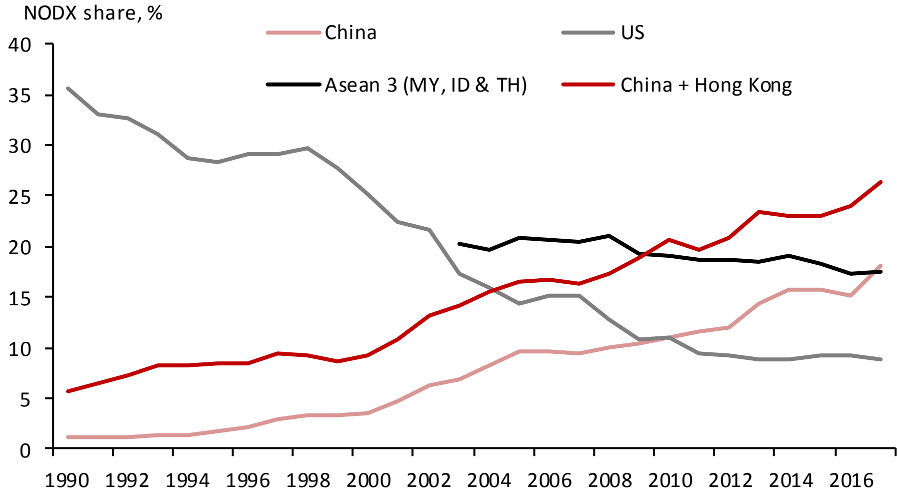
Indeed, **while some companies will be negatively affected by the trade war, those that are able to quickly re-orientate their strategies and leverage on Singapore's FTAs would stand to gain new business grounds**.

Diversification and regionalisation

Diversification is key in navigating the new trade environment

The ongoing trade disputes has highlighted the importance of diversification. Having a well-diversified supply chain and market portfolio would enable companies to avoid concentration risk. In this regard, Singapore may have to focus more on ASEAN going forward.

Growing importance of China in terms of NODX share



Source: Department of Statistics

While Singapore has a diversified export profile, its exposure to ASEAN is relatively limited. In contrast, the liberalisation of China in the late 1980s and the drive towards internationalisation had led to Singapore's trade structure to be skewed towards China over the years. NODX share to China rose from just 1.1% in 1990 to 18.2% in 2017. Including Hong Kong, which is often seen as a transhipment hub for China, the figure rises to 26.4%, from 5.7% over the same period (chart above).

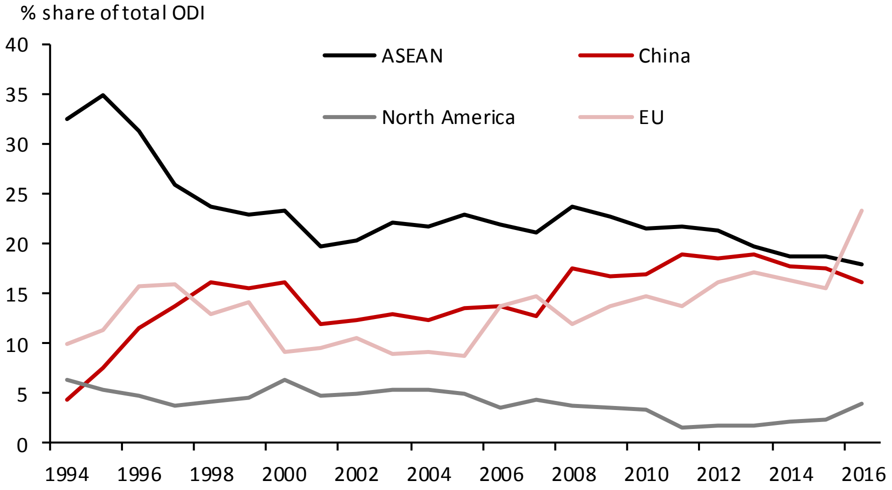
Yet, although Singapore's total NODX share to her top three ASEAN partners (Malaysia, Indonesia and Thailand) is comparable to that of China, it has been moderating in recent years. It eased to 17.5% in 2017, from 20.3% in 2003.

Singapore companies need to focus more on ASEAN

There is a similar profile in terms of outward direct investment (ODI) by Singapore firms into ASEAN too (chart next page). ODI share to ASEAN has been falling while investment into China has risen over the years. Note that these numbers are likely a little distorted because of the high proportion of FDI outflows that are coming from MNCs based in Singapore.

Nevertheless, diversification into ASEAN will offer additional opportunities for Singapore companies as well as to reduce exposure to China amid the new trade landscape [2]. Besides, an increasing share of global FDI could be redirected to within a few hours' flight of Singapore as global companies reshuffle their supply chains in the coming years. This could bring about more opportunities for Singapore companies, especially if they have strong presence in the region.

ODI to Asean has been falling



Source: Department of Statistics

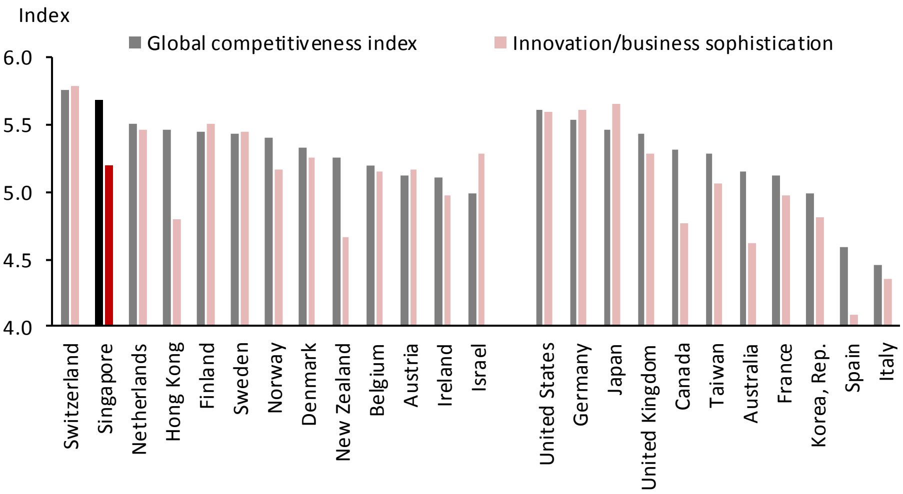
Innovation and competitiveness

As much as bringing about more opportunities for Singapore companies, stronger foreign investment flows into ASEAN could also stoke more competition. Companies would have to up their game to benefit from the changes and remain relevant. **Leveraging on technologies and enhancing business capabilities will enable Singapore companies to have the competitive edge in their internationalisation efforts**.

From a macro perspective, Singapore is well-placed to take advantage of these opportunities as well as to manage the risks. The World Economic Forum recently ranked Singapore as one of the best positioned economies in terms of innovation and business sophistication.

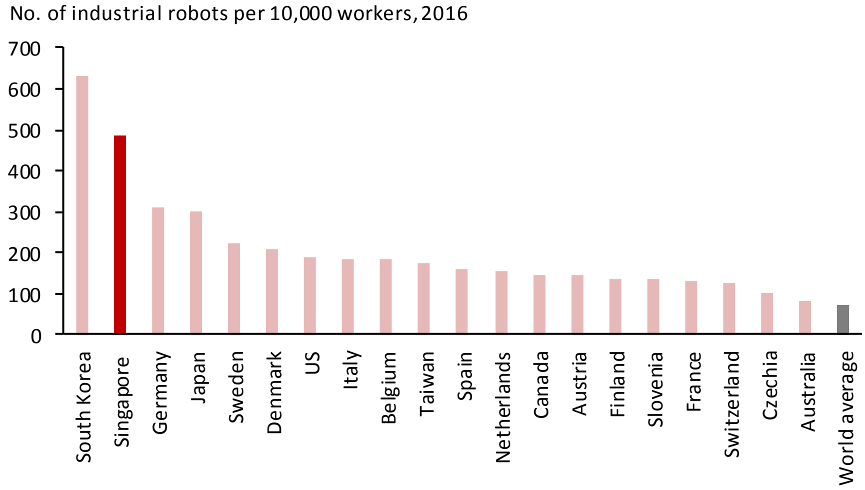
Innovation and technology will give Singapore companies an edge

Singapore is ranked highly in competitiveness and innovation



Source: Global Competitiveness Report, World Economic Forum

Singapore has one of the highest densities of industrial robots



Source: International Federation of Robotics

Moreover, the trade war is focused on goods and the corresponding effects will be most keenly felt in the manufacturing sector. Given Singapore's relatively higher level of sophistication in this sector, it commands an edge in this regard compared to the regional peers. According to the International Federation of Robotics, the economy has one of the highest density of industrial robots in the world (chart above).

Beyond technology, Singapore also has high levels of human capital and skills, with workers able to upgrade and adapt to new ways of working. This is supported by active government initiatives on skills upgrading. Indeed, **Singapore's head-start in technologies complemented with the right skill-sets, should put the economy in a better position to ride through the trade war**.

Implications

Just as the trade war can be perceived as a power struggle between the US and China, it can also be seen as a rebalancing of regional trade and investment dynamics. As the game of attributions wage on between these two economic giants, there will be losers, as well as winners. The regional economic landscape will change significantly.

Companies must re-orientate their strategies to gain from the trade war

While some economies could lose out, the reshuffling of supply chains and diversification of sourcing locations by global companies in response to such disruptions could in fact present others with opportunities. **The key lies in how economic entities (both companies and economies) respond and re-position themselves in this new environment.**

Singapore is in a unique position given its regional hub status, a comprehensive FTA network and higher level of innovation and business sophistication. But to capitalize on the arising opportunities and mitigate against the risks, **companies must re-orientate their business strategies by leveraging on FTAs, technologies and diversify to the ASEAN region**.

Notes:

[1] Details of the US-Singapore FTA (https://ie.enterprisesg.gov.sg/Trade-From-Singapore/International-Agreements/free-trade-agreements/USSFTA).
Details of the China-Singapore FTA (https://ie.enterprisesg.gov.sg/Trade-From-Singapore/International-Agreements/free-trade-agreements/CSFTA)

[2] Singapore companies are increasingly more encouraged to venture into ASEAN markets. Based on the National Business Survey published by the Singapore Business Federation (SBF), 69% of the companies that had ventured overseas in 2017 are planning to intensify their Southeast Asia footprint; and the top three markets are Myanmar (27%), Vietnam (25%) and Indonesia (21%).

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Economics & Strategy

Taimur Baig, Ph.D.
Chief Economist - G3 & Asia
+65 6878-9548 taimurbaig@dbs.com

Nathan Chow
Strategist - China & Hong Kong
+852 3668-5693 nathanchow@dbs.com

Masyita Crystallin
Economist – Indonesia & Philippines
masyita@dbs.com

Joanne Goh
Regional equity strategist
+65 6878-5233 joannegohsc@dbs.com

Neel Gopalakrishnan
Credit Strategist
+65 68782072 neelg@dbs.com

Eugene Leow
Rates Strategist - G3 & Asia
+65 6878-2842 eugeneleow@dbs.com

Chris Leung
Economist - China & Hong Kong
+852 3668-5694 chrisleung@dbs.com

Ma Tieying
Economist - Japan, South Korea, & Taiwan
+65 6878-2408 matieying@dbs.com

Radhika Rao
Economist – Eurozone, India, & Thailand
+65 6878-5282 radhikarao@dbs.com

Irvin Seah
Economist - Singapore, Malaysia, & Vietnam
+65 6878-6727 irvinseah@dbs.com

Samuel Tse
Economist - China & Hong Kong
+852 3668-5694 samueltse@dbs.com

Duncan Tan
FX and Rates Strategist - Asean
+65 6878-2140 duncantan@dbs.com

Philip Wee
FX Strategist - G3 & Asia
+65 6878-4033 philipwee@dbs.com

Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).