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Asia's Role In The Post-Crisis Environment

1. I would first like to thank the organisers for inviting me to speak at this year's Swiss Re Forum.
2. The topic of my speech is "Asia's role in the Post-Crisis Environment". I will first take stock of how the Great Financial Crisis of 2008/09 is likely to change the global economic, political, and investment environment. I will then focus on the challenges and opportunities these changes pose for Asia.

The Global Outlook

3. First, let me share a few thoughts on the global economic outlook.
4. The global economy has clearly rebounded from the Great Crisis of 2008/9. After hitting a trough in the first half of 2009, the global economy has seen consistent growth. Massive policy support provided by governments and central banks is working. Global growth could hit 4% in 2010, up from a contraction of close to 2% last year.
5. Growth, however, will be uneven with the strongest performance coming from the emerging market economies, especially Asia. Asia has benefited from the pick-up in global trade and manufacturing; additionally, strong balance sheet fundamentals remain supportive of domestic demand. Growth in Asia ex-Japan could reach 8% this year, with China and India among the larger countries leading at 8-10%.
6. The US and Europe should continue to grow over this year notwithstanding higher downside risks. In the US, growth is likely to moderate in the second half of 2010 to a 2-3% pace. Although prospects for the US economy have improved, it does not look like the US will enjoy the growth spurt that typically follows a deep contraction. Growth in Europe should be weaker at around 1%, reflecting turmoil in the periphery states and more rapid fiscal consolidation.
7. The current global recovery is likely to continue into 2011, albeit at a more moderate pace. The strong rebound in global industrial production is peaking while monetary and fiscal policies, particularly in the larger emerging economies, are being normalised.

8. However, downside risks to the global economy have increased.

I highlight three risks:

- i) the turmoil in Europe;
- ii) continued deleveraging in the US; and
- iii) protectionist pressures in many countries.

The economic recovery, while real, is fragile and there is a risk that negative shocks could push the global economy towards a recession sooner than expected.

A Riskier Post-Crisis Environment

9. The post-crisis global economic and financial environment will be affected by three major trends.

10. First, it will take a long time for the developed world to fully heal from this crisis. The current recovery in the developed economies could continue, at least in the very short-term, but even the most optimistic economist expects the bounce to be much weaker than what has occurred in the past.

11. The second major trend in the post-crisis environment is the increasing importance of the emerging economies, anchored by Brazil, Russia, India, and China or the BRICs. For the first time in economic history, the long term fiscal debt trends in much of the emerging world are better than those in much of the developed world.

12. The shift in economic power to the emerging world will likely increase geopolitical risks. For one, the emerging economies, especially the BRICs will become key global powers and increasingly demand more say on world affairs. Conflicts could also arise over access to natural resources.

13. For investors, the rise of emerging markets will mean that a larger proportion of their investments will be in these markets. Far from being a risky and perhaps optional part of their portfolios, emerging markets will become a core and unavoidable asset class in global portfolios.

14. The third major trend in the post-crisis environment will be increased vulnerability to negative events and extreme reliance on government policies both for support and far reaching reforms over the next few years.

15. The current recovery is being sustained by unprecedented policy support. Changes in policies or mistakes will thus have a significant impact on the global economic and financial environment.

16. A key challenge for policymakers is to properly time the withdrawal of unprecedented monetary and fiscal policies. Policymakers risk derailing the recovery if withdrawal is too early or too sharp. However, policymakers run the risk of creating excessive inflation over the medium-term, if emergency-levels of policy stimulus are left unchanged for too long.

17. In some countries, policymakers have come under pressure to repair public finances which have deteriorated markedly because of the financial crisis. Over the past couple of months, we have seen the turmoil in European debt markets spread as markets question the fiscal sustainability of an increasing number of states within the European Monetary Union. The challenge for policymakers in many developed economies will be to convince markets that they have credible plans to ensure sustainable public finances over the medium to long-term, while minimizing

the negative short-term impact on growth. This is particularly true for countries that already faced difficult medium to longer-term fiscal challenges before the crisis. While markets have focused on Greece, Portugal, Spain, Ireland and Italy, this risk remains high for the UK, US, and Japan.

18. In the emerging economies, policymakers will have to deal with rising inflation and possible asset price bubbles. In contrast to the developed countries, the strong recovery in emerging markets means that CPI inflation will be driven by narrowing then positive output gaps and rising commodity prices. Asset prices, particularly in Asian real estate, have been supported by extremely accommodative global financial conditions, credit policies, a positive structural story, and in some countries, strong capital inflows.

19. Finally, high unemployment and unhappiness over “bail-outs” could lead to populist policies, including excessive regulation and protectionism. There is, especially in the developed world, a feeling that the financial sector has “rigged” the system so that it cannot lose—it is simply too big to fail. While there is little doubt that some rebalancing towards better regulation, restructuring and supervision is needed, there is a risk in this environment that such reforms are excessive and ends up stifling innovation and growth. Protectionism also remains a risk despite the recovery, given high unemployment and what seems to be, for the first time in many years, increasing tensions between American and European businesses and the Chinese policy environment.

Implications for Asia: Post-Crisis Opportunities

20. Asia has benefited tremendously from post-WWII globalisation and liberalisation trends. Strong growth in the developed world, trade liberalisation, and a broadly stable geopolitical environment has enabled Asia’s export-oriented development strategy to work. This has underpinned Asia’s rapid economic growth and convergence to the developed world.

21. The post-crisis environment I have just described challenges these basic trends which, till now, have been taken almost for granted. Going forward, growth in the developed world will be modest at best. High unemployment increases the risk of protectionism and a reversal of globalisation. Shifting economic power could lead to conflicts among nations. Asia will increasingly face labour, natural resource, and commodity constraints to its high growth strategy.

22. Can Asia and the West adapt to these challenges? While we should not underestimate the difficulty of the challenges and there will certainly be setbacks from time to time, I believe that the answer broadly is yes as it is in the interest of Asia and the West to work together for mutual benefit.

Opportunities in economic rebalancing

23. In the next stage of Asia’s economic development, Asia’s economic growth model is likely to change from depending largely on exports to a more balanced model in which private domestic demand is also a key source of growth. In some countries, especially the larger economies of the BRICS, an expanded middle class will consume more goods and services, such as TVs, computers, and tourism. In many countries, extensive infrastructure investment will help meet the demands of massive urbanisation.

24. Asian countries and sub-regions like ASEAN are continuing to build strong WTO consistent and inclusive regional trading and financial relationships and free trade areas. This will insulate them from economic shocks, further raise domestic living standards and contribute to balanced global growth.

25. Asia's economic rebalancing will, over time, result in significantly stronger currencies. As productivity in Asia rises relative to that in the developed countries, real wages will also rise. Asia's better growth prospects will also attract capital inflows. Both factors should, over time, lead to an appreciation of Asian countries' exchange rates. This reflects the region's strength and will be a spur to further productivity improvements as well as provide a boost to Asian consumers.

Increasingly sophisticated financial systems

26. In the area of finance, Asia's increasing economic wealth and consumer sophistication will demand a wider variety of more sophisticated financial markets, products, and institutions. Financial systems in a number of Asian countries are still dominated by banks, with relatively undeveloped foreign exchange, bond, and equity markets. Retirement savings and fund management are nascent. Banks are likely to continue to be the core of many systems, but other markets and institutions will develop.

27. This crisis gives financial institutions and markets in Asia tremendous opportunities to grow and develop. The globalised Western banking system, hampered by capital constraints and re-regulation, will likely not be able to intermediate the massive capital demand needed to finance Asian growth. This leaves the playing field unusually open for Asian financial institutions and markets, particularly for several years.

28. Fortunately, given the experience of the 1997 Asian Crisis, Asian financial institutions generally came into this crisis much healthier than their global counterparts. Capital, liquidity, and nonperforming assets were at healthy levels while exposures to toxic assets were limited. Asian household, business and government sectors are also relatively un-leveraged. In order to take advantage of this opportunity, however, Asian banks and capital markets will need to quickly step into the breach.

Sharing Global Responsibilities

29. The shift in economic power from the developed world to the emerging world could, however, raise geopolitical risks. However, I do not see Asia aggressively challenging the global order, which has benefitted Asian countries for decades. Asian countries, including China, generally share the view that a multilateral, rules-based international order is critical to their long-term growth and development. Asia's rise therefore is not inevitably a zero-sum geopolitical game where the US and Europe must decline as Asian countries grow.

30. Asia will of course assert its views on global political and economic governance but will do so as a stakeholder wanting to strengthen international institutions and cooperation. For instance, Asia's voice in global affairs will rise in tandem with its economic power. The governance and functioning of the international order – the G20, World Bank, IMF, WTO, and the UN – will also be reformed to take into account Asia's rise. But this is a rebalancing to take into account the growing importance of the emerging world and not a supplanting of the older order.

31. Asia continues to believe in the benefits of open economies and globalisation. The region also benefits from regional integration, whether through ASEAN, ASEAN+3, or Asia-Pacific Economic Cooperation (APEC). For many in Asia, the Great Crisis of 2008/9 has reinforced the benefits of regional cooperation to promote trade, investment, markets, and provide avenues for conflict resolution.

32. Given the shift in economic power, Asia and the developed world will need strong and wise political leadership to preserve the global trading and financial system. This global order has, by and large, brought significant benefits to citizens of both the developed and emerging economies. I am confident that Asian countries will do their part to maintain an international order conducive to expanding world trade and enhancing global prosperity.

Environmental Challenges

33. Finally, as Asia develops, Asia will learn to better manage its environmental footprint, more so given its rapid development and high population density.

34. Challenges include land contamination, water scarcity, water and air pollution, destruction of bio-diversity, and climate change. This situation is not sustainable. A richer and more sophisticated citizenry will also demand policies which are environmentally friendlier.

35. I believe Asia will innovate to deal with these constraints. Government policies will seek to address these challenges, while increased R&D will drive technological advances. China, for instance, is becoming a major force in research and development of technologies that address environmental constraints such as renewable energy. One reason why I am optimistic is Singapore's own experience in water scarcity. As an island nation, we have limited water catchment areas and rivers. But intelligent planning and taking advantage of technological improvements have enabled Singapore to move to self-sufficiency in water.

Conclusion

36. To sum up, Asia is recovering well from the Great Financial Crisis of 2008/9. The crisis seems likely to accelerate the shift in economic power from the developed to the emerging world.

37. Asia is at the cusp of the next stage in its development. There will likely be bumps along the way, perhaps a few crises, but if we learn the right lessons from history, especially those of the recent Great Crisis, Asia will innovate and adapt. There are difficult challenges but I am optimistic that we can overcome them.

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