Brexit: Impact of the Referendum on the Singapore Business

Talk cum Panel Discussion Report by Jason Ji Xianbai
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Introduction

To help the business community understand some of the complexities involving Brexit, the Singapore Business Federation (SBF), together with the EU Centre in Singapore, organised a talk-cum-panel-discussion on 19 July to discuss the future of UK-EU relations, how these would in turn affect Singapore's trade and investments in the UK and EU, and other more immediate impact on the currencies and stock markets.

The event got under way after short welcome remarks by Mr **Shabbir Hassanbhai** (Vice President, SBF) and Dr **Yeo Lay Hwee** (Director, EU Centre). Mr Hassanbhai stressed that the United Kingdom (UK), despite its 3 per cent share of global gross domestic product (GDP), sits at the very heart of global market; and its business, financial and legal models prove hugely attractive to business communities across the globe. Dr Yeo thanked the SBF for co-organising and hosting the event, and introduced the speakers that will be sharing their different perspectives and outlook on Brexit, starting with the Keynote speaker, Dr **Michael Pulch**, Ambassador and Head of Delegation of the EU Delegation in Singapore.

Keynote speech

Dr **Michael Pulch** in his keynote speech touched on three key dimensions: (i) the context of the referendum, (ii) the evolving EU-UK relationship and (iii) the way forward for EU-Singapore economic relations.

On the context, Dr Pulch noted that the referendum, however UK-specific it appeared to be, reflects the wider concern that globalisation in its current form is not inclusive. The strong anti-globalisation sentiments led many Britons to vote against their own economic interest.

With regards to what we can expect on the future EU-UK relationship, Dr Pulch quoted the speech made by European Commission President Jean-Claude Juncker, who said: "[…] we will build a strong new partnership with the United Kingdom. The British remain our friends, and we will not turn our back on each other. We will continue to share common interests both at home and abroad." Dr Pulch also made it clear that for the time being, the UK remains a full member of the EU and will remain so until the British government formally invokes Article 50 to start the exit negotiations.

On Brexit's impact on EU-Singapore economic relationship, Dr Pulch expressed confidence that the bilateral economic ties are fundamentally strong and will continue to grow. The EU-27, with a collective GDP of €12.4 trillion, is the second largest economic area in the world. The EU-27 will still be Singapore's third largest trading partner and largest foreign investor in terms of investment stock. In addition, the EU has stepped up its efforts in boosting trade relations with Singapore and Southeast Asia. For example, the EU has just launched the European Business Avenues in Southeast Asia Programme and Enterprise Europe Network Singapore Centre. It has also started its negotiation with Indonesia and has received mandate to start region-to-region negotiations with the Association of Southeast Asian Nations (ASEAN) on an aviation agreement worth €8 billion.

Presentations

Dr **Yeo Lay Hwee** in her presentation mainly discussed the political repercussions of the Brexit vote, because, as Singapore's Deputy Prime Minister Tharman Shanmugaratnam said, the more profound questions about Brexit revolve around politics.

Dr Yeo remarked that an erosion of trust and consensus in society has led to fragmentation and polarisation in politics which cannot mean anything good. Whether we will see a growing appeal of regressive nationalism, and in some cases, outright xenophobia and racism will depend on what happens to the UK after Brexit. If the UK shows that it can cut off its links to a multilateral political system like the EU and emerged unscathed or even stronger, then disintegration of the EU is possible. However, if the experiment of "taking back control" ends as a disaster for the UK, demonstrating that globalisation has made the pooling of sovereignty indispensable, then the EU may turn out stronger in the global arena. In any case, Dr Yeo judged that the immediate impact of Brexit is to weaken the international standing of both the UK and the EU. UK will face a rude awakening with Scotland raising the flag for another independent referendum, rumblings from Northern Ireland that they will seek "reunification" with the Irish republic, and Spain raising the issue of Gibraltar. The soft power of an integrated Europe that has inspired reforms and emulation in other regions is being undermined.

Dr Yeo then elaborated on some of the political consequences of Brexit and lessons that can be drawn from them. First, the Brexit vote is a lesson about economic dislocation and political disconnect. The people who perceive themselves to be "worse off" are lashing out against globalisation, free trade, labour migration and even against the political establishment. Second, Brexit points to the problems of referendum itself. As Chris Patten, the former EU Commissioner for External Relations, said, a referendum reduces complexity to absurd simplicity. Questions have also been raised if this referendum actually represents a failure or abuse of democracy. When such a low bar (a simple majority) was set for Brexit, the referendum may not be democracy but Russian roulette. Third, at a time when close transatlantic cooperation is crucial to maintain the post-war global order, Brexit would deliver a "body blow" to this western-centric global order. How serious the implications of Brexit will have on geopolitics would in turn depend on Britain's unity, the EU's unity and the status of EU-NATO and EU-US relations after British withdrawal. Much more consequential is the blow on the international liberal economic order fashioned by the Americans with enthusiastic support by the British. For example, the Transatlantic Trade and Investment Partnership (TTIP) has garnered controversy across Europe but was enthusiastically promoted by the British government under David Cameron. Since the referendum, several European politicians have come forward to express doubts over the direction of the deal.

At the end of her presentation, Dr Yeo reminded the audience it is still too early to say what the longer term impact of Brexit will be but we need to stay vigilant and watch the developments in Europe carefully and be prepared to make adjustments.

The second speaker, Mr **Shivaji Das** (Partner and Global Head, Public Sector Consulting Practice at Frost & Sullivan Careers), analysed the impact of Brexit through the lens of trade. Mr Das set the tone by asserting that the UK is indeed a "small dot" – in terms of share in global GDP, international trade and relevance to Singapore – as compared to the US or China.

According to Mr Das, a host of inter-related factors may affect the impact of Brexit, including for instance the speed of exit, whether the pound sterling will continue to fall, the changing investment climate, the impact of free trade agreements (FTAs) worldwide, the political stability in the UK and the EU, what will the Brexit model be in the future, and the wider global economic outlook. The immense amount of uncertainties associated with those factors mean that Brexit could either be "a death by 1000 cuts" for the UK or "lift the UK to new heights to the good".

Before sketching out his opinion on the future of the UK, Mr Das took a detour to give the audience an overview of the landscape of international trade and trade deals. In the past decades, global trade has grown tremendously. At the same time, we see a surge in the number of FTAs, giving rise to the "noodle bowl" effects. In addition, according to APEC Policy Unit research, the positive impact of North American Free Trade Agreement (NAFTA) for the US has been much less than that for Mexico.

Going forward, Mr Das argued that the outlook for global trade is uncertain. Adverse trends include the sluggish European and Japanese economies, the slowdown and restructuring of Chinese economy, terrorism and rising geopolitical tensions, climate change concerns, and the decline of the manufacturing sector. As a result, in the past five years, growth in global trade has been less impressive in relation to GDP increase.

Mr Das then highlighted four factors that could affect the future trajectory of international trade: technology, economic structure, politics and regulations. First, new technologies, such as 3D Printing and Blockchains, will transform the trade structure from a Hub-and-Spoke model to a Node-to-Node model. Second, unbundling of economic structure from reliance on central bodies to a P2P structure will reduce the barriers further. Third, global conflicts and new political friendships will change the face of future trade. Last but not least, homogenisation of regulatory structures is pursued globally in the fight for competitiveness.

According to experts' estimates, the economic impact of Brexit could be anywhere from -3.55 per cent to +1.55 per cent by 2030 for the UK. The most likely scenario suggests that Brexit's impact on Britain's GDP is between -0.8 per cent and 0.6 per cent. The largest victim of Brexit outside the UK is likely to be the EU, which may see its GDP shrinks by more than 1 per cent. Emerging economies, notably the BRICS countries were also singled out by Mr Das to be vulnerable to Brexit.

Therefore, Mr Das concluded that Brexit, given its moderate economic impact and limited trade implications, is a political event, rather than an economic event. It could lead to the disintegration of the UK and the independence of London ("Lexit"). In addition, the episode of the British voting to leave the UK implies that, for any trade deals to be concluded and implemented in the future there should be sufficient education and explanation to prevent the populist backlash from derailing an otherwise economically beneficial FTA.

The last speaker, Mr **Philip Wee** (Senior Currency Economist, DBS Bank), examined the impact of Brexit from the perspective of a currency trader. To Mr Wee, the referendum results are decisive, and Theresa May, the new British prime minister, has already made it clear, "Brexit means Brexit". He then gave a timeline of events that would likely impact the currency markets.

On 5 September, the UK Parliament will debate the petition for a second referendum. On 27 September, the EU-27 will meet to discuss the EU's future. The UK will then meet other EU member states on 20 October. Given that France and Germany will enter election mode soon, the UK may wait until late 2017 to invoke Article 50.

Due to the UK's wide twin deficits in current account and primary budget, credit rating agencies have lowered the UK's sovereign debt rating following the vote. Standard & Poor's said the UK's triple-A credit rating is no longer tenable after Brexit vote. Moody's also placed the UK's sovereign debt rating outlook on negative watch. Moody's explained that the Brexit outcome would herald a prolonged period of uncertainty that would dampen the UK's economic and financial performance.

In addition, Mr Wee pointed out that the weakening of pound sterling is not yet over. Technically speaking, the UK's financial centre status could be threatened once GBP/USD rate fell from 2.00 to 1.40. Notwithstanding, Mr Wee felt that a good sign following Brexit vote was that the strength of the euro which did not correlate much with that of the pound sterling, unlike in the aftermath of previous episodes of economic hardships like the European Exchange Rate Mechanism crisis and the sub-prime mortgage crisis. The unbundling of euro and pound sterling in terms of foreign exchange rate suggests that a speedy recovery for the EU is on the horizon.

Which countries are likely to follow in the UK's footstep to hold their own EU referendums? A poll conducted by IPSOS pointed at Italy and France, the two founding members of the EU back in the 1950s. Rome Mayor Virginia Raggi called for an Italian referendum on EU membership. French National Front Party Leader Marine Le Pen has similarly vowed to call for a referendum within 6 months, if elected as French President in April-May 2017. Nevertheless, Mr Wee reminded the audience that the poll was conducted before the Brexit vote, and public opinion may well be different now.

In terms of the impact on euro, Mr Wee noted that the correlation between ADXY Index and EUR/USD has tightened recently and that if oil prices fall again, so could the euro. That said, EUR/USD may not drop too much in the future, according to a euro value chart with data starting from 1984. The long-term trend shows that EUR/USD is unlikely to touch the parity line; therefore, further scope for EUR/USD to decline is rather limited.

Mr Wee proceeded to speculate on whether Brexit will stop US interest rate hikes. With Brexit, investors expected more quantitative easing from the US Federal Reserve. After all, the US is most exposed to Brexit via the financial channel. But DBS' in-house assessment is still that the US Fed may raise interest rates twice this year (in September and December). Mr Wee explained that this is largely because stock market reacted to Brexit shock orderly, Brexit impact will take time to play out and the US economy is in good shape.

Panel discussion

Mr **Christopher Pook** (Regional Director for UK Trade and Investment at the British High Commission, Singapore) and Mr **Christopher Humphrey** (Executive Director, EU-ASEAN Business Council) joined the three speakers and kicked off the panel discussion.

Mr Pook firstly said he was impressed by how efficient British politics is at a time of economic volatility and political turmoil – a new government was put in place within a short period of time following the Brexit vote, for example. In his opinion, Ms May is a thoughtful and able person that is capable of leading Britain out of the EU; and she will have strong support from three leading Brexiteers – Boris Johnson, Liam Fox and David Davis. Mr Pook added that, despite Brexit, the UK and the EU-27 will maintain a good and friendly relationship.

Mr Humphrey shared with the audience his belief that Article 50 could be triggered around Christmas time this year. Although business hates uncertainty, the reluctance to trigger the Brexit process on the part of the UK government is justified because the country has no pre-conceived exit plan. When it comes to the prospect of trade between the UK/EU-27 and Singapore/Southeast Asia, Mr Humphrey said the economic ties between them are fundamentally strong and Brexit will not change that fact. Even so, there is danger that investment to the UK from Southeast Asia may be affected as investors hold on their capital commitment until the new relationship between the UK and the EU-27 are sorted out. In addition, negotiating bilateral trade deals should not be the priorities of the UK as currently it does not have the legal autonomy in trade policies. Reinvigorating the WTO and re-establishing trade relations with the EU-27 should top the new government's to-do list.

Several questions and comments were raised by the audience:

1. Legally, the UK has to be out of the EU in order to pursue its own trade accords. How is the UK going to address this issue?

Mr Pook agreed that from the legal perspective, the UK in the EU does not yet have the competence to negotiate and sign its own trade arrangements until it has exited the EU. But from a pragmatic point of view, it could be in the interest of the UK as well as that of the EU-27 to hold free trade talks in parallel to Brexit negotiations with the aim to save time and reduce uncertainty.

2. Would London's status as the world's financial centre be affected by Brexit?

To this question, Mr Das replied that the future of London depends on whether the UK will be granted full access to the EU financial market. Mr Wee added that at the end of the day, it is the access to European financial market that matters. Just like Singapore is the gateway to ASEAN, London is valued by investors as the gateway to the EU. It will be good if London can retain its financial centre status in light of "Moore's Law" – the more participants, the more vibrant the market is. Another pressing concern is that negative interest rates have become commonplace in the financial world and in the practice of central banking. G20's announced intention to stimulate economy through non-monetary policies ought to be welcomed in this regard.

3. What will be the main forces that can help the UK back on feet?

Mr Pook remarked that paradoxically, the greatest challenges facing the UK government right now are also the unique window of opportunity to bring about economic prosperity. The people who voted to leave were also demanding changes to government policies, and the rethinking over what new economic policies to pursue could be helpful.

Mr Humphrey added that in addition to getting the UK out of the EU, the new government also has to deal with a huge social divide within the country. Brexit is not a crisis, but a problem, which warrants rational solutions. There should be parallel discussions on the future UK-EU27 economic relations while the exit negotiations are going on so as to put an end to economic uncertainty as soon as possible. Approaching the issue in a sequential way serves no one's interests.

Mr Das sounded a note of caution with regards to the idea that the UK will sign many FTAs with countries from across the globe. What is important is the nature of those FTAs. If the UK pursues shallow FTAs, the economic benefits is likely to be modest. The UK's export-oriented economic structure and high domestic consumption could help the UK to recover from Brexit. More importantly, the British economy will be boosted once European and Chinese economies see upticks in their growth.

At this juncture, Dr Yeo cited an online survey by SBF amongst its members to find out their responses to Brexit. Interestingly, 57% of the respondents said they will not hold back from investing in the UK. Additionally, half of the respondents said that Brexit will not have a negative impact on the Singapore economy. Perhaps these are signs of optimism with regards to the UK (and the EU) economic prospects despite Brexit. (Survey results can be downloaded on EU Centre's website.)

On whether FTAs would indeed help with the recovery of British economy, Mr Humphrey added that most FTAs are about politics rather than economics. Second, in Southeast Asia, the utilisation rate of ASEAN Trade in Goods Agreement (ATIGA) is particularly low because many small-and medium-sized enterprises either are not aware of the agreement or do not know how to use it. Third, it is in the UK's best interest to pursue ambitious and comprehensive FTAs. The UK can model its future FTAs with Southeast Asian economies on, for example, the EU-Singapore and EU-Vietnam FTAs. Likewise, it is preferable to have a deep trade deal between the EU and ASEAN.

4. Does the referendum suggest that there is a fundamental lack of democracy in the EU to accommodate British citizen's concerns?

On this, Dr Yeo noted that to some extent, the EU has a representative democracy – democratically elected governments go to the EU to represent their people. If more democracy at the EU means more direct democracy this is a different subject matter altogether. That said, there is a lack of accountability for decisions made by national governments at the EU – if things go well, they take the credit; if not, they blame the EU.

5. The EU does not separate free trade from the free movement of people, but countries should be able to manage the migration influx. The EU has to tackle this issue; otherwise more hostile national governments may be elected.

Mr Humphrey agreed that the Remain campaigners failed to comprehend the deep-seated frustrations with regard to migration, and the vote result is a wake-up call for the rest of the EU. But, practically, it is impossible have a single market – that guarantees free movement of goods, services and capital – without free movement of people.

Dr Yeo, however, had a slightly different take on this. She added that there could be some rules governing the movement of people. This concept was originally conceived as "free movement of labour", but with the introduction of European citizenship in the Maastricht Treaty, it gradually changes to "free movement of people" partly in an attempt to create a European identity. Perhaps the EU could learn from ASEAN, which envisions "freer movement of skilled labour" under its ASEAN Economic Community.

Mr Das cautioned that the free movement of people is important as long as service is concerned. In light of the growing importance of service sectors in the global economy, FTAs should aim to liberalise cross-border flows of services and people.

6. Can the UK anchor its future relations with the EU under the framework of TTIP? Is it possible for the US-EU TTIP to become a trilateral US-EU-UK FTA?

Mr Pook replied that the UK government is looking at a wide range of Brexit models including the existing trade agreements such as TTIP, EU-Canada Comprehensive Economic and Trade Agreement (CETA). The UK wants to study the history of those agreements and see if it can replicate some of them. It is also possible that the UK can join other mega-FTAs such Trans-Pacific Partnership (TPP).

7. How will Brexit affect the creative industries and can trade agreements help to mitigate the impact?

Mr Das replied that the creative industries will be most affected by FTA's intellectual property rights provisions, and rules concerning storage of information and cross-border flow of data.