Scenarios of fragmentation

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What fragmentation would cost

Economists have tried to measure the cost of a divided world economy. Staff analysis of the International Monetary Fund published in January 2023 estimated that the long-term cost of severe trade fragmentation could reach almost 7 per cent of global output. If technology also decoupled, some countries could lose up to 12 per cent of their output.[1] Small open economies with high ratios of trade to output would be among the most affected. Singapore, whose trade is a multiple of its gross domestic product, stands near the top of any list of exposed economies.

The financial effects would be no less serious. The *Global Financial Stability Report* of April 2023 warned of "more limited opportunities for international risk diversification" and of volatile capital flows. It recommended that "Financial institutions may need to hold adequate capital and liquidity buffers against rising geopolitical risks".[2] For a centre that earns its living from diversification across borders, the warning describes a direct threat to its business model.

The following scenarios describe three paths for the rivalry over the next decade. Chapter K.VI combines them with other variables into four overall scenarios for the financial centre in 2035.

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First scenario: managed rivalry

In the first scenario the rivalry continues without open conflict. Tariffs rise and fall with negotiations, export controls tighten in a narrow band of advanced technologies, and investment screening becomes routine on both sides. Trade in most goods continues while capital still moves between the camps through intermediaries.

This scenario is favourable to Singapore, since multinational companies would continue to diversify their supply chains, which benefits Southeast Asia. Investors would value a jurisdiction trusted by both sides, which benefits Singapore's wealth management, fund management and family office sectors. As compliance work grew, the city's lawyers, auditors and consultants would find steady demand. The main risk would lie in individual cases of diversion or evasion that damage Singapore's standing in Washington or Beijing.

Second scenario: bloc formation

In the second scenario the world divides into blocs with separate standards for technology, data and payments. The United States extends its controls to wider categories of goods and services and presses its partners to adopt them. China responds by expanding its own payment systems and controls and by requiring its companies to choose sides. Third countries face growing pressure to align.

Singapore would find this scenario difficult, because its strategy of openness to both camps would become harder to sustain when each camp demanded exclusivity. Its banks would have to decide which payment systems to join, and its technology sector which standards to follow. Some business would remain, because both blocs would still need a place to trade with each other. The volume and profitability of that business would be smaller than in the first scenario, and its compliance risks greater.

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Third scenario: regional conflict

In the third scenario the rivalry turns into military conflict in the region, for example over Taiwan or in the South China Sea. Sanctions and counter-sanctions would then be imposed on a scale far greater than those against Russia in 2022. Shipping through the Strait of Malacca and the South China Sea could be disrupted, insurance costs would rise sharply and capital would flee the region.

The events of 2026 have shown that maritime chokepoints are vulnerable. In April 2026 Prime Minister Wong warned that an illegal weaponisation of the Strait of Hormuz would set a dangerous precedent. Singapore and Indonesia later affirmed their common interest in keeping the Strait of Malacca open to all.[3] A conflict in Singapore's own waters would test the city's institutions as they have not been tested since 1942, when the occupation described in Chapter C.I destroyed the trust on which the colonial port had relied. Singapore's preparation for this scenario lies in national defence, reserves and the resilience of its financial infrastructure. Its strategic aim is to prevent it, which explains the energy it devotes to regional diplomacy.

Signals to watch

Institutions that plan for the future of the financial centre can follow a small number of indicators. The first is the scope of American export controls and whether they extend from advanced chips to broader categories of technology and services. The second is the state of the legal basis for American tariffs after the litigation of 2026. The third is the share of trade settled in currencies other than the dollar, and the development of alternative payment systems. The fourth is the tone of American and Chinese official statements about Singapore itself, especially in cases of diversion or sanctions evasion. A fifth is the military situation in the Taiwan Strait and the South China Sea.

Although none of these indicators predicts the future, taken together they show in which direction the world is moving and how much time Singapore's institutions have to adapt. Chapter K.VI uses them to weigh its scenarios.

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Notes

1. Kristalina Georgieva, "Confronting Fragmentation Where It Matters Most: Trade, Debt, and Climate Action", IMF Blog, 16 January 2023 (imf.org, accessed November 2026): longer-term cost of trade fragmentation from "0.2 percent of global output in a limited fragmentation scenario" to "almost 7 percent in a severe scenario"; with technological decoupling "some countries could see losses of up to 12 percent of GDP"; the blog draws on Shekhar Aiyar et al., "Geoeconomic Fragmentation and the Future of Multilateralism", IMF Staff Discussion Note SDN/2023/001, January 2023 (the note itself was not retrieved). ↩
2. International Monetary Fund, *Global Financial Stability Report*, April 2023, chapter 3 (imf.org, summary page, accessed November 2026): "more limited opportunities for international risk diversification"; "exacerbated capital flow and macro-financial volatility"; "Financial institutions may need to hold adequate capital and liquidity buffers against rising geopolitical risks." ↩
3. Ng Wei Kai, "Illegal weaponisation of Strait of Hormuz would set dangerous precedent: PM Wong", *The Straits Times*, 17 April 2026; "'Strategically aligned': Singapore, Indonesia want Strait of Malacca open and free for all, say leaders", 7 July 2026; headlines seen in the reference list of Wikipedia, "Lawrence Wong" (accessed November 2026), articles not retrieved. ↩

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