Ravi Menon: Monetary Authority of Singapore's Annual Report 2012/13

Opening remarks by Mr Ravi Menon, Managing Director of the Monetary Authority of Singapore, at the Monetary Authority of Singapore's Annual Report 2012/13 Press Conference, Singapore, 23 July 2013.

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Good morning. Welcome to MAS' annual report press conference.

I would like to highlight five key messages today.

- first, macroeconomic outlook better this year than last;
- second, strong S$ more than offset good returns on MAS' investments;
- third, banking system sound but build-up in household debt worrying;
- fourth, stepped up efforts to ensure we remain clean and trusted financial centre;
- fifth, good progress in key drivers of financial centre growth.

GDP growth stronger and CPI inflation lower this year compared to last

Let me start with the economy. The overall macroeconomic outlook this year is better than last year.

Barring shocks, Singapore's GDP growth will be stronger and CPI inflation lower in 2013, compared to 2012.

Economy comfortably on track to meet 1–3% growth forecast

The Singapore economy will comfortably meet the growth forecast of 1–3% for 2013. Growth was estimated at 2% in H1 and should pick up further in H2

First, the advanced economies are in better shape this year.

- Tail risks have receded. There is less likelihood of a Eurozone break-up or a fiscal cliff in the US.
- Growth in the US is gaining momentum, supported by consumer spending and the strengthening of the housing market. Corporate profitability is also rising.
- In Japan, expansionary macroeconomic policies will lift private consumption and net exports.
- In the Eurozone, the pace of contraction has moderated; and exit from the recession may be in sight for several economies towards end of year.

Second, there has been some consolidation in Asian domestic demand but the export sector will gradually improve.

- The slowdown in China has so far been measured. Consumption and investment growth is moderating amidst tighter financial conditions. Job creation is strong and the labour market tight. China's GDP growth for 2013 is unlikely to fall below 7%.
- In some of the ASEAN countries, public spending has eased. China's slowdown has softened demand for commodities and this could dampen broader intra-regional trade flows.
- But anticipated pick-up in exports to advanced economies will partially offset some of these headwinds in Asia.

Third, there are several signs that global IT industry, which Singapore is plugged into, will do better this year.

- Global chip sales have improved.
- Previously high inventory levels are reverting to historical trends.
- Final IT demand, particularly from US corporate sector, is on a general uptrend.

Fourth, financial services in Singapore is expected to grow faster compared to last year.

- There is broad based strength in both financial intermediation and asset management activities.

Inflation forecast revised down to 2–3% but core inflation pressures will persist

For the first time in three years, CPI inflation has come down closer to historical trends and within MAS' comfort range.

- CPI-All Items inflation averaged 4.2% over 2010–12. Car prices and imputed accommodation costs contributed around 60% to overall inflation during this period.
- But this year, there has been a clear and significant step-down in inflation. CPI-All Items inflation in H1 is estimated to have dipped below 3%.

CPI-All Items inflation forecast for 2013 is therefore revised down to 2–3%, from 3–4% previously.

- The sharp fall in car prices following the tightening of financing restrictions on motor vehicle loans is a major factor. COE prices have risen recently and could be volatile for the rest of year, but this should be accommodated within the 2–3% inflation forecast range.
- Accommodation costs are also increasing at a slower pace. More completed housing units are coming on stream, easing the pressure on market rentals.

But MAS' Core Inflation, which excludes car prices and imputed accommodation costs, will show moderate increase to around 2% or slightly above by end-2013, due to continuing tightness in labour market.

- This is a percentage point lower than recent peak in Q1 2012, and in line with the historical average.
- The Core Inflation forecast for 2013, therefore, remains at 1.5 to 2.5%.

MAS' monetary policy stance since 2010 has underpinned the gradual improvement that we are seeing in Singapore's inflation-growth trade-off.

- MAS is committed to ensuring that recent improvements in inflation are sustained.
- The current policy stance of modest appreciation of the Singapore dollar is appropriate in containing the re-emergence of strong cost and price pressures in a restructuring economy.

Strong Singapore Dollar impacts MAS profits despite good investment returns

Let me now move on to MAS' financial results.

MAS made investment gains of S$8.9 billion for the FY ended March 2013.

- This is lower than the S$12.0 billion earned in the previous FY, due primarily to lower interest income as interest rates continued to decline in FY 2012/13.

But MAS recorded an overall loss of S$10.6 billion after taking into account translation effects from an appreciating Singapore dollar.

- In FY 2012/13, the Singapore dollar appreciated against all major currencies
- In particular, the Singapore dollar strengthened 5% against the Euro, 6% against the Sterling, and 14% against the Yen during FY.
- It also appreciated against traditionally strong currencies like the Aussie Dollar and the Canadian Dollar.

In short, we made good investment returns, but when measured in Singapore dollars, these gains more than offset by strength of the currency.

- This is an issue of reporting currency. If we had reported our profit and loss in international currency, it would show healthy profit.

It is important to note that the international purchasing power of our reserves is unaffected by the strength of the Singapore dollar.

- Our foreign reserves serve two key purposes during a crisis: they finance our imports from rest of world, and they help to safeguard the value of our currency.
- On both fronts, it is the foreign currency value of reserves that matters.
- We report our profit and loss in Singapore dollar only because it is international convention for central banks to report in national currencies.

Banking system remains sound, but concerns over rising household debt

Now I will touch on financial stability, asset prices, and leverage.

A key focus of MAS in the last two years is managing risks posed by extremely loose global monetary conditions.

- Short-term interest rates at or close to zero bound globally.
- This has in turn spurred strong demand for credit in Asia and banks flushed with liquidity are more than willing to lend.
- There is a substantial flow of credit to asset markets, especially in real estate.
- Accelerations in property prices and build-up in household leverage are seen throughout Asia.

The combination of low interest rates, growing leverage, and surging property prices poses significant risks to financial stability – hence MAS' concern.

Singapore's credit-to-GDP ratio has risen from 200% to 270% over last three years. MAS has been monitoring this very closely but credit growth, in and of itself, is not a cause for major concern.

- Growth in total credit reflects Singapore's growing role as regional financial centre.
- Banks in Singapore are intermediating surplus funds to meet credit demand throughout Asia, particularly for productive economic activities like trade financing.
- The increase in resident credit-to-GDP ratio is less sharp, from 125% to 155% over last three years.
- Domestic credit growth is broad based across both households and corporates, including financing capacity expansions by the petrochemical industry.

Nonetheless, the strong flow of domestic credit to real estate is a concern:

- Housing loans by banks grew 18% each year over last three years.

- Housing loans as a percentage of GDP now stands at 46%, up from 35% three years ago.

When interest rates rise and if property prices fall, any risks built up will materialise.

- A return to normal monetary conditions is not far off.
- Financial markets are already reacting to anticipated tapering and unwinding of quantitative easing (QE) in the US.
- Long-end bond yields are already rising as markets price in higher interest rates.

So how do we stack up against this global backdrop? Our banking system remains sound.

- Our local banks have strong financial positions. They are well-capitalised with prudent provisions against loss.
- There is a healthy buffer against property price reductions. In fact, the average outstanding housing loan-to-value ratio in the banking system is just under 50%.
- Our banks also undertake regular stress tests on their own and those coordinated by MAS.
- We have subjected the banks' balance sheets to a combination of stresses – including a sharp rise in interest rates, a decline in property prices, and a rise in unemployment rate. They have enough capital to see them through.

It is the household sector that we are concerned about.

- At the aggregate level, household balance sheets are resilient. Cash and deposits exceed household debt.
- But the health of the balance sheet is not uniform across all households.

Many households could have over-extended themselves, fuelled by low interest rates and stretched loan tenures.

- The vast majority of mortgage loans are on floating-rate packages, which means that households will face higher monthly repayments when interest rates normalise.
- An estimated 5 to 10% of borrowers have probably over-leveraged on their property purchases, i.e. they have total debt service payments at more than 60% of their income.
- If mortgage rates were to rise by 3 percentage points, the proportion of borrowers at risk could reach 10 to 15%.
- In particular, lower income households and those with smaller saving pools may find this a strain. Those with longer tenure loans will also be adversely affected.

So, when interest rates rise, long before any bank gets into trouble, some households will. Banks must therefore practice responsible lending, and consider the ability of borrowers to service their debt in a sustainable manner.

This is the main reason why MAS introduced the Total Debt Servicing Ratio (TDSR) framework. During our inspections, we picked up some worrying practices.

- Most of them are in ***property loans***
  - A couple with combined household income of $6,000 was able to obtain a new housing loan of $400,000. Their monthly installments on this new loan and their existing loan obligations came to more than 90% of their combined monthly income.
  - The bank's decision to approve the loan was based solely on fact that couple had savings deposit of $90,000. This is not prudent.

- We picked up similar instances for ***car loans***
  - Some applicants of car loans borrowed close to 100% of the value of car, with little or no down payment, for what is essentially a depreciating asset.
  - This is also not prudent.
- We also found cases of excessive borrowing through ***credit cards***
  - A concerned mother called MAS for assistance: her 24-year old son had been paying only the minimum sum on his credit card bills and steadily chalking up debts.
  - She requested MAS to stop financial institutions from issuing credit cards to those who have not been making full payment on their credit card bills.

Over last three years, MAS has introduced variety of measures to contain excessive borrowing against the backdrop of highly loose monetary conditions globally.

- For property loans, tighter loan-to-value ratios, higher minimum cash downpayments, caps on loan tenures, and guidance on total debt service ratios.
- For car loans, tighter loan-to-value ratios and caps on loan tenures.
- For credit card loans, new proposals to:
  - help individuals with credit problems avoid further debt accumulation;
  - improve due diligence conducted by FIs; and
  - empower consumers to make informed decisions.

These measures helped to limit risks facing financial institutions but more importantly helped to encourage greater financial prudence among borrowers.

- It is important that we act now to limit the build-up of leverage.
- It is much harder to do so later, when growth might be weaker, interest rates higher, and property prices lower.

Stringent efforts to ensure Singapore's financial centre remains clean and trusted

Next, let me touch on the efforts we have been making to ensure that Singapore remains a clean and trusted financial centre.

- There has a growing concern internationally on the use of financial centres to hide illicit funds or evade taxes.

Singapore takes seriously the integrity of its financial centre and is fully committed to international efforts to combat money laundering and tax evasion.

The policy measures Singapore has taken on this front well-known; so I will not elaborate.

- Laundering proceeds of tax evasion and tax fraud is now a crime in Singapore, effective 1 July. Financial Institutions are required to conduct customer due diligence to deter and detect proceeds from serious foreign tax offences, even if they are not offences in Singapore.
- We will automatically extend Exchange of Information (EOI) assistance in accordance with OECD standard to all existing Avoidance of Double Tax Agreement (DTA) partners without the need for negotiation.
- We signed the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters.

What is less well-known is the rigorous supervisory regime in place to combat financial crime.

MAS' approach is preventive.

- We seek to identify control weaknesses early so that financial institutions can strengthen their processes and prevent attempts to launder money or finance terrorism.
- This is more effective than punishing financial institutions only after actual acts have been committed and detected.

Our coverage is comprehensive.

- Over last three years, MAS conducted total of 108 Anti-Money Laundering/Countering the Financing of Terrorism (AML/CFT) inspections covering banks, insurance companies, money changers, remittance agents, and licensed intermediaries.
- Financial institutions have enhanced AML/CFT controls over the years, and most have in place the necessary policies, procedures and controls to combat money laundering and terrorism financing.

Financial institutions with control deficiencies are firmly dealt with.

- Example:
  - A bank which facilitated ship-closing transactions, did not conduct adequate due diligence on the final identity of buyers behind these transactions.
  - MAS ordered the bank to commission an independent audit of its AML/CFT controls.
  - The audit uncovered serious control weaknesses and compliance failures.
  - MAS imposed a composition sum of S$350,000 on the bank.
  - The bank has since beefed up its control framework and checks.
- Another example:
  - A licensed financial adviser was rated poor following MAS' inspection, for serious lapses in policies and procedures on customer due diligence.
  - We did not discover any actual money laundering or terrorism financing cases but MAS imposed composition of $187,500 on the licensed financial adviser for breaching AML requirements.
  - MAS then directed the licensed financial adviser to cease all new business until the independent person has verified that the licensed financial adviser has taken corrective actions to address inspection findings.
  - The licensed financial adviser is in process of winding down its financial advisory operations.

MAS will not tolerate abuse of our financial system for criminal activity.

- Our message to tax criminals is loud and clear: their money is not welcome in Singapore.
- And our message to our financial institutions is also loud and clear: if you suspect the money is not clean, don't take it.

Financial centre made good progress in future drivers of growth

Last, a few words on prospects for financial sector.

The growth of the sector is often volatile, due to the sentiment-sensitive nature of many financial activities.

- Abstracting from this volatility, there are a few discernible trends emerging that augur well for future of Singapore's financial centre.

First, asset management.

- As at end-2012, total assets managed by Singapore-based asset managers reached an all-time high of S$1.63 trillion, a year-on-year increase of 22%.
- About 80% of AUM was sourced from outside Singapore and more than 70% of total assets were invested in the Asia-Pacific region, reflecting Singapore's role as an asset management hub serving both regional and international investors.
- We continue to see strong interest from global fund houses, seeking to set up or expand their Asian presence in Singapore

Second, insurance and reinsurance.

- Singapore is now the leading reinsurance and specialty insurance hub in Asia, housing a strong cluster of direct insurers, reinsurers, captives, brokers and ancillary service providers.
- Increasingly, more insurers and brokers are offering specialised lines such as trade credit and political risk insurance, aviation, marine, energy, against terrorism and professional indemnity.
- For example, we are home to Lloyd's Asia, the only major marketplace outside of Lloyd's of London that writes specialist and reinsurance business in the region.

Third, our offshore RMB centre. A key milestone in 2013 was launch of RMB clearing facilities in Singapore. More importantly, a broader ecosystem is taking shape.

- MAS has entered enhanced bilateral currency swap arrangement with People's Bank of China (PBOC) in Mar 2013:
  - The size of the swap arrangement has doubled to RMB300 billion.
  - The scope of the facility has been expanded to allow short-term liquidity to be provided to promote market stability.
- The Industrial & Commercial Bank of China (ICBC) Singapore branch has commenced RMB clearing services in May 2013.
- We have since seen issuance of four RMB bonds amounting to RMB2.5 billion. This is a promising start.
- This month, MAS issued rules allowing participating banks to conduct foreign exchange (FX) conversion in China via the RMB Clearing Bank in Singapore for the settlement of eligible cross-border trade.
- And the move by China last week to extend RMB Qualified Foreign Institutional Investor (RQFII) privileges to Singapore means that financial institutions in Singapore can expand their RMB product offerings to cater to needs of their investors.
- MAS will work closely with the industry to develop the infrastructure and capabilities necessary to fully tap on opportunities created by RMB internationalisation.

Conclusion

Let me sum up on how MAS has done on its key functions.

- ***Monetary policy.*** Our tight stance since 2010 is paying off. Inflation has come down to within our comfort zone. But there is no room for complacency. Wage and cost pressures will persist and bear close watching.
- ***Reserve management.*** We made good investment returns last FY. But in Singapore dollar terms, we have recorded a loss because of strength of currency. This is not a cause for concern because it is the foreign currency value of the reserves that matters.
- ***Financial stability.*** Our financial system is sound. It will be resilient against a normalisation of global monetary conditions. But household balance sheets are a source of concern – not at the aggregate level, but a significant minority could be over-leveraged. Hence, the variety of macroprudential measures we have taken over the last three years.
- ***Financial supervision.*** We are fully compliant with international standards, and have taken strong measures to ensure we remain a clean and trusted financial centre. We have stepped up to meet enhanced global standards on information exchange and have intensified our supervision of financial institutions to ensure we keep illicit money out from our financial centre.
- ***Financial development.*** The key drivers of future growth in our financial centre are showing good promise. The asset management industry has reached a new peak. We are now clearly the insurance and reinsurance hub in a growing Asia. And we are off to a good start to building a vibrant ecosystem as an offshore RMB hub.