Koh Yong Guan: Review of Singapore's economy and financial sector

Opening remarks by Mr Koh Yong Guan, Managing Director of the Monetary Authority of Singapore, at the press conference releasing the MAS's Annual Report, Singapore, 15 July 2003.

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Introduction

Good morning, ladies and gentlemen. Welcome to this media briefing for the release of the Monetary Authority of Singapore's 2002/2003 Annual Report.

MAS has had an eventful year. The economy performed weaker than expected in the first two quarters of 2003. The financial sector faced more volatile markets, heightened competition, and continued global industry consolidation. Amidst this more challenging environment, MAS has remained focused on supporting non-inflationary economic growth, promoting key growth areas in the financial sector, and enhancing the supervisory framework for a sound and resilient financial sector.

Supporting non-inflationary economic growth

Global geopolitical uncertainties and the outbreak of SARS derailed the recovery of the Singapore economy earlier this year. We lowered our GDP forecast for 2003 to a range of 0.5-2.5 per cent. More recently, however, signs have emerged of a pick-up in economic activity. Several indicators in the global electronics industry have improved. The SARS-hit services sectors are turning around. We expect the economy to resume a modest recovery in the second half of the year, although some downside risks remain. At the same time, inflation has turned out lower than expected, and the outlook is for inflation to remain subdued into 2004. MAS has therefore re-centred its exchange rate policy band at the current level of the nominal effective exchange rate of the S$, while maintaining a zero percent appreciation path and no change in the width of the policy band.

Promoting key growth areas in the financial sector

The weaker domestic and regional economic environment in the last two years has dampened growth in Singapore's financial sector. Financial sector value-added contracted by 4.8 per cent in 2002 compared with a rise of 2.2 per cent in 2001. The banking industry was affected by weak loan demand. The insurance industry experienced a sharp decline in activity following three years of rapid growth. The securities industry was dragged down by falling equity market volumes and bearish market sentiment.

But the weakness in overall financial activity masks strong performance in key growth areas such as asset management and treasury business. Total assets managed by Singapore-based financial institutions grew a healthy 12 per cent in 2002, bucking the global trend of a decline in assets under management. In the debt market, 2002 saw continued healthy growth in structured debt and a record number of issues by foreign entities. Singapore has also benefited to some extent from the consolidation of financial sector companies worldwide. Various institutions have chosen to centralise their regional operations in Singapore. For instance, in treasury, several global players consolidated in Singapore their regional foreign exchange and derivatives business. The Singapore dollar has been included as one of eight settlement currencies in the Continuous Linked Settlement (CLS) system - a global initiative aimed at eliminating foreign exchange settlement risk arising from time zone differences.

Going forward, the outlook for the other segments of the financial sector has improved. The stock market has rebounded with daily transactions nearly tripling in Q2, compared to Q1. With the expected pick-up in domestic and regional economic activity in H2 2003, we are also likely to see further improvement in commercial banking. The financial sector is expected to post a small positive growth this year, following the 4.8 per cent contraction in 2002.

Enhancing supervisory framework for sound financial sector

On the supervisory and regulatory front, MAS continued its efforts to move away from a prescriptive, rule-based approach to a more flexible, risk-based approach. This entailed strengthening risk-based and disclosure-based regulatory frameworks, enhancing corporate governance standards to foster better risk management on the part of institutions, and empowering consumers to make better informed investment decisions. Let me touch on key initiatives in each of these areas.

An important step towards a disclosure-based regime was the full implementation last year of the Securities and Futures Act and Financial Advisers Act. MAS will continue to refine the regulatory framework for capital markets, taking into account industry feedback.

In the area of risk-based supervision, we implemented last year the new Liquidity Supervision Framework for banks. Several banks that have better risk management systems and processes have been allowed to lower their minimum liquid asset requirements from the existing 18 per cent on the basis of their liquidity risk profile and liquidity risk management capabilities. Similarly, in the area of capital adequacy, we are currently developing a framework for setting individual bank-specific requirements according to their risk profile and risk management capabilities as part of our ongoing review of the overall capital adequacy framework. For securities and futures intermediaries, we introduced a risk-based capital framework last year. For insurance companies, we tested such a framework last year and are working towards implementation in 2004.

Shifting from a rule-based to a risk-based approach requires MAS to sharpen its supervisory capabilities. It involves assessing key risks faced by individual financial institutions and their ability to manage these risks. We are building more comprehensive risk profiles of individual institutions, leveraging on technology and better information collection.

Primary responsibility for risk management rests with the Board and senior management of the institutions themselves. This is why strengthening corporate governance standards in financial institutions has been a key priority at MAS for several years. Building on earlier initiatives, we have issued a consultation paper, proposing to set higher standards of financial transparency and corporate governance for locally-incorporated banks and direct insurers. We have proposed making it mandatory for the roles of the Chairman and CEO to be separated, and strengthening the independence of boards of directors from substantial shareholders. We have received good feedback on these proposals and will issue a final set of guidelines shortly.

A less prescriptive regulatory approach requires that consumers be empowered through enhanced disclosure and education to make better-informed decisions themselves. This is particularly relevant in the current context of financial innovation which has spawned a growing array of retail products and services with enhanced distribution networks. MAS will work closely with industry associations and other public sector agencies to develop consumer guides and educational programmes to raise the financial literacy of consumers. We have also facilitated the development of industry-based mechanisms to offer consumers faster and more cost-effective ways to settle disputes with banks and insurers. The banking industry has set up a Consumer Mediation Unit and the insurance industry the Insurance Disputes Resolution Organisation.

Enhancing organisational effectiveness

The year was also eventful for MAS as an organisation, as we continued to build on our structure, systems, and people to better meet the challenges posed by a changing and uncertain external environment. We restructured the organisation to better integrate our supervisory functions, align resources with our objectives, and build technical and managerial depth. We stepped up efforts to enhance the skills and expertise of our staff, sending more of our staff on external attachments to financial institutions and supranational organisations, and putting in place a more systematic approach in functional training. The integration with the previous Board of Commissioners of Currency, Singapore (BCCS) was carried out successfully following the merger on 1 October 2002.

Annual accounts

A few quick words on MAS' financial statements. The Authority's total assets grew 18.6 per cent during the year ended 31 March 2003 to S$153.9 billion. About 11 per cent or S$16 billion is due to the transfer of the Currency Fund from BCCS. All other assets and liabilities of BCCS as at 30

September 2002 were similarly transferred to the MAS and have been incorporated into our financial statements. The net assets of the Currency Fund at the end of the financial year provided 112 per cent asset backing for the currency in circulation of S$13.8 billion. MAS' profit after provisions for the financial year ended 31 March 2003 declined by 2.8 per cent to S$623 million as our investments continued to be affected by the low global interest rate environment and volatile financial markets.

Conclusion

In closing, let me restate MAS's priorities going forward. Supporting economic growth while maintaining domestic price stability will remain the key focus of monetary policy. In the financial sector, we will continue to partner with industry players to build on our successes in key growth areas like asset management, the debt market, and treasury business, while looking out for new niche areas and opportunities. We will continue to refine our regulatory and supervisory framework as we progressively shift the emphasis from a rule-based regime to a risk-based and disclosure-based approach. This is necessarily work-in-progress, as it will take several years of learning and adaptation by MAS, financial institutions, and market participants. But achieving this is an important part of ensuring that Singapore remains a resilient, competitive, and dynamic financial centre.

Thank you very much. My colleagues and I will be pleased to take any questions that you may have.