Anselmo L S Teng: Macao and the perspective of syndicated loans

Speech by Mr Anselmo L S Teng, Chairman of the Monetary Authority of Macao, at the Syndicated Loans Conference, Asia Pacific Loan Market Association, Macao, 7 June 2007.

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Distinguished Guests, Dear Delegates, Ladies and Gentlemen,

I am very pleased to have the honour of speaking to the Association today. It is our privilege that this conference is held in Macao. First and foremost, on behalf of the Government of the Macao Special Administrative Region, I would like to express my warmest welcome to all of you to Macao, a city well known for its eastern and western patrimony.

I would like to take this occasion to share with you the development of the Macao economy and our government's strategy to promote sustainable development via proper economic diversification. I will then move on to talk about the local banking sector, loan market and some of my views.

Macao is one of the leading tourism centres in the Asia-Pacific region in terms of visitor arrivals and receipts. Our economy, following the establishment of the Special Administrative Region of the People's Republic of China in 1999, could be characterised as high growth, low unemployment, and strong fiscal and external balances.

Capitalising on competitive advantages of the tourism sector, our economy has sustained a remarkable uptrend in the past seven years. With a population of just about half a million, Macao saw its record of visitor arrivals reaching 22 million last year. In the first quarter of this year, we achieved a real GDP growth of 25.6%, after having attained 16.6% in 2006. The unemployment rate is currently at a 10-year low of 3.2%, while inflation eased to 4.57%.

In the past few years, our economic prosperity has been largely built on the thriving tourism sector, which is concentrated on a few products and markets. The SAR Government is fully aware that "putting all eggs in one basket" is risk-prone and counterproductive to macroeconomic stability. Diversifying the structure of our economy is not only related to a valid concern for sustainability, but also our ability to generate new types of employment opportunity and ultimately, to maintain a high degree of social stability.

For a small and open economy like Macao that possesses a competitive tourism sector, we believe that diversification should be strictly based on the economic principle of comparative advantage. Macao should not arbitrarily divert its scarce resources to a large number of sectors simply for the sake of diversification. Instead, our policy of economic diversification is strategically focused on a small number of target sectors that underline Macao's comparative advantages in regional division of labour.

As the first step to proceed with diversification, we incline towards sectors that are complementary to the development of the leading industry. This strategy would facilitate a more efficient allocation of resources and possibly create new sources of economic expansion in the long run. In this vein, the SAR Government has placed great effort in promoting vertical diversification of the tourism industry, putting emphasis on non-gaming tourism with new elements such as culture, leisure, sport, shopping, convention and meeting.

Besides, we have been utilising Macao's strong connections with Mainland China and Portuguese speaking countries and also our business merits in terms of low costs, modern information technology, free commercial policies and capital flows, high flexibility and low tax system. The entry into force of the Closer Economic Partnership Arrangement between Mainland China and Macao (CEPA), the establishment of the Cross-border Industrial Zone between Zhuhai and Macao and the Ministerial-level Forum for Economic and Trade Co-operation between Mainland China and Portuguese-speaking Countries held in Macao are all concrete initiatives taken by the SAR Government to diversify our economy.

Our objective for economic diversification is definite and consistent. We strive to develop non-gaming elements in tourism services, and to establish Macao's position as a business platform in three aspects, namely the Service Platform for Economic Co-operation between China and Portuguese Speaking Countries, the Economic Co-operation Platform for western Guangdong, and the Global Chinese Entrepreneurs Networking and Co-operation Platform.

Looking ahead, as new tourism facilities would keep coming up to the market throughout the rest of this year, our tourism sector would continue to perform in 2007. It is noted that some of these new facilities are instrumental to our strategy of diversifying into new business segment of convention and meeting. In view of the strong GDP figure in the first quarter and other relevant statistics on hand, it is expected that the economy will grow at a reasonable pace in 2007.

In fact, our positive assessment is shared by some international organisations and a reputable credit rating agency. Just a week ago, Moody's placed Macao's credit ratings on its list of review for possible upgrade, pointing to our persistently strong fiscal and external positions.

Benefited from the buoyant economy, the banking sector of Macao has achieved remarkable growth in recent years. Up to this moment, there are 26 authorized banking institutions, including 11 locally incorporated banks and 15 branches of banks incorporated outside Macao. Apart from local capital, the rest are from Mainland China, Hong Kong, Portugal, the United States, the United Kingdom, France, Singapore and Chinese Taiwan. The origin of capital reflects the highly open nature of this small city.

By the definition of the Bank for International Settlements, over 80% of bank assets in Macao are of international nature. It is apparent that Macao's financial sector is firmly integrated into the global financial community. This APLMA Conference, held here in Macao, can certainly help promote our guests' understanding of our fast-growing market on the one hand, and further foster exchange, networking and partnership between domestic and foreign financial communities on the other.

As at the end of the 1st quarter of 2007, total assets of the banking sector grew by 22.3% year-on-year to MOP 281.1 billion; deposits increased by 18.2% to MOP 236.4 billion; loans reached MOP 78.1 billion, representing an increase of 18.1%. Nearly 30% of loans are related to properties, infrastructure and project financing. Non-performing loan ratio, the yardstick of asset quality, was at record low of 1.1%. The overall profit for the 1st quarter jumped by 30.3% to MOP 1.0 billion, after a notable result of MOP 3.9 billion scored for the full year of 2006.

The barometer of financial strength, measured by the consolidated capital adequacy ratio of the whole sector at the end of 2006, was kept at a high level of 14.7%, well above the minimum 8% required by the Basel Committee.

These encouraging figures are in fact accompanied by a dramatic change in the domestic loan market landscape, particularly the syndicated loan market. In the past, the demand for financing was met mostly through lending made by local banks, and usually on a bilateral basis between the borrower and the lending institution. For certain projects such as property development or infrastructure which involved large sums, syndicates were formed. The related documentary, operational and legal support might not be that sophisticated owing to limited experience and resources.

Lending business opportunities for financial institutions always arise when an economy is on a fast track of growth. As we can see in these few years, the syndicated loan market has expanded in terms of number of arrangements and value of each arrangement.

The rapid development of Macao's syndicated loan market has brought professionalism, diversification and internationalization to the financial sector of this enclave. They certainly have had positive impact.

The arrangement of syndicated loans involves higher demand for professionals, such as analysts for specific industries, back office administrative and operational staff, property valuation agents and legal counsels. The growth in syndicated loan markets thus stimulates professionalism in a number of service sectors.

In the past, syndicated loans concentrated on financing of local construction projects. But in the past few years, funding purposes of syndicated loans show diversification – from casinos, hotels, residential and commercial properties to construction projects of various nature. We expect that the development of syndicated loan market locally will accelerate the economic diversification process.

The recent arrangements of several syndicated loans for gaming projects have attracted the participation of renowned international investment and commercial banks as arrangers and book-runners. We believe that the continued growth in Macao's economy, and hence the accompanying expansion of the local syndicated loan market will certainly serve as catalyst for further globalization of the Macao economy.

As financial regulator, I encourage local financial institutions to participate in syndicated loans which will accelerate the expansion and internationalization of our financial sector. In the process, we should always be on the alert to mitigate losses arising from reckless lendings which will certainly undermine the stability and healthy development of our financial sector.

Before the Asian Financial Crisis, some might use the term “asset-based financing” to describe the lending culture of the region. Many credit exposure were in fact backed by assets before the crisis. But after the value of these assets had taken a nose-dive, the shock to the financial system was critical and it took a long time to recover. Collaterals do provide good protection for credit risk but their market values are prone to fluctuations under the ever-changing economic and monetary conditions and should only be regarded as the last resort for repayment.

The condition of the overall economy, the soundness of the financial system and the self-perfection of the regulatory regime in the region have greatly improved since the Asian financial crisis. The resilience of the region to withstand the same sort of crisis has been much strengthened. But will it be able to withstand another shock of a more devastating magnitude, especially now that the global financial markets have been characterized by two features; inflated asset prices and excess liquidity. Infact, it was excess liquidity which causes the universal asset inflation. There are many explanations why there is so much money moving around the global village. Some of them are:

1. To alleviate the economy from plummeting into a tailspin after the dotcom bubble of 2000 and 911 incident of 2001, the FED eased money supply during the ensuing years;
2. The thrifty Asians save much of their trade surplus and continue to keep their currencies tied to a weak dollar which results in the printing of more local currencies in the process to feed their export led growth;
3. Although many central banks have raised short term interest rate, Japan however still clings to a near zero interest rate monetary policy in an attempt to uplift the economy. The comparatively weaker Yen has given rise to carry trades;
4. Oil exporters have reaped a windfall in the wake of a sharp rise in oil prices in the past 5 years, the huge surplus has joined the river of excess liquidity;
5. Demand for higher return by investors and deployment of derivatives have expanded lending capacity of financial institutions.

The excess liquidity has pushed up prices of all categories of assets. In the equity market, it has triggered an increased concern of shareholders to enhance the value of their shareholdings. Leveraged buy-out firms are prowling to buy public companies or merge them and remove them from the stockmarket. A large chunk of their ammunition has been provided through debt financing, either by willing banks or hedge funds. On the other hand, directors of “prey companies” tend to raise funds through borrowing to buy back shares to avoid being gobbled up by the predators. In the past, only big companies swallowed small companies. Nowadays, with the help of easy money, relatively smaller companies are taking on companies of bigger size. The demand for syndicated loans has also increased due to the prolonged prosperity of the world economy. Financing is needed for additional infrastructure and exploration for commodities and energy. This is especially true for emerging markets, particularly Asia.

We have explored the demand side. How about the supply side? The financial institutions appear to have unlimited capital and are not afraid of taking credit risk arising from hitherto not so desirable borrowers. What is the reason behind it?

Again, it has something to do with excess liquidity. As I have just mentioned, there has been a universal inflation of all kinds of assets. When the price of a certain asset is high, it purports that the return on the asset must be low. In an attempt to maintain a reasonable return on money, money manager tends to acquire an appetite conducive to taking greater risks. This will enable banks and financial institutions to repackage their loans on their books and sell them to willing investors. Technically, banks can easily parcel out the risk to hedge funds, pension funds and insurers. Therefore, the capital which is hitherto tied up is now free for taking new loans.

In the past decade, lenders have found a new way to mitigate credit risk. The new innovation has led to the development of a series of instruments called credit derivatives. Some of them are very complicated. A relatively simple and popular one is called credit default swap. It is in fact a kind of insurance policy in a form of agreement whereby one party makes a series of payments to another in return for compensation in the event of a default.

Syndicated Loans will continue to flourish for quite some time in the future. I believe this is the consensus. But should lenders rely more on the above factors to take in syndicated loans instead of applying due diligence in making a credit decision? As a regulator, I would like to draw your attention to the following observations:

- When a bank has parcelled out the risk to its clients, the risk has gone out the front door but only to come in the back because of the bank's trading and financial relationships with these same counterparties.
- Credit derivatives have prospered in an easy liquidity, low interest rate and benign economic environment. Again, there is counterparty risk involved in addition to market risk. Credit derivatives have not yet been tested in a credit crunch.

Nonetheless, I am still bullish about syndicated loans, particularly in thriving Asia. However, it is my candid advice to our credit institutions that before making a decision to participate in a syndicated loan, the usual lending rationale should apply. The commitment of depositors' funds should depend more on the merit of the project and the credibility of the borrower than anything else.

Thank you.