Lim Hng Kiang: Singapore's significance in Asia against the background of global financial crises

Keynote address by Mr Lim Hng Kiang, Deputy Chairman of the Monetary Authority of Singapore and Minister for Trade and Industry, at the 5th Annual Citi Asia Pacific Fixed Income Investor Conference, Singapore, 28 January 2008.

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Distinguished guests,
Ladies and gentlemen,

Good morning and a very warm welcome to everyone here today, especially to our guests from abroad.

I am very pleased that Citi is holding its Annual Asia Pacific Fixed Income Investor Conference here in Singapore for the second time. I am confident this conference will serve as an excellent platform, through the dynamic discussions and exchanges of views, to conceive fresh ideas and to establish new business relationships.

The landscape of the Asian bond markets has evolved rapidly over the last ten years. The Asian Financial Crisis in 1997/98 has highlighted the need to develop deep and liquid domestic bond markets; to serve as an alternative source of financing and to alleviate the overdependence of short-term or foreign currency bank borrowings to meet long-term funding needs. The over-concentration of credit risks within the banking sector in 1997, entailing currency and maturity mismatches, contributed to the severity and contagion of the crisis. When the crisis broke, turmoil in the currency markets quickly spread through the stock market, the corporate and banking sectors.

But, Asia made a remarkable recovery.

Following the crisis, the Asian governments strengthened the macroeconomic fundamentals and put in place structural and fiscal reforms. The strong economic development in China and, then, India also helped to propel the region ahead.

Today, the Asian economies growth rate averages around 8%. Businesses have repaired their balance sheets and have started to invest again after purging out the excesses of the 1990s. This is reflected in the Asia (ex-Japan) domestic bond markets, with a significant increase of almost five times in size from US$760 billion to more than US$3.6 trillion; far exceeding the global growth rate, which has doubled since 1997.

Having said that, the global financial markets today are facing yet another crisis. Ten years ago, Asia was at the centre of the storm. However, this time round, the financial market turbulence started in the US and Europe and then spread throughout the world. The challenges facing the capital markets show that the banking system is intertwined with the capital markets more intricately than was previously believed.

While the characteristics of the two financial crises are different, let me share 3 common themes that run through both crises. The first has to do with the tendency of the market to assume that current market conditions can be extrapolated into the long term. Before the Asian financial crisis, most investors extrapolated the rapid growth in Asia and the currency pegs maintained by some countries without factoring in the sustainability of such trends. This time round, the strong credit market from 2003 to 2005 have lulled investors into placing big bets in high-yielding structured credit instruments, on the assumption that such favourable credit conditions will continue unabated.

The second point is on proper risk assessment. Back in 1997, lenders were providing funds without executing necessary scrutiny or appropriately balancing the risks against returns. Likewise, the recent credit turmoil has highlighted the importance of assessing risks. The distribution of risk through leveraged structured vehicles or conduits, and complexities in the structures have made it extremely difficult for investors to disaggregate the risks in times of stress and volatility. As a result, over-reliance has been placed on financial models and ratings without full comprehension of the risks of the product and misunderstanding the scope of the ratings that measures default risk.

Third, excessive leverage in both crises has exacerbated the problems triggered by the mounting default rates. Excess liquidity led to massive domestic lending; at the same time, investors geared up aggressively and bet on continually rising asset prices as collateral. When the crisis broke, the use of leverage accentuated the losses, which led to widespread risk aversion and uncertain market sentiments. The loss of confidence along with the re-pricing of credit risk have intensified the volatility in the financial markets; and this contagion spread rapidly beyond the structured credit space and across markets.

So what does all this mean for Asia? The inter-connectedness of global financial markets and capital flows has been amply demonstrated. The resilience and current strong economic growth in Asia have therefore to battle against the strong headwinds and challenges from the global financial landscape.

The sub-prime-triggered credit turbulence has, undoubtedly, created a lot of uncertainty. The adverse impact of the potential slowdown in the US economy is likely to be felt in Asia as the region's economies are generally export-oriented. Large and volatile capital flows into the region have also placed pressures on exchange rates. This has posed risks of inflationary pressures, intensified by the recent high oil and food prices, spilling over into the Asian bond markets. Hence, it is crucial for regulators in the region to remain vigilant and to continue to control the risks that accompany the surging capital inflows while managing the currency and monetary conditions.

Nonetheless, amidst this financial market turmoil, Asia's resilience has thus far demonstrated its ability to weather the turbulence. Apart from Asia's relatively limited exposure to sub-prime mortgages and related collateralized debt obligations (CDOs), the region's strong economic growth and large liquidity pool, stimulated by the significant momentum coming from the domestic demand of China and India, and increasingly ASEAN, have cushioned the blow.

Some may suggest that 2008 will be a difficult year for the credit markets and investors, especially those with weak credit profiles or the highly leveraged ones, may even divert exposures from equity and currency markets. However, the Asian bond market prospects, in my opinion, are not without bright spots.

Local currency bonds are gaining the attention of foreign investors both from the perspectives of diversification and return enhancements, coupled with the optimism of appreciating Asian currencies. On the other hand, Asian bond markets are also growing as an increasingly attractive asset class for domestic borrowers as they steer clear from the international market. This indicates that the economies are increasingly relying on domestic demand and intraregional credit investments. Infrastructure financing, for instance, is also regaining importance in a number of Asian economies. The key is to have sufficiently deep and efficient markets to effectively channel the high bank liquidity and abundance of savings in Asia into regional investments. With the robust outlook in Asia, this will continue to underpin the need for investment opportunities to fuel the growth engine.

Singapore, right in the heart of Asia, is poised to play a significant role as a gateway for global investors to access the Asian bond markets. We are also poised to serve as the centre for debt financing in the area of infrastructure, real estate and transportation related projects. Project sponsors are increasingly tapping our debt capital market in financing major infrastructure related projects in Asia. Since we started developing the REIT market in 2002, there are now 19 REITs and 1 property business trust listed on the SGX with an aggregate market capitalization of approximately S$27 billion. Issuance of Commercial Mortgage-Backed Securities (CMBS) remained strong on the back of a healthy REIT market. We see a similar potential with infrastructure funds, business trust and project bonds. We have also put in place a PPP framework to encourage public private participation in Singapore infrastructure projects. With this, we have successfully tendered for the ITE College West and the Singapore Sports Hub, the first and the largest sports facilities infrastructure PPP in the world. We believe these initiatives will bring business opportunities for the debt capital market community based in Singapore.

Singapore prides herself to have established the reputation of a trustworthy and reliable financial centre, build on political stability, strong legal system, and a sound regulatory and supervisory framework that raises disclosure standards, fosters market discipline, and provides for greater transparency.

As a regional hub, Singapore is also well connected to the rest of the world through our extensive network of FTAs, including Australia, India, Japan, South Korea and the US. Over 600 local and foreign financial institutions based here are able to access the growing pool of investors and opportunities; fueled by the strong performance of asset management activities in Singapore. The diversity in the sources of funds flowing into and through Singapore has also broadened, with increasing financial flows coming from South Asia and the Middle East.

We have also taken the proactive and responsive approach to changes in the marketplace; having constant dialogues with institutions and listening to market players, like yourselves, to create a conducive business environment for financial institutions to operate in Singapore. As part of our efforts to offer a broad range of financial products and services as an international financial centre, we are also constantly reviewing our policies to ensure a level playing field for the development of Islamic financing.

Beyond the financial industry, Singapore is also committed to building a vibrant and cosmopolitan society that offers high quality of life with world-class facilities for education, healthcare, housing and recreation – an attractive city for global talents to work and live in.

Let me conclude. Asia has made remarkable progress and I believe the outlook for the region remains positive. In the middle of difficulty lies great opportunity. Asia will continue to develop strong and sustainable fundamentals in order to enhance the robustness of our financial systems for the Asian bond markets to become a truly global asset class. On that note, I wish you a very successful and fruitful conference. Thank you.