Ravi Menon: MAS' Annual Report 2013/14 – economic overview and challenges

Remarks by Mr Ravi Menon, Managing Director of the Monetary Authority of Singapore, at MAS' Annual Report 2013/14 Press Conference, Singapore, 24 July 2014.

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

2 I will touch on four broad areas today. First, growth and inflation, including asset prices; second, our regulatory measures to safeguard the interests of consumers of financial products; third, the growth of the financial sector and fourth, an overview of MAS' financial results.

3 Let me start with the economy.

Momentum slows but economy on track to meet 2–4% growth forecast

4 The economy grew an average of 0.4% on q-o-q seasonally adjusted, annualised (SAAR) basis over the first two quarters. Export-oriented sectors were sluggish in the first quarter due to the slippage of final demand in the US and China. In the second quarter, there was modest improvement in trade-related services – wholesale trade and transport and storage sectors. But electronics production remained weak.

5 Looking ahead for the year, the economy remains on track to grow at 2–4%. The economy has already averaged 3.4% growth in the first half on a year-on-year basis. More importantly, sequential quarter-on-quarter growth should see a modest pick-up in the second half even if there is some drag to year-o-year growth due to the high base in the second half of last year.

6 There are several key factors to the improved prospects for the rest of the year.

7 First, the external environment remains generally favourable, with both major engines of global growth intact.

- In the US, recent data indicate continued economic expansion. Both manufacturing and services PMIs are up. The labour market continues to improve. There is also a modest rise in business spending, which is a key driver of growth in the US.
- In China, growth should come within the consensus range of 7–7.5%. There are some headwinds from ongoing structural reforms but targeted policy measures will provide support to the economy.

8 Second, sectors dependent on regional demand – such as financial intermediation services, business services, and chemicals – should do well. They will benefit from higher regional incomes as the pick up in exports bolsters domestic demand in Asia.

9 Third, domestic oriented sectors should stay resilient. The construction industry is supported by a pipeline of infrastructure projects while domestic corporate and consumer spending will lend support to the info-communications and other essential services such as healthcare and education.

10 However, there are downside risks to the growth outlook. This year, geopolitical risks are larger than macroeconomic risks. The MAS is closely monitoring the ongoing conflicts in the Middle East and Ukraine. Should the conflicts intensify or drag on, they could adversely impact confidence, generate financial market volatility, and increase global oil prices. These would, in turn, affect Singapore's growth, particularly in trade-related sectors and sentiment-sensitive segments in the financial services.

11 Having said that, barring significant escalation, moderate spillovers to Singapore from these geopolitical developments should be accommodated within current forecast range of 2–4% growth.

Overall inflation has moderated but underlying price pressures persist

12 Let me move on to inflation.

13 In assessing inflation in Singapore, we look at two main indicators. First, All-Items or headline inflation, which is the most comprehensive measure. Second, core Inflation, which excludes the volatile components of car and housing costs and is a better measure of underlying inflation.

14 Core or underlying inflation in turn has two sources: imported and domestic.

15 I will start with imported inflation, which has been flat. On average, imported inflation has been zero so far this year, compared to same period last year. The appreciation of the Singapore Dollar has neutralised the impact of foreign prices on domestic prices.

16 However, the prices of non-cooked food items – although imported – have been volatile and generally higher. Papaya prices went up by 16% (y-o-y) in first half of this year, while banana prices went up by 18%. This was due to the effects of adverse weather in Thailand and Malaysia. At the same time, the prices of oranges went down by 7% and tomatoes by 10%. Looking beyond fruits, sugar prices were down, wheat prices were up, while the price of Thai white rice was broadly stable.

17 Taking all non-cooked food items together, prices went up by 2.8% in H1 2014. This is higher than overall inflation. The greater volatility reflects the periodic shocks in global food prices that have become more frequent in recent years.

18 Domestic inflationary pressures, however, remain firm. These stem mainly from the pass-through of higher costs, particularly wages, to consumer prices. The cost of services most affected, given their high labour content. As a result, the cost of eating out, education, healthcare, and recreation rose at a faster rate compared to overall inflation in the first half of 2014.

19 Taking together imported and domestic sources of inflation, Core Inflation was higher than the historical average but well contained – the forecast for Core Inflation is unchanged at 2-3%. Core Inflation was 1.8% in the second half of 2013, rose to 2.1% in first half of 2014, and is likely to increase slightly over the rest of the year.

20 But overall or CPI-All Items inflation is on a different trend. All-Items inflation was 1.9% in the second half of 2013, came down to 1.7% in the first half of this year, and is likely to continue easing through the rest of the year. The MAS is therefore narrowing the 2014 forecast range for All-Items inflation to 1.5–2.0% from 1.5–2.5%. Overall inflation is falling due to the moderation in housing costs and car prices. Government measures to cool the property market have helped stabilise prices and rent and higher COE supply has lowered premiums.

21 Therefore the focus of MAS' monetary policy, as before, is on Core Inflation. Just as we were not unduly alarmed when All-Items inflation was running at 5%, we should not be complacent now just because All-Items inflation is running below 2%. Our focus remains on Core Inflation, which has persisted at 2–3% for the last few years. Monetary policy has therefore been steady and consistent during this period – a gradual and modest appreciation path for S$NEER since April 2010. This was reaffirmed most recently in April 2014. This policy stance will ensure that Core Inflation stays within 2–3% this year.

22 We expect Core Inflation to be higher than historical average of 2%, during period of economic restructuring next few years. The aim of our monetary policy is to keep core

inflation expectations anchored at around 2.5%. Inflation may exceed this level from time to time but we aim to ensure that it does not do so on sustained basis.

Property cooling measures working but too early to ease

23 Next, I will touch on to the property market.

24 The MAS has also been focused on asset price inflation in recent years, especially in the property market. The MAS, working with other government agencies, has introduced several rounds of measures to cool an overheated property market.

25 There were three motivations behind MAS policy measures.

- Anchor inflation expectations. High and rising asset prices could fuel expectations of still higher general prices.
- Support financial stability. Unsustainably high property prices could create risks of financial stability given the banking system's loan exposure to property.
- Encourage greater financial prudence. The combination of global low interest rates and high asset prices could lead to some households over-extending themselves financially.

26 How far have these policy objectives been met?

- There are some indications that property market is stabilising. The private property price index has moderated by cumulative 3.3% over the last three quarters. This has alleviated the pressure on headline inflation, as I have explained earlier.
- The banking system is resilient to property market shocks. Stress tests of our banks during last year's Financial Sector Assessment Programme by the IMF showed they were resilient against various stress scenarios. These stresses included a combination of: domestic interest rates increasing by more than 200 bps; unemployment rate rising above 10%; cumulative decline in equity prices up to 70% over three years; and cumulative decline in residential property prices up to 50% over three years. MAS' own stress test this year – assuming disorderly unwinding of quantitative easing in US and higher level of USD funding squeeze – shows similar results.
- Household balance sheets are in better shape. Last year I highlighted MAS' concerns over rising household leverage. Property-related measures have helped to strengthen overall household balance sheets in two ways. First, they have tempered the growth of household debt. Year-on-year growth of household debt has moderated from nearly 13% in the third quarter of 2011 to 5.5% in the first quarter of 2014. Second, the risk profile of new housing loan borrowers has improved. Almost all new housing loans granted since introduction of Total Debt Servicing Ratio, or TDSR, were within the 60% threshold.

27 But it is too early to ease property-related measures

28 The measures can be broadly categorised into structural and cyclical measures.

- Structural measures include the TDSR and caps on loan tenures. They aim to ensure that households do not take on financial obligations beyond their repayment capacity. Structural measures are therefore meant for the long-term.
- Cyclical measures include MAS' LTV limits and MOF's stamp duties. They are designed to prevent households from over-extending themselves in purchasing property during periods of rapid price increases or elevated prices. Cyclical measures can be recalibrated according to market conditions.

29 It is too early to unwind cyclical measures as the risk factors have not changed.

- Property prices remain at elevated levels. Prices went up 60% over last four years but have declined by just 3.3% over the last three quarters.
- Global interest rates are still at historical lows. Relaxing property measures in the current easy liquidity environment may set off another spiral of price increases.
- The level of debt among highly leveraged households remains high. For these highly leveraged households, reducing the level of leverage will take time. They need to work with their banks and commit to debt repayment plans.

30 Hence on the whole, MAS' assessment is that it is premature to ease property cooling measures now. It is important that we secure the gains we have made in stabilising the market and restoring financial prudence.

Comprehensive measures to safeguard interests of consumers of financial products

31 On the financial regulatory and supervisory front, I will focus on measures being taken to safeguard the interests of consumers of financial products.

32 Several measures were announced recently and some will be announced soon. Let me set the context for these measures – motivating factors, overall approach, and how the various pieces fit together.

33 Three trends are shaping market for financial products.

- Low interest rates globally have spurred investors to seek better returns.
- Growing affluence and financial awareness have generated greater demand for a broader range of retail investment products.
- There has been an increased sophistication and variety in financial products offered to retail public.

34 Against this backdrop, MAS is taking a multi-pronged approach to safeguard consumer interests. First, we are enhancing regulatory safeguards for retail investors in unconventional investment schemes. Second, we will facilitate retail access to simple, lower cost products. Third, MAS will help to empower consumers with enhanced disclosure and information access. Fourth, we are raising standards of financial advice to consumers.

35 MAS issued a consultation paper earlier this week with proposals on the safeguards for retail investors in unconventional investment schemes. Let me elaborate here on our thinking and rationale.

36 Many retail consumers have ventured into unconventional and unregulated financial products promising higher yields. But these products may also entail risks that are not well understood by retail investors. MAS has therefore decided to extend to these unconventional products regulatory safeguards that apply to capital markets.

37 In extending boundaries of regulation, we are guided by the need to balance costs and benefits.

- If we take too broad-brush an approach, we could end up regulating all commercial arrangements involving some form of investment return. For example, buying gold jewellery or piece of art that could appreciate in value over time. This will only add to costs without advancing consumer interests.
- But if we craft the regulatory framework too narrowly, products may be deliberately structured to fall outside the regulatory perimeter. For example, restricting regulation to land-banking arrangements will fail to capture other schemes operating on similar premises, such as investments in ostrich farms or in plantations.

38 Therefore, taking into account market developments in Singapore, MAS will selectively enhance regulatory safeguards for retail investors in buy-back arrangements involving precious metals, which has the same economic effect as borrowing cash from customers; and collectively managed investment schemes. The latter includes land-banking and forestry schemes. These are in substance collective investments for which rules on public offerings and disclosure should apply.

39 One reason why consumers venture into unconventional and often risky products is that simple, lower cost products not easily available. MAS working to address this.

40 Following FAIR recommendation, MAS will introduce a direct channel through which consumers can purchase insurance products that focus on meeting their protection needs. Such products will be cheaper as consumers do not need to pay for distribution costs. The features of these products will also be largely standardised, making them easier to understand and compare across products.

41 By early next year, consumers who do not require financial advice will be able to purchase term and whole life insurance products, directly from insurers. MAS will be announcing details on this by the end of the month.

42 MAS is also working to facilitate better access to fixed income products. We are seeing growing retail investor interest in fixed income products, e.g. plain vanilla corporate bonds. While the risk-return profiles of such fixed income products are easier to understand they are not readily available to retail investors.

43 MAS reviewing how retail access to fixed income products can be improved. We are looking at how disclosure requirements can be streamlined for issuers satisfying certain criteria such as issuances of a certain size or with a track record. The idea is to make it easier for issuers to offer bonds to retail investors while maintaining sufficient safeguards. MAS will be putting out proposals for consultation next month.

44 Financial products have become more innovative and complex to cater to investors along a wider spectrum of financial sophistication and risk appetites. While this is good, it does mean we need to empower consumers to navigate this complexity, understand the risk-return trade-offs, and compare and choose products most suitable to their financial objectives.

45 I will highlight three initiatives in this direction.

- Complexity-risk framework. MAS proposes to introduce a new tool to aid consumers in comparing inherent complexities and risks of investment products.
- Product highlight sheet (PHS). PHS requirements were first introduced in 2010 to govern sale and marketing of more complex investment products like asset-backed securities and structured notes. MAS is proposing to extend requirements for PHS to offers of equities, bonds, and hybrid securities. MAS has gathered feedback on the proposals and will announce our final decision soon.
- Web aggregator. MAS working closely with the industry and consumer groups to develop a web aggregator so consumers can compare term insurance, whole life, and endowment products. The online portal is targeted for roll-out in early 2015.

46 There are also initiatives to improve the quality of financial advice to consumers. The majority of retail investors obtain financial advice from and purchase investment products through financial advisory (FA) firms. Thus, it is critical that FA firms and their representatives offer quality financial advice to help consumers make appropriate financial decisions.

47 MAS is enhancing standards for FA industry in a few ways.

- We are raising admission and ongoing requirements for FA firms. These requirements will be in place in 2015.

- We have also set higher minimum academic entry requirements for FA representatives with effect from 1 February 2014 and will mandate minimum hours of continuing professional development training for them in 2015.
- MAS will also implement in 2015 a balanced scorecard remuneration framework that will recognise FA representatives and their supervisors for providing good quality advice.

48 Ultimately, consumers must take responsibility for their financial decisions. But MAS will continue to work with the industry and other government agencies to enhance financial literacy among Singaporeans so that they can take sound financial decisions. MoneySENSE, the national financial education programme, is the centrepiece of this effort. We seek the media's support and partnership in this effort so that we can reach out to all Singaporeans.

Another good year for Singapore's financial centre

49 Moving on to our financial sector, Singapore's financial centre continues to perform well. Financial and insurance services grew by 10.8% last year. Four segments are worth highlighting.

50 Asset management. Assets under management (AUM) grew close to 12% to reach S$1.82 trillion in 2013. Growth was broad-based – both traditional as well as alternative managers like hedge funds and private equity players registered good increases in AUM.

51 Foreign exchange and derivatives. Singapore is now third largest FX centre globally after London and New York. Two trends augur well for Singapore as FX and derivatives centre.

- One, regulatory reforms to promote greater transparency in markets will spur growth of exchange-traded instruments globally. This "futurisation" trend plays to SGX's strength in derivatives and it has seen strong growth in equity index futures trading.
- Two, investors in Asian time zone will need a comprehensive suite of pan-Asian risk management products. SGX is well-placed to fill this need. SGX launched six Asian FX futures contracts in 2013 and plans to launch RMB futures in H2 this year alongside other currencies.

52 Insurance. Singapore is Asia's leading insurance centre. Offshore insurance business in both direct and reinsurance markets is growing strongly. The offshore non-life insurance business has grown by average 11% per annum in the last 3 years. Singapore has also built up significant capacity and expertise for large, complex and specialty risks. Most large reinsurance and specialty Asian risks can now be fully placed in Singapore.

53 RMB business. There has been strong growth in RMB activities since the launch of RMB clearing services in Singapore in 2013. Growth is broad-based across various activities – deposits, trade finance, cash management and FX trading. Banks have expanded their RMB capabilities to serve needs of corporates based in Singapore and region. Based on SWIFT's recent data, Singapore is currently the top RMB offshore clearing centre outside China/HK.

54 Looking ahead, MAS will focus on two areas to further develop the RMB market.

- First, deepen range of RMB products and services, in particular, in fund management and capital markets. The award of RMB Qualified Foreign Institutional Investor (RQFII) quota to Singapore financial institutions to invest RMB funds in China is a significant step. It will help expand the range of RMB investment products, given growing investor interest in China. We have had seven successful Lion City bond issuances worth RMB10.5 billion to-date, and we will look to promote greater bond issuance activity on a sustained basis.
- Second, enhance market infrastructure to facilitate growth of RMB activities. In response to market demand, MAS has recently introduced RMB Overnight Liquidity

Facility to meet end-of-day RMB liquidity needs in the market. We will work with the industry to develop a RMB Real Time Gross Settlement (RTGS) System to raise the efficiency of RMB payment settlements in Singapore.

Investment gains stable but profits higher due to translation effects

55 Finally, I shall touch on MAS' financial results.

56 MAS recorded overall profit of S$15.8 billion for FY2013/14. In FY2012/13, we recorded a loss of S$10.6 billion. However, focusing on these numbers misses larger point about how MAS' investments have performed.

57 As I had explained on previous occasions, MAS' overall profit position is strongly influenced by currency translation effects – these are the effects of converting value of our reserves in foreign currency to Singapore Dollars (SGD).

- A weaker SGD means a positive translation effect, i.e. investment gains on our foreign assets are amplified when reported in SGD.
- Conversely, a stronger SGD means a negative translation effect, i.e. investment gains are smaller or even negative when measured in SGD. But these translation effects have no bearing on the international purchasing power of MAS' reserves.

58 Therefore, it is important to look at the underlying investment gains holding the SGD exchange rate constant to strip out currency translation effects. When we do this, for FY2013/14, MAS posted foreign investment gains of S$10.6 billion, comparable to investment gains of S$9.4 billion for FY 2012/13.

59 For this financial year, we recorded positive translation effects as SGD weakened against the USD, EURO and GBP. In the last financial year, we had negative translation effects because the SGD appreciated against these three currencies as well as the JPY.

60 To help make sense of MAS' underlying investment performance, we have provided a write-up on page 27 of annual report, showing the overall profit position, currency translation effects, and investment gains.

61 As shown in the chart on page 27, MAS' investment gains have been relatively stable. This reflects our conservative investment strategy, which balances the need to hold sufficient liquidity to support the conduct of monetary policy with the aim to preserve the international purchasing power of the foreign reserves. MAS' portfolio is well-diversified with a risk profile that is commensurate with our role as a central bank.

62 I will stop here, and will be happy to take your questions.