Ravi Menon: Budget carefully, borrow responsibly, invest wisely

Remarks by Mr Ravi Menon, Managing Director of the Monetary Authority of Singapore, at the Launch of the Tamil Financial Literacy Guide, Singapore, 16 November 2014.

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Mr Kumaran Barathan, CEO of SINDA

Ladies and gentlemen, good morning.

Value of patience and prudence

In the 1960s and 1970s, a psychology professor at Stanford University in the US conducted a study on children's behaviour.

- He offered each child a choice: get a marshmallow immediately or, if they waited a little longer, get two marshmallows.
- Some children did not want to wait, or perhaps they had doubts about the professor keeping his word. So, they chose to have their sweet there and then.
- Others were more patient and received two marshmallows, as promised.

Fast forward 20 years. Follow-up studies were done on the same group of children.

- Those children who had chosen to delay getting their marshmallow generally performed better in their lives.
- They achieved better test results in school, for example.
- And yes, they kept themselves in better shape too!

The results have intrigued psychologists, social scientists, and educators ever since. Many more studies are being conducted and more elaborate theories are being proposed to explain them.

But maybe our forefathers knew the answer all along: the value of patience and prudence; in other words, delay rewards today so that we can reap greater rewards tomorrow. Does that not offer a recipe for success in so many areas of our lives?

- We tell our children to play less and study more, so that they can acquire the education necessary to lead productive and comfortable lives in future.
- We tell ourselves to eat less and exercise more, so that we can keep in good health for a longer time and continue to enjoy good food.
- Should it be any different in matters financial?

What does it mean to be patient and prudent in finance? Three things.

- Budget carefully
- Borrow responsibly
- Invest wisely

These are the three areas that MoneySENSE – our national financial education programme – will focus on increasingly. MoneySENSE – spearheaded by MAS and involving a number of government agencies – has been working in partnership with the financial industry, education institutes, and professional and consumer associations to help empower Singaporeans to manage their finances well.

Budget carefully

Let me start with budgeting – the first area of focus.

The financial questions we face in our lives are quite similar to the dilemma the children had with their marshmallows. If anything, they are more complicated. For one, marshmallows or the good things in life are usually not free. We have to pay for them with money we receive from working or from our savings. Or from borrowing.

In our lives, there are many marshmallows to tempt us:

- Do I buy that expensive pair of shoes?
- How much should I spend on my wedding?
- Can I afford to upgrade my HDB flat?
- Should I take a holiday in Penang or Perth?

Budgeting is critical to making financial decisions that work for us. One does not need to be a financial expert to do effective budgeting. Many regular people do this very well, on a weekly or monthly basis.

- They look at how much they have, what they want to set aside, and what they need to buy.
- They compare prices for the best deals, look out for bargains and sales, and stretch their dollar.
- Most important, they set a target for how much they want to save and stick to the discipline, buying only what they need and postponing the rest.

Building up our savings puts us in a stronger position to plan for big ticket items such as buying a home as well as to meet emergency expenditures. Saving is key to funding long-term commitments such as our children's education and our own retirement needs.

Borrow responsibly

Second, borrowing. Even with savings, most of us have to borrow at some point in our lives: to buy a house, pay for education, or meet an emergency. It is not wrong to have debt. But good financial planning is about keeping debt low and managing it well.

Most Singaporeans manage their debt well. The consumer credit situation in Singapore is healthy, with strong household balance sheets, especially compared to many other countries. But a small minority of people have problems related to excessive borrowing.

According to Credit Counselling Singapore, overspending is one of the top reasons why people fall into debt. This brings us back to the importance of budgeting and not spending beyond our means.

MAS has in place safeguards to discourage excessive borrowing on credit cards and unsecured credit. We are one of the few countries in the world that have such extensive rules on the use of credit cards. These rules have generally helped to keep us out of trouble. Even so, some 3% of those who have borrowed on credit cards and unsecured credit have accumulated debt that exceeds their annual income.

And this does not mean that secured borrowing – to buy a house or car – is free of risk. When we borrow, we have to make sure that we can service our debt even if interest rates rise or our income falls. Households who have over-extended themselves often get into deeper debt when they cannot service their existing debts and end up borrowing even more. And once they are in a debt spiral, it becomes very difficult to get out.

In recent years, MAS has tightened loan-to-value ratios for housing loans, and introduced the Total Debt Servicing Ratio (TDSR) framework to prevent households from over-stretching themselves.

Invest wisely

As we build up our savings, some of us may wish to invest part of it to obtain higher returns. Investments in bonds, equities, mutual funds (or unit trusts) and other financial products typically yield higher returns than bank deposit rates over the medium to long term. But they also carry higher risks.

- For the majority of financial investments, neither the returns nor the principal amount invested are guaranteed. This means we could potentially get less than what we have put in.

MAS has set stringent disclosure requirements for financial products. We also require that information be provided in a clear and concise manner, through the use of Product Highlight Sheets, for example.

But the responsibility ultimately lies with the investor. Every month, MAS receives, on average, about 10 complaints from the public involving the sale of investment products. To be sure, some of them involve mis-selling or poor disclosure, for which the financial adviser or institution is responsible. But there many others – sad stories of people who have lost their money because they did not exercise basic due diligence:

- people who were attracted by the lure of high returns and purchased investment products without realising their risks;
- people who listened to tips about "sure-to-win" investments and invested large sums of money in them without reading the product documentation;
- people who signed blank sheets of product assessment forms without understanding what they were buying.

It is very difficult to help in cases like these.

Helping Singaporeans invest wisely is a major thrust of our financial education efforts. The lessons are simple.

- High returns come with high risks.
- Do not put money into investments you do not understand.
- Do not put all your eggs in the same basket; diversify your investments:.
- Keep your investments simple and for the long-term.

Bringing financial education to the community

If people can manage their finances well, it will help to minimise many other social problems. Community organisations like SINDA and the media have been playing an important role in bringing financial education to the community and encouraging prudent financial habits among the community. Individual members of the community have also contributed to making financial education more accessible to the public.

Ponnaana Ethirkaalam ("Golden Future"), written by MP Sellvem and Jaafar Ghany, is a shining example of such an initiative.

- The book explains key concepts in personal financial management in easy-to-understand Tamil.

- But more interestingly, it provides useful financial advice relating to each of the key milestones in our lives: buying a home, starting a family, funding children's education, looking after aged parents, planning for retirement.

In fact, the book starts with the premise of life as a journey that requires careful financial planning. And such planning is based on the values of patience and prudence.

அதாவது, நமது வாழக்கைப் பயணத்திற்கு நிதித் திட்டமிடுதல் அவசியம். இவ்வாறு திட்டமிடுவதற்கு, பொறுமையும் முன்மதியும் அடிப்படைப் பண்புகளாகும்.

The practical insights in *Ponnaana Ethirkaalam* are relevant not only for the Tamil or Indian community but for all Singaporeans. I understand the authors have plans to translate their book into English to reach out to more people.

I congratulate MP Sellvem and Jaafar Ghany on their achievement and wish them every success in the launch of *Ponnaana Ethirkaalam*. Thank you.