Ravi Menon: MAS' Annual Report 2015/16

Remarks by Mr Ravi Menon, Managing Director of the Monetary Authority of Singapore, at MAS' Annual Report 2015/16 Media Conference, Singapore, 25 July 2016.

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Good morning. Welcome to MAS' annual report media conference.

Economic growth

The global economy is headed for another year of lacklustre growth. Recovery in the advanced economies is hesitant and uneven. Economic activity is slowing in the emerging market economies. The IMF has just released its latest projection for global GDP growth in 2016 – at 3.1%. This is the same as last year.

MAS is closely watching these developments, especially three factors that are key to the growth outcomes this year: one, Brexit and its implications; two, the shape of the recovery in the US economy; and three, slowdown in the Chinese economy.

The UK referendum vote to exit the EU will have an impact along several dimensions: first, on financial markets and possible consequences for financial stability; two, on investment and GDP growth in the UK, with potential spill-overs to the EU and beyond; and three, on political and social developments, and what they mean for globalisation.

Brexit's impact has been most keenly felt so far in the financial markets. This is to be expected as prices need to adjust to reflect the new reality of a UK that is outside the EU. So, exchange rates, bond yields, and equity prices have all seen sharp movements as markets search for a new equilibrium. Uncertainty prevails over exactly when and how Brexit will take place; we can expect recurrent bouts of market volatility in the months ahead. Central banks across the world have said they will do what it takes to safeguard financial stability and maintain smooth functioning of their markets. We expect the global financial system to stay resilient, given ample liquidity and the generally stronger balance sheets of banks.

But the UK economy is expected to take a hit and there will be some fallout on the EU. Uncertainty, especially over the terms of the UK's exit from the EU and its future access to EU markets, will weigh on business confidence and investment spending. Growth in the EU will be weighed down by Brexit, on account of its significant trade and financial linkages with the UK. This in turn is likely to have a small dampening effect on global growth.

The political and social implications of Brexit could have more significant economic consequences over the medium to long term. But it is too early to tell what these implications might be. There are several key elections taking place in Europe next year. They will determine the ability of governments to maintain support for structural reforms as well as for the European project. Destabilisation of politics in Europe could impact global markets and global growth.

The US is expected to stay on a moderate expansion path. The consensus growth forecast for 2016 is 1.9%. The economy is more or less at full employment, consumption has rebounded, and household income growth has recovered to near pre-crisis rates.

The problem with the US recovery, at least from the perspective of Singapore and the region, is not its pace of growth but its composition. US GDP growth is not generating as much trade as previously, with persistent weaknesses in business investment, including in IT. This has implications for export growth in Asia and in Singapore. US consumption generates only around two-thirds the import demand that US investment does. So for Asia and Singapore, we need to see a recovery in US investment.

China's growth should slow but we do not expect a "hard landing". The official target of 6.5% is quite attainable on the back of fiscal stimulus and continued credit expansion. In fact, the risk is not of too low a growth rate but a growth rate that is achieved by adding to the underlying vulnerabilities in the Chinese economy: high and rising levels of corporate debt, industrial over-capacity and deteriorating asset quality in the banking system.

Changes in the composition of China's growth will continue to have an impact on Asia and Singapore. The rebalancing of demand away from investment and towards consumption has weighed on the region's exports of commodities and capital goods. But over time, there are opportunities for countries which re-orientate the structure of their exports to tap on China's burgeoning demand for consumer goods and services. With growth at nearly 10% p.a. over the past decade, China's imports of consumption goods have expanded twice as fast as intermediate goods.

Singapore's economic growth remains sluggish. Real GDP growth came in at 0.8% in the second quarter on a quarter-on-quarter, seasonally adjusted annualised basis. Growth in the first half of 2016 has averaged 2.2% in year-on-year terms.

The economy's performance in the second half of 2016 will not be too different from the first half. But there will be some month-to-month volatility in economic activity and the composition of growth will shift somewhat.

The trade-related cluster is showing tentative signs of stabilisation with improvement in certain segments.

- The electronics industry, which recorded positive sequential growth in April and May, shows tentative signs of a patchy recovery.
- The wholesale and sea transport sectors have benefitted from buoyant oil trade.

The modern services cluster, which has been a key pillar of growth in the last few years, will see its contribution fall significantly in 2016.

- Financial services, which had grown much faster than the rest of the economy in the last four years, will see growth much closer to the overall economy.
- Professional services – like architectural and engineering services– which are more exposed to the UK and EU, will experience slower growth.
- Info-communication services will see a moderation in growth but will be supported by demand for productivity-enhancing IT solutions in a restructuring economy.

The domestic services cluster will continue to see modest growth. Healthcare, education, and public infrastructure construction will be the better performing segments. The retail sector is likely to remain weak for the rest of the year, weighed down by sluggish consumer and business sentiments.

The forecast of GDP growth in 2016 is 1.0–3.0%. The Ministry of Trade and Industry and MAS are reviewing this range.

Inflation

Inflation, which has been low for long, is on a modest ascent.

Core inflation, which excludes accommodation costs and private road transport costs, is expected to rise gradually over the course of this year. Core Inflation bottomed-out in the fourth quarter last year and picked up to 0.6% in Jan-May 2016. The drag from oil-related items will continue to diminish. The disinflationary effects of some budgetary and other one-off measures will dissipate. The pace of increase in inflation will be restrained, however, by benign external price pressures, reduced tightness in the labour market, and a more muted pass-through of business costs to consumer prices.

For 2016, core inflation will likely average around 1.0% and trend towards its historical average of close to 2.0% over the course of 2017.

Likewise, headline inflation is expected to climb out of negative territory and move towards 1.0% next year. CPI-All Items inflation fell to −0.9% in the first five months of this year, as a result of declines in housing rentals and car prices. Headline inflation has been negative for quite some time, but could turn positive towards the later part of this year, barring large shocks to global oil prices or an unexpected decline in COE premiums.

Our forecast for 2016 remains unchanged for CPI-All Items inflation at −1.0 to 0%. Headline inflation is expected to converge towards its historical average over the next couple of years.

Monetary policy

The progressive easing of monetary policy since January last year has been in line with weak underlying inflationary pressures. MAS has taken measured steps to reduce the slope of the nominal effective exchange rate band over the past 18 months. This has been validated by accumulating evidence of weakening inflationary pressures.

In April 2016, MAS moved to a zero percent rate of appreciation for the Singapore dollar nominal effective exchange rate policy band.

The current stance of monetary policy remains appropriate for overall macroeconomic conditions in 2016. MAS is monitoring global developments closely. Unless there is a marked deterioration in the global economy or significant shift to the inflation outlook, there is no need to change the monetary policy stance. The current stance will help ensure price stability in the medium term.

Notwithstanding recent volatility in exchange rates, the nominal effective exchange rate of the Singapore dollar remains within the policy band. MAS' exchange rate policy framework is sufficiently flexible to accommodate such heightened volatility in international financial markets. MAS stands ready to curb excessive volatility in the trade-weighted Singapore dollar.

Macroprudential policy – car loans and property loans

While monetary policy is focused on overall price stability, macroprudential policies target specific areas to promote economic and financial stability. The two key macroprudential measures taken in recent years relate to the property market and car market. In the property market, MAS has implemented prudential limits on loan-to-value, loan tenure, and debt service ratios while the Ministry of Finance has implemented stamp duties on buyers and sellers. This collection of measures is the so-called property cooling measures. In the car market, MAS has implemented limits on loan-to-value and loan tenure.

MAS eased the limits on car financing in May this year. But it is not time yet to ease the property cooling measures. The considerations and circumstances in the two markets are quite different.

The restrictions on car financing were imposed in 2013 – at a stringent level – primarily to restrain the strong demand for cars and COEs, and consequential pressures on inflation. The objective of curbing inflationary pressures has been achieved. The contribution of private road transport (excluding petrol) to headline inflation has eased from +1.3% points in 2011–2012 to –0.5% point in the first quarter of this year 2016. MAS therefore reset the car loan restrictions in May this year at a level that would continue to promote financial prudence and support the move towards a car-lite society over the long term.

The property cooling measures, while also aimed at reining in inflationary pressures and promoting financial prudence, had the additional aim of promoting a stable and sustainable property market. The contribution of accommodation costs to inflation has come down significantly. Household balance sheets have started to strengthen, with annual growth in household debt moderating to 1.7% in the first quarter of this year, down from about 8.0% over the last five years. The property market has also been stabilising over the last two years, with prices moderating from their peak in the third quarter of 2013.

But there is still some way to go, to entrench the gains in stabilising the property market and restoring household debt sustainability. Property prices have thus far adjusted only modestly after a strong run-up that exceeded income growth. Prices have moderated by a cumulative 9.4% from their peak in the third quarter of 2013. But they had gone up by 60% between 2009 and 2013 when nominal incomes had increased by only 30% during the same period. The risk of a renewed surge in property prices is not trivial given that interest rates are likely to remain low and global investors continue to search for yield. And while the growth in household debt has eased considerably, it will take time for household balance sheets to strengthen and become more resilient to interest rate and income shocks.

MAS, MOF, and Ministry of National Development will continue to keep a close watch over developments in the property market.

Mas’ financial performance

MAS’ profit and loss position in the financial year 2015–16 (FY2015/16) showed a profit of $0.2billion. In the financial year 2014–15 (FY2014/15), MAS recorded a profit of $0.3 billion. Holding the S$ exchange rate constant to strip out currency translation effects, foreign investment gains amounted to S$5.2 billion in FY2015/16, compared to S$10.4 billion in FY2014/15. The lower foreign investment gains reflected the decline in global equity markets in FY2015/16.

The financial centre: robust and resilient

Singapore’s financial centre has grown handsomely in recent years and is today regarded as one of the top five centres in the world. MAS’ role is to work closely with the industry to ensure that Singapore’s financial centre is robust and resilient; clean and trusted; and dynamic and purposeful.

Let me speak briefly on each of these dimensions.

Our banks and the financial sector remain robust and resilient despite the challenging global economic conditions.

The banking system’s ratio of non-performing loans (NPLs) was 1.7% in the first quarter,, up from 1.3% a year ago. Exposures to regional economies and the oil and gas industries, which are experiencing slowdowns, have contributed to this rise in NPLs. This is to be expected: when economic conditions weaken, it is only natural that NPLs will rise. What is important is that the NPL ratio remains low and banks are resilient against any rise in NPLs.

The banking system in Singapore is well-placed to ride the current soft patch in economic conditions.

- First, banks in Singapore are well provisioned against potential losses. The banking system has set aside provisions to cover more than 100% of its NPLs.
- Second, the major banks in Singapore have sufficient liquid assets to meet continuous cash outflows over a 30-day period of high stress.
- Third, MAS’ annual industry-wide stress tests indicate that the banking system would remain resilient under very severe stress scenarios. Banks incorporated in Singapore have healthy capital buffers that are able to absorb the losses that are likely to occur under these severe scenarios. Banks in Singapore are also able to meet liquidity and funding needs under these extreme scenarios.

The financial centre: clean and trusted

The growth of our financial centre has been underpinned by Singapore's reputation as a clean and trusted jurisdiction.

Upholding high standards of integrity in the financial industry is an absolute priority for MAS. There can be no compromise on this.

This means having an effective regime against financial misconduct and misdemeanours, and money laundering and terrorism financing.

These threats have escalated in recent years as our financial centre grew in scale, sophistication, and connectedness with the rest of the world.

Take financial misconduct. You would recall the widespread manipulation of interest rate benchmarks by errant traders across the world's major financial centres in the aftermath of the financial crisis. And it happened here too. MAS reviewed the controls of all 19 rate-setting banks in Singapore and took firm supervisory actions against them, including requiring them to place additional reserves with MAS, which imposed a financial cost. We worked closely with the Association of Banks in Singapore (ABS) to strengthen governance and conduct in the process for setting benchmark rates.

And more recently in the limelight, the scourge of international money laundering.

Combating money laundering and illicit financing is a national effort. In 2014, a multi-agency team under the leadership of MAS, the Ministry of Finance, and the Ministry of Home Affairs, published a National Risk Assessment report on the money laundering and terrorist financing risks faced by Singapore in both the financial and non-financial sectors. The report found that, like other major international financial and business centres, Singapore faced a high inherent risk of being used as a conduit for illicit funds. The many agencies worked with their respective sectors to strengthen the framework for anti-money laundering and countering financing of terrorism – AML/CFT for short.

The financial sector is particularly vulnerable to money laundering and illicit financing risks. This vulnerability is part of our karma as an international financial centre. Billions of dollars flow every day through hundreds of financial institutions (FIs) in Singapore. And given our prominence and growth as a wealth management centre, that vulnerability is even greater.

The ongoing probe into financial transactions related to 1MDB is a stark reminder to us that the risks are real. It would not be proper for me to say anything about the ongoing investigations beyond the joint statement issued last week. It would also not be proper for me to comment on any specific institution beyond MAS' statement last week because the supervisory examinations are still ongoing and we have to be fair to the institutions. The two statements last week are unprecedented. We have already said a lot more publicly than we usually do when investigations and reviews have not been completed yet.

Instead, I want to focus today on what the findings imply for our financial sector.

There is no doubt that the recent findings have made a dent in our reputation as a clean and trusted financial centre.

MAS is disappointed with the lapses in AML/CFT controls and breaches of AML/CFT regulations that we have picked up in our FIs.

I am told that money laundering is growing more sophisticated in nature and is carefully designed to avoid detection; that these incidents happen in every financial centre and the large and rising frequency in which fines are imposed in other jurisdictions show we are not alone in facing this challenge; and that the rules and practices here are already very strict and on par with global standards.

This may all be true but they cannot be an excuse for what has taken place. What happened is simply unacceptable. We may not be any worse than other jurisdictions. But that is no consolation. We have not met the high standards we have set for ourselves.

AML/CFT is like cyber security. Those who seek to abuse our financial system are getting smarter and more sophisticated. That cannot be a reason for failing to detect and deter them. As the threat grows, so must the effectiveness of our risk management.

MAS is determined to fix the problem, working together with the industry. We need to draw lessons from the failings we have observed in the FIs and see how we can further bolster our AML/CFT regime. We will work hard with the industry to ensure that Singapore offers neither safe haven nor safe passage for tainted money from anywhere. Let me share our preliminary thoughts.

Our AML/CFT regime comprises four key prongs:

- one a robust legal and regulatory framework that sets the rules;
- two, active supervision of FIs to check for compliance with the rules and adequacy of controls;
- three, strict enforcement to punish non-compliance; and
- four, good cross-border cooperation.

First, regulation. AML/CFT rules in the financial sector are strict. It is mandatory for all FIs to perform proper due diligence to know their customers. FIs are required to assess the risks and perform enhanced due diligence where the risks are higher. FIs are also required to monitor transactions on an on-going basis so as to identify and report any suspicious activities.

Given that our AML/CFT rules are in line with international standards, it is not readily apparent that we need more new rules. The problem in all the instances we have picked up has been a failure to comply with the rules and poor judgement.

Second, supervision. MAS has stepped up AML/CFT supervision in recent years and FIs are devoting more resources to managing money laundering risks. Through onsite inspections, we assess if the AML/CFT policies and procedures set out by the FIs are adequate and adhered to on the ground. The frequency of MAS inspections has increased six-fold in recent years. In the three-year period from the second quarter of 2010 to the first quarter of 2013, MAS conducted a total of 108 onsite inspections of FIs; between 2013 and 2016, 608 inspections were conducted. MAS requires FIs to promptly address all deficiencies identified in the course of these inspections.

But we can do better. MAS will further sharpen its supervision of AML/CFT controls in the industry. We are establishing a dedicated AML Department to consolidate existing supervisory resources and take a more targeted approach to combat money laundering and illicit financing risks, as we announced earlier. We will conduct more intrusive inspections of FIs identified as facing higher risks. We will increase our engagements with the industry to share perspectives on emerging risks and typologies, as well as best practices on how to mitigate them.

Third, enforcement. In recent years, MAS has been stepping up its enforcement actions against FIs that breach our AML/CFT regulations. In the last three years, MAS has imposed financial penalties on 27 FIs for AML/CFT offences. In a couple of cases, where ineffective management oversight resulted in inadequate implementation of AML/CFT controls, we have asked the senior management to be replaced. In the last six years, MAS has revoked the licenses of 15 money changers and remittance agents for serious AML/CFT breaches.

But here too, we can do better. MAS will further strengthen its enforcement capability to conduct rigorous investigations and to take swift and dissuasive actions against errant FIs. We will take stronger regulatory actions against those FIs whose AML/CFT practices fall short of the expected standards. And we will make public our sanctions against persistently or egregiously errant FIs. Our closure of BSI Bank shows that we will not hesitate to take the most punitive actions where warranted. We are centralising all our enforcement functions across MAS in a new Enforcement Department. The new department will be responsible for not just AML/CFT offences but all other breaches of regulations and rules administered by MAS, including market conduct offences under the Securities and Futures Act. We are using data analytics to enhance market surveillance, to help us identify potential market misconduct and investigate specific offences. For example, we are exploring the use of machine learning algorithms to identify manipulative trading behaviour in the capital markets or to detect patterns across suspicious money laundering transactions.

Finally, good cross-border cooperation with our foreign counterparts. Money laundering and terrorist financing is often cross-border in nature. Hence we have established effective channels to facilitate international co-operation and exchange of information. This will continue to be an important part of our overall AML/CFT regime.

Enhancing Singapore's reputation as a clean and trusted financial centre must be a collaborative effort by all stakeholders. It is neither realistic nor desirable to expect MAS to police every single transaction or activity in our financial markets. The responsibility lies with every FI to instil high standards of risk management and proper conduct at all levels. Boards and senior management in particular must send a clear signal that profits do not come before values and ethics. There can be no room for flexibility in ethical standards.

Our financial centre must continue to be built on a bedrock of trust and integrity.

The financial centre: dynamic and purposeful

Next, building a financial centre that is dynamic and purposeful.

The financial sector grew by 5.3% last year, compared to overall GDP growth of 2.0%. In fact, since the recovery from the global financial crisis, financial sector growth has consistently outpaced that of the overall economy. But this year, financial services and overall economy growth will be closer.

Notwithstanding the slowdown in growth, the financial sector has continued to build on its strengths – strengthening infrastructure, deepening markets, and enhancing connectivity. Let me highlight some of the new initiatives we are embarking on.

In asset management, we are building depth and breadth. The asset management industry continued to grow well last year, with assets under management posting a 9% increase to reach S$2.6 trillion. Singapore will introduce a new corporate and regulatory framework to encourage fund domiciliation in Singapore and build up fund administration capabilities. MAS is working closely with the private equity/venture capital (PE/VC) industry to see how we can enhance financing for growth-stage companies, both local and from around the region. PE/VC financing has been increasing at a compound annual growth rate of 30% over the last 5 years.

In the Renminbi (RMB) market, we are expanding two-way flows between China and Singapore. Besides Suzhou and Tianjin, Singapore has established cross-border RMB initiatives with the rapidly growing city of Chongqing. Corporates in Chongqing that issue RMB bonds in Singapore can fully repatriate the proceeds raised for infrastructure and other development projects in western China. We are witnessing a healthy volume of transactions now.

In foreign exchange trading, we are working on electronification of the market. Digitisation, competition, and consolidation are rapidly transforming the global foreign exchange (FX) landscape. MAS' focus is to position Singapore as Asia's e-trading hub to build on our FX centre, which is already the largest in Asia. We are working with FIs and FX trading platforms to build relevant infrastructure such as matching and pricing engines that will anchor liquidity in our marketplace.

In infrastructure finance, the focus now is on enabling capital recycling. MAS is currently working with industry to unlock more investment flows into infrastructure via capital markets. This includes developing an infrastructure debt takeout facility to facilitate the transfer of infrastructure debt from banks to institutional investors. A group of banks and investors has agreed to conduct a "proof of concept" pilot transaction in September this year.

In the promotion of FinTech, MAS has been updating its regulatory framework to ensure that it remains conducive to innovation while providing the necessary safeguards. We have proposed a regulatory sandbox for FIs and non-financial players to experiment with FinTech solutions while limiting the consequences of product failure. We have issued guidelines to enable start-ups and SMEs to more easily access securities-based crowd-funding. We will soon be issuing new guidelines which will provide clarity for FIs leveraging on cloud services to fulfil business and operational needs.

Finally, the financial sector continues to create good jobs and build relevant skills.

Last year, the financial services sector created a net total of 4,500 jobs. There is a compositional shift towards front office and higher value-added jobs. Demand for talent is strong in sectors such as asset and wealth management, corporate banking, and insurance. Demand is also strong in compliance roles, and technology related fields like cyber security and application development. But there is consolidation in back office jobs, such as roles in lower-skilled IT infrastructure management, operations, and support.

Under the national SkillsFuture programme, MAS introduced new initiatives last year to help finance professionals deepen their expertise and acquire new cross-functional capabilities. The Financial Sector Tripartite Committee, which MAS co-chairs with NTUC, has set up the Financial Industry Career Advisory Centre (FiCAC) to offer advice to finance professionals transiting into new jobs within the industry. Since its launch in April 2016, more than ***600*** finance professionals have tapped on FiCAC services.

For Singaporeans aged 40 years and above, MAS has increased to 90% the subsidy it provides on finance-related training schemes. MAS has increased the number of Financial Sector SkillsFuture Study Awards and Finance Scholarships, to help deepen Singaporeans' skillsets in key growth areas. In 2016, about 100 such awards and scholarships were offered. They were given to individuals to pursue specialist courses in risk and compliance, data analytics, cyber security, investment management and corporate banking.

Conclusion

Let me wrap up.

Across all areas of MAS' work, a common theme has been to be alert to both challenge and opportunity. Global economic developments – ranging from Brexit to the shift in global demand and trade patterns- present both upsides and downsides. There are risks to be managed but also opportunities to be seized.

The same duality applies to MAS' approach to the financial sector. In the face of risks to the stability or reputation of the financial sector, MAS is a "no- nonsense" regulator. But MAS also works closely with the industry in a spirit of partnership to create a conducive business environment for them to operate in and grow Singapore as a dynamic and purposeful international financial centre.

This approach is quite unique to Singapore and it has served us well.