Ravi Menon: Monetary Authority of Singapore's Annual Report 2018/19

Remarks by Mr Ravi Menon, Managing Director of the Monetary Authority of Singapore, at MAS' Annual Report 2018/19 Media Conference, Singapore, 27 June 2019.

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Good morning. Welcome to MAS' Annual Report media conference.

GLOBAL ECONOMY

The outlook for the global economy has deteriorated in recent months.

- In April, the IMF revised downwards its forecast for global GDP growth to **3.3%**, from **3.7%** last October.

Last year at this time, at our annual report conference, I said that if the trade conflict between the US and China escalates into a trade war, all three engines of global growth – manufacturing, trade, and investment – will stall.

We are now in the throes of a trade (and technology) war, and all three engines have indeed stalled.

Global manufacturing is in a synchronised downturn.

- Last month, the global Purchasing Managers' Index (PMI) for manufacturing fell to **49.8**, its lowest level in more than six years.
- In the ***US***, new orders are near their weakest levels in three years.
- In the ***Eurozone***, the downturn in manufacturing is even more severe.
- In China, the manufacturing PMI is in negative territory.
- In Asia, manufacturing output is contracting in about half of the economies, including Singapore.

Global trade volumes have declined for two quarters in a row – in Q4 2018 and Q1 2019.

- This consecutive two quarters of contraction in world trade is rare.
- The last time this occurred was ten years ago.

Global investments have suffered from weakening business confidence.

- In Q1 this year, ***G3*** investment growth moderated to **3.4%** on a year-on-year basis, from **3.7%** last year.
- In the ***ASEAN-4 economies***, year-on-year growth in fixed investment spending has pulled back sharply, to **3.1%** in Q1 this year. This is half the pace seen in 2018.

There are three factors driving the current weakness in manufacturing, trade, and investment.

- **a downturn in the global electronics cycle;**
- **the lagged effects of deleveraging in China; and**
- **the trade conflict between the US and China.**

Of the three factors, the trade conflict poses the biggest risk to global growth outcomes.

- Cycles in electronics production are a common feature and structural trends in digitalisation and the Internet-of-Things should support a recovery eventually in chip production in the next few years.
- As for deleveraging in China, there has clearly been an easing of the policy stance in recent months in response to the slowing economy.

If the trade impasse between the US and China drags on and further tariff measures are imposed, growth in the second half of 2019 is likely to be weaker than earlier envisaged.

- MAS' estimates suggest that the direct impact of the tariffs that have been introduced to-date would already shave off a cumulative **0.3% points** from global GDP growth over 2019–2020.
- The indirect effects on business and consumer sentiments and financial markets are difficult to estimate. Some analysts believe these indirect effects could be even larger than the direct effects.

The impact of the trade conflict between the US and China will be felt across Asia – through three key channels:

- **disruptions in supply chains;**
- **slowdown in China; and**
- **firms holding back their capex plans.**

The tariffs imposed by the US on China are beginning to affect supply chains in Asia.

- China's exports of tariff-hit goods to the US have fallen since the first tranche of tariffs announced last June.
- This is having knock-on effects on some firms in Southeast Asia which are deeply enmeshed in production networks that are linked to China.
- These firms are adversely affected as producers switch to alternative suppliers for essential parts and components.
- While there is talk of some Southeast Asian countries gaining from the diversion of US imports from China, this appears to be the case only for Vietnam.
- The other Southeast Asian economies have not seen an increase in exports of tariff-hit goods to the US.

A slowdown in the Chinese economy is likely to have significant spill-over effects on Asia.

- Economic indicators have weakened across the board in China.
- A slower China will mean a slower Asia.

China is Southeast Asia's largest trading partner and a key source of investment and tourism.

Heightened uncertainty over trade could significantly hold back firms' capex plans.

- Various surveys of capex intentions point to a significant pullback in corporate investment this year.
- This is probably the biggest risk to Asia, given the region's exposure to the corporate investment cycle.

Beyond the tariff war, there is a new and unknown risk on the horizon – the broadening of the trade dispute to the technology front.

- With global value chains, production is distributed and technology dispersed over several countries, industries, and products.
- Moves to restrict the supply of critical technologies could potentially lead to significant disruptions in these value chains.
- Some of these technologies are deeply embedded across multiple products and there may be mutual dependencies across these products.
- We do not fully understand the dynamics of these value chains and technology dependencies.
- But it is not difficult to imagine how restrictions on the use of key technologies – like advanced semiconductors – can potentially disrupt activities ranging from data centres to communications between network devices.
- The disruptions to supply chains and economic activity could potentially be even larger than from tariffs.
- A prolonged technology conflict could lead to a bifurcation of technology infrastructures globally.

While downside risks have clearly increased, we should not over-react.

The engines of manufacturing, trade, and investment have stalled, but the global economy is not headed for a crash. Two other engines are providing support:

- easier monetary policies in the major economies; and
- resilience in services and consumption.

Monetary policy in the US has turned more accommodative against the backdrop of benign inflation.

- The Federal Reserve has shifted to a 'wait-and-see' stance and markets are expecting cuts in interest rates.
- This has significantly loosened financial conditions, and bond yields have fallen across the board.
- US GDP growth for this year, projected at **2.5%**, is still the strongest among the G3 economies.

China has eased fiscal and monetary policy significantly since late 2018.

- The Chinese government has stepped up support for infrastructure investment.
- Efforts are underway to enhance credit flows to small firms and private enterprises.
- But the effects of the stimulus will be somewhat restrained.
  - The high level of indebtedness is likely to constrain the scale of stimulus measures.
- Policy stimulus is unlikely to be able to prevent China's GDP growth falling below last year's 6.6% but may be able to avoid a slippage below 6.0%.

Private consumption remains resilient in the major economies as well as in Asia, underpinned by healthy labour markets.

- Unemployment in both the advanced economies and in Asia is at low levels, and wage growth is picking up gradually.

- With strong labour markets, household consumption is providing an important support to global growth.
- In ***ASEAN***, domestic demand has so far proven resilient to the slowdown in trade.

The services sector has continued to be resilient globally.

- The global services PMI averaged **53.1** in the first four months of this year, similar to that for the whole of last year.
- However, it fell to **51.6** in May.
- This is perhaps an early signal that a prolonged period of erosion in global manufacturing activity and investment will eventually have some knock-on effects on services.

The bottom line: consumption and services will provide some buffer to global growth but will not be entirely immune to persistent weakness in trade and corporate investment.

SINGAPORE ECONOMY

The Singapore economy is being clearly affected by the global slowdown in manufacturing, trade, and investment.

- The economy grew by **1.2%** in Q1 2019, compared to **3.1%** for full-year 2018.
- Recent indicators suggest that growth in Q2 could be lower than in Q1.
- Non-oil domestic exports have contracted by **9.3%** since the beginning of this year.
- The manufacturing sector is in a downturn.

GDP growth for the year as a whole is likely to be weaker than earlier envisaged.

- MTI and MAS are reviewing the 1.5-2.5% forecast range for this year's GDP growth.
- Growth in the first half of the year is looking to be quite weak, particularly in the trade-related sectors.
- Currently, the full-year forecast is premised on the economy stabilising in the third quarter of 2019, with a modest pickup thereafter.
- But the strength of this pick-up, given the softer external environment and ongoing trade conflict, is unlikely to offset the weakness in the first half.
- And downside risks have clearly increased.

As with the global economy, it is important to look beyond the headline growth numbers and assess the composition of growth in the domestic economy.

Last year, Singapore's GDP growth was driven by two engines – the trade-related cluster and modern services cluster – with domestic industries flat.

- The trade-related cluster – manufacturing, wholesale trade, transport and storage – grew **4.3%** and contributed **55%** to overall GDP growth.
- The modern services cluster – financial, information and communications, and professional services – also grew **4.3%** and contributed **40%** to overall GDP growth.
- Growth in the domestic industries cluster – construction, retail and F&B, health and education services – was negligible, mostly weighed down by the slump in construction.

This year, the trade-related cluster is decelerating, modern services is holding up, and the domestic industries cluster is gradually recovering.

- The trade-related cluster will continue to face the full brunt of the maturing of the global tech cycle and growing trade tensions.
- The modern services cluster will be the main driver of growth this year, supported by healthy regional demand and increased investments in digitalisation as the domestic economy undergoes transformation.
- Domestic industries will make a modest, positive contribution to overall growth, as the construction sector turns around, and retail and F&B benefits from firm labour demand conditions and efforts to lift productivity.

INFLATION AND MONETARY POLICY

Inflation in Singapore remains subdued and within expectations.

MAS Core Inflation this year is expected to come in near the mid-point of the forecast range of 1–2%.

- While there will be some domestic cost pressures from firm labour market conditions, underlying inflationary pressures should remain contained.
- First, the slower pace of GDP this year is expected to close the positive output gap. In recent years, GDP was growing faster than potential.
- Second, the fall in global oil prices in Q4 2018 and the deregulation of the electricity distribution market have exerted a dampening effect on inflation.
- Third, the two rounds of monetary policy tightening last year by MAS will continue to have a restraining effect on inflation.

CPI-All Items inflation for the year is projected to be between 0.5 and 1.5%.

- Private road transport costs could pick up slightly from 2018 with higher car prices more than offsetting lower petrol prices.
- Accommodation costs are likely to decline, but at a slower pace this year.
- Overall inflation in Singapore remains well below the historical average.

MAS' monetary policy stance remains appropriate against the backdrop of subdued inflation and weakening growth prospects.

Last year, MAS began the process of monetary policy normalisation by exiting from the zero percent appreciation path of the nominal effective exchange rate (S$NEER) policy band.

- MAS increased slightly the slope of the policy band in April 2018 and again in October 2018, against the backdrop of healthy economic growth and gradually rising inflation.
- In April this year, with inflationary pressures stabilising and the output gap beginning to narrow, MAS kept the policy stance unchanged.
- Our current stance of a modest and gradual appreciation path of the S$NEER policy band will help to keep the economy close to potential and ensure medium-term price stability.

FINANCIAL STABILITY

Globally, risks to financial stability remain elevated, amidst high levels of indebtedness.

- In the ***Eurozone***, the large exposure of banks to government securities means the risk of a sovereign-bank debt crisis remains.
- In the ***US***, corporate debt has increased by **30%** since the Global Financial Crisis, with a sizeable allocation of credit to highly-leveraged corporates.

- In ***China***, the total leverage in the system is about **300%** of GDP, with high levels of indebtedness among local governments, state-owned enterprises, and households.
- In ***Asia***, there has been a surge in the issuance of foreign currency bonds, denominated mainly in US dollars and concentrated in the real estate sector.

High leverage in itself does not suggest an impending financial crisis but, if coupled with a sudden shift in investor sentiment, can lead to financial instability.

- The potential triggers for such a sudden shift in investor sentiment are not hard to find – escalation of trade tensions, disorderly Brexit, sharp slowdown in China, or unexpected tightening of financial conditions.
- In ***Asia***, the key risk is an abrupt reversal of portfolio flows and consequent stresses on indebted corporates with large foreign currency liabilities.

Singapore's financial system, corporate and household fundamentals remain sound.

- MAS' most recent stress tests indicate that our financial system is resilient to an adverse scenario of a severe global downturn as a fallout from rising trade tensions.

That said, continued vigilance is warranted.

- Some households and corporates could face pressures on their cash flows and hence debt servicing ability if the economy slows more than expected.

PROPERTY MARKET AND MACROPRUDENTIAL POLICY

Last July, the government took macroprudential measures to cool a property market that was showing early signs of potential over-heating.

- In less than one year, between Q3 2017 and Q2 2018, private residential prices had surged by **9%**, offsetting most of the gradual decline of **12**% over the preceding four years since Q3 2013.
- There was a real possibility that property price increases would once again run ahead of economic fundamentals – as they did in the lead-up to 2013.
- If a renewed property bubble were to form, it would risk a destabilising correction later that would hurt households, businesses, and the banks.
- This risk was especially pertinent, given the strong pipeline of private housing supply coming on stream over the next few years.
- This is why, MND, MOF and MAS decided to act early and decisively to restrain the property market.

We have learnt from experience that preventing a bubble from forming is less painful than deflating one that has fully formed.

The measures implemented last year have helped to moderate the property market cycle.

- Since end-Q2 last year, private residential price increases have eased significantly and average transaction volumes have fallen by **30%**.
- Bids for land tenders, in both the en-bloc sale and Government Land Sale markets, have become sober.

The government's aim is not to depress property prices but to promote a stable and

sustainable market.

- The government does not have a target rate of increase for property prices nor can it manage the cycle too tightly.
- But the government does have a role to help ensure that price movements are broadly consistent with economic fundamentals.
- In an economy that is growing in nominal terms at 3-5%, it is not sustainable to have property prices increasing at double-digits.

The government will continue to monitor the property market closely and stands ready to help ensure a healthy and sustainable market.

MAS' FINANCIAL OPERATIONS

Let me now move on to MAS' financial operations. I will start with:

- how MAS has been accumulating Official Foreign Reserves (OFR); and
- why MAS decided to transfer part of its OFR to the Government; before touching on
- MAS' financial performance and return of profit to Government.

MAS has been steadily accumulating OFR, especially since the Global Financial Crisis.

- Most of the period since the Global Financial Crisis was characterised by extremely loose monetary policies in the advanced economies, with interest rates near zero and massive expansion of central banks' balance sheets.
- This led to a surfeit of liquidity in the global financial system and large capital flows to many emerging market economies.
- As an economy with very sound fundamentals, Singapore naturally attracted quite a large portion of these capital flows, which exerted sustained and large appreciating pressures on our exchange rate.
- To keep the S$NEER within its policy band, MAS had to intervene in the foreign exchange markets to mop up these large and persistent capital inflows.
- In the process, MAS accumulated a large stock of OFR.

MAS' foreign exchange intervention operations are essentially how we conduct monetary policy – which is solely directed at securing price stability.

- This is what we explained in our response to the US Treasury's Report last month.
- Singapore's monetary policy is centred on the exchange rate because it is the best way to secure price stability in a small, highly open economy.
- MAS manages the exchange rate as its monetary policy tool in the same way that other central banks conduct monetary policy by managing interest rates.
- Other central banks buy and sell government securities to affect liquidity and attain their interest rate targets.
- MAS buys and sells foreign currency against the Singapore Dollar to keep the S$NEER within its policy band.
- Just as other central banks' monetary policy operations cannot be construed as interest rate manipulation, MAS' foreign exchange operations cannot be described as currency manipulation.

MAS has been in active dialogue with the US Treasury to ensure that our monetary policy framework and the role of foreign exchange intervention operations are well understood.

- The criteria the US Treasury uses is part of a generic framework that it has developed to assess the policies of its major trading partners.
- While the assessment is unable to incorporate the unique characteristics of individual countries, the US Treasury has indeed acknowledged in its Report the uniqueness of Singapore's exchange-rate based monetary policy system.

Singapore's inclusion in the US Treasury Report has no direct consequences for the economy or the conduct of MAS' monetary policy.

- MAS will continue to manage the S$NEER as we assess to be appropriate, for price stability.
- We will also continue to engage in constructive dialogue with the US Treasury to explain the underlying structural factors which impinge on our current account and MAS' FX interventions.

The sustained accumulation of OFR over the years meant that MAS' stock of OFR was in excess of what was needed to conduct our exchange rate-centred monetary policy.

- MAS has assessed that OFR equivalent to at least **65%** of GDP would provide a sufficiently strong buffer against stresses in the global economy and financial markets.
- Our OFR, at the end of Q1 2019, was more than **80%** of GDP.
- We therefore decided to transfer **S$45 billion** from OFR to the Government for investment on a longer-term basis with expected higher returns.
- In return, the Government will reduce its deposits with MAS by the same amount.

This means that MAS' balance sheet will show a reduction in foreign assets of **S$45 billion** and an equivalent reduction in its domestic liabilities to the Government.

MAS made a net profit of S$19.2 billion in FY2018/19.

- The ***investment return*** from the OFR was **S$26.2 billion**.

This comprised foreign investment gains of **S$25.2 billion**, and a small positive currency translation effect of **S$1.0 billion.**

- After factoring in expenses of **S$3.1 billion** from domestic and other operations, MAS made an ***operating profit*** of **S$23.1 billion**.

From that, MAS recorded a ***net profit*** of **S$19.2 billion**, after contributing **S$3.9 billion** to the Government's Consolidated Fund.

The investment return of S$26.2 billion in FY2018/19 is relatively high and reflects mainly the effects of an increasingly larger OFR base.

- First, the income from investing a larger stock of assets would be higher.
- Second, realised gains would also be higher, as a larger OFR base means a higher turnover of securities for rebalancing and other portfolio transactions.

We do not expect investment returns to be sustained at these high levels as the OFR

base will now be smaller after the transfer of S$45 billion to the Government.

- Income from a smaller portfolio will be less, and portfolio transactions are also likely be fewer.

MAS returned to Government the full net profit of S$19.2 billion and another S$16.0 billion from its general reserve fund, making a total of S$35.2 billion.

- MAS decided to return this amount to Government as a smaller OFR base would mean that we need less capital and general reserves as buffer.
- This does not mean that the Government is getting **S$45 billion** and another **S$35.2 billion**.
- The return to Government increased its deposits with MAS by **S$35.2 billion**.
- As explained earlier, the transfer of **S$45 billion** of OFR to the Government will reduce its deposits with MAS by **S$45 billion**.

FINANCIAL SECTOR

Let me conclude with a quick update on the financial sector.

- MAS' various regulatory and developmental initiatives are detailed in the annual report, so I will provide just a high level overview of the sector's performance.

In 2018, the financial services sector did very well, growing at 6.1%.[1]

- This brings the three-year average growth rate of financial services to **4.1%**, which is within striking distance of the Industry Transformation Map (ITM) target of **4.3%** per annum over 2016–20.

In 2019, financial services is expected to grow slower but should continue to outpace the overall economy.

- Prospects for financial ***intermediation*** are mixed, with credit demand weighed down by a slowing Chinese economy, though loans to Southeast Asia are showing a bit more resilience.
- The picture for ***insurance*** is more promising, on the back of growing demand for insurance products catering to high net worth and mass affluent customers in the Asia-Pacific.
- Growth in ***asset management*** will be lacklustre, weighed down by falling market valuations and fee compression.
- The ***payments services*** space should continue to thrive in line with continued expansion of e-commerce activities, both locally and in the region.
- FinTech-related activities should also continue to grow handsomely, boosted by ongoing digital transformation across the financial sector.

Even more heartening than the growth numbers are the jobs numbers for financial services.

- There was a net increase of about **6,900** jobs in financial services and FinTech in 2018, driven mainly by the banking and insurance industries.[2]
- Over the last three years (2016–18), we saw an average of **4,900** financial services and FinTech jobs created on a net basis per year.
- This is above our ITM target of **4,000** net jobs growth in financial services and FinTech.

- Hiring in the financial sector remains healthy so far this year and job growth is on track to meet the ITM target of **4,000**.

Sustaining this rate of job growth will not be easy in the face of technological change unless efforts are continually stepped up to upskill the workforce.

- As digitalisation and automation become more pervasive in the financial industry, jobs will be transformed. Some will inevitably be displaced.

MAS, the financial industry, and our tripartite partners are taking this very seriously and undertaking a variety of measures to help prepare the financial sector workforce for a digital future.

- Last year, more than **20,000** individuals – or about one out of eight workers in the industry – went through MAS/IBF-supported upskilling programmes.
- Nineteen financial institutions have stepped forward and committed to re-skill close to **4,000** finance professionals and redeploy them in new or expanded roles over the next two years.
- Some **1,700** of them have already started this journey, and **800** have successfully transited into new roles.

CONCLUSION

Let me wrap up.

The global economy has weakened and this is already affecting Singapore.

- Downside risks have grown, and some of these risks may have prolonged effects.

We need to be alert but there is no need to be alarmed.

- There are pockets of resilience that should provide a degree of support to the global economy.

The Singapore economy is in for a rougher ride but is well placed.

- Our economic fundamentals are robust and policy buffers are healthy.
- Asia's growth, digital transformation, and the resilience in modern innovative services play to Singapore's strengths.
- While external headwinds will slow Singapore's pace of growth in the short term, domestic economic restructuring is proceeding well and will enable the economy to emerge stronger.

The financial sector is a good example.

- Growth will be slower than last year given the sector's exposure to the external environment.
- But the relentless effort by financial institutions to promote innovation, harness technology, transform jobs, and upskill the workforce, will position the sector well for the future.
- MAS will continue to closely partner the industry to make Singapore the leading global financial centre in Asia, supporting the region's growth and creating good jobs for Singaporeans.

Let me stop here and we will be happy to take your questions.

[1] This refers to growth in the finance and insurance industry, excluding holding companies. The unadjusted growth rate for the sector, published by DOS, was 5.8%.

[2] The net job creation figure of 6,900 includes FinTech jobs in the overall economy, but excludes jobs in holding companies. The employment increase of 7,600 for the financial and insurance sector in 2018, published by MOM, includes holding companies.