The Rise of Asian Banking

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Dr John Williams, President and CEO, Federal Reserve Bank of San Francisco,
Distinguished guests, colleagues, ladies and gentlemen, good morning.

Welcome to Singapore once again for this year's Symposium on Asian Banking and Finance, jointly organised by the Federal Reserve Bank of San Francisco and the Monetary Authority of Singapore.

Let me say what a delight it has been for us at the MAS working with John and his colleagues at the San Francisco Fed, putting together this event.

- 2017 marks the tenth anniversary of the Symposium. It is also the third year that MAS is partnering the San Francisco Fed to host the event.
- This Symposium has been providing a high-quality platform for policy-makers, industry captains, and academics to exchange views on global finance.
- It stands out from other conferences for its focus on bringing Asian voices to the discussions.

We at the MAS have a soft spot for this event, as it represents a milestone in our long-standing relationship with the San Francisco Fed – a relationship that dates back to the time current Fed Chair Janet Yellen was at the helm, before she handed over to John.

- One person at the San Franciso Fed that we had a close working relationship with was Teresa Curran, who passed away last year.
- We will miss her, her professionalism, and her passion for the Asia-Pacific region.

Since this is a symposium on Asian banking and finance, let me share some quick thoughts on the subject:

- how Asian banks have stepped up in recent years to play a greater role in the region;
- how they are dealing with the challenges posed by today's environment; and
- how they are positioning themselves for a digital future.

Asian banks have stepped up

Asian banks emerged from the global financial crisis with stronger fundamentals relative to their global peers.

- The crisis revealed glaring weaknesses in many global banks. This led to the implementation of wide-ranging regulatory reforms.
- These weaknesses were less pronounced in Asian banks, which had already built up significant buffers following the Asian Financial Crisis.
- Asian banks' strong deposit funding placed them in a strong position to meet the new, higher global standards.

Helped by stronger fundamentals, Asian banks have stepped up in regional markets where global banks have retreated.

First, they have increased their lending to the region significantly.

- In 2007, Asian banks accounted for just a third of all international claims[1] to the region. Today, they account for more than 60% of non-local lending to the region.[2]
- This increase comes on the back of a decline in lending by Euro-area banks – over the same period, their share decreased from around a third to less than 15% as they pulled back from the region.

Second, Asian banks have been acquiring the Asian business lines from global banks, especially in wealth management.

- In 2013, Sumitomo Mitsui Banking Corporation bought over SocGen's Japanese private banking arm.
- And just late last year, OCBC Bank acquired Barclays' wealth and investment management business in Singapore and Hong Kong.

Even as Asian banks push for growth, they continue to maintain high prudential standards.

- The average Tier 1 capital ratio of Asian banks was 13.4% as of last year, up from 10.6% in 2008 and comfortably above the Basel minimum requirement of 6%.
- Key Asian jurisdictions who are members of the Financial Stability Board – including China, Japan, Indonesia, Korea, Hong Kong and Singapore – have been assessed to be compliant or largely compliant with the Basel Committee's capital and liquidity standards.
- Several other Asian countries – Malaysia, Philippines and Thailand – have also implemented the Basel III rules.

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[1] BIS' definition of international claims comprises cross-border claims and local claims of foreign banks' affiliates in foreign currency.

[2] Based on a presentation by E Remolona (2017), "Bank flows in EMEAP: Neither a lender nor a borrower be". See also E Remolona and I Shim (2015), "The rise of regional banking in Asian and the Pacific", BIS Quarterly Review, September 2015.

Asian banks are dealing with cyclical headwinds

The major Asian banks' sound prudential standards position them well to face the challenges in the current environment – ranging from geopolitical risks to heightened policy uncertainty in the advanced economies.

The post-crisis operating environment has been difficult for banks around the world.

- European bank profitability remains depressed seven years after the global financial crisis, with return on equity or RoE averaging below 3%.
- Asian banks have also not been spared, though they have done better.
    - The RoE of Asian banks has been declining in recent years, and is currently hovering around 8%.

A recent study by MAS[3] found that three cyclical factors have driven the decline in Asian bank profitability.

- First, weaker global economic growth has affected credit demand in the region, leading to slower loan growth.
- Second, prolonged accommodative monetary policy in the advanced economies has compressed domestic interest rate spreads in Asia. This has reduced banks' interest income.
- Third, asset quality has declined, as non-performing loans (NPLs) have risen in many regional economies.

But an increase in NPLs must be viewed in perspective.

- Banks are in the business of intermediating risk. When risks materialise – as they sometimes do when those who borrow get into difficulties – NPLs must rise.
- This may be odd for a regulator to say – but if NPLs did not rise at all during difficult times, then the banks are probably not lending enough or taking on sufficient risk to promote business expansion or enterprise.
- What is important is:
    - Is the rise in NPLs manageable and contained?
    - Are problem loans being monitored closely and classified prudently?
    - Are provisions made proactively and conservatively?

Take for example Singapore. NPLs have risen amidst a weakening economic environment and emerging asset quality risks in the oil and gas (O&G) sector, which has been weighed down by low oil prices.

- But our banks' exposure to the O&G sector is contained.
    - The banking system's aggregate exposure to the O&G sector is around 10%.
    - For local banks, this figure is lower at 6-7%.
- Banks in Singapore have also made adequate provisions for their overall NPLs.

[3] MAS (2016), "What Drives Bank Profitability in Asia?", Financial Stability Review, November 2016.

- The overall provisioning cover for the banking system, as a percentage of total unsecured NPLs, is above 100%
- The local banks' provisioning cover is even higher, at above 200%.

The good news for Asian banks is that these cyclical headwinds should pass in time.

- Growth is recovering, monetary policy is normalising, and commodity prices are stabilising.

Asian banks are positioning for Asian growth and a digital future

And that takes us to the medium to long term. The prospects for Asian banks are good – chiefly because the prospects for Asian economies are good.

- The region is expected to continue registering relatively high growth rates in the medium term – about 6% on average over the next 5 years, compared to the global average of 3.7%.
- Higher Asian incomes will drive demand for financial services, leading to more opportunities in banking.

At the same time, financial inclusion remains low in many parts of Asia.

- A 2015 World Bank study found that of the 2 billion adults on the planet with no bank accounts, more than half were in East and South Asia.[4]
- A more recent study by the ADB covering Cambodia, Indonesia, Myanmar and the Philippines found significant gaps between demand and supply in several financial services, including payments, savings, and credit.[5]
  - Interestingly, the authors estimated that using digital finance to enhance financial inclusion would boost GDP by between 9-14% in large economies such as Indonesia and the Philippines, and up to as much as 32% in Cambodia.

Global banks will continue to play an important role in the region, especially in wholesale banking and the intermediation of US Dollar flows. But the onus largely falls on Asian banks to expand financial inclusion, especially at the retail and small business level. Using innovative FinTech solutions, they can mobilise untapped savings and provide access to credit for under-banked individuals and businesses.

Asia is fertile ground for digital innovation in banking.

- In Indonesia and Vietnam, only around a third of the population is formally banked.
- Yet, their mobile phone penetration rates are above 100% – that's more than one phone per person on average!
- Coupled with a young and tech-savvy population, what we have is a ripe environment for mobile banking.

[4] World Bank (2015), "The Global Findex Database 2014: Measuring Financial Inclusion around the World".
[5] Asian Development Bank (2017), "Accelerating Financial Inclusion in South-East Asia with Digital Finance".

And we are seeing interesting innovations across Asia, bringing banking services to the broader population.

In Indonesia, the Financial Services Authority (OJK) runs a branchless banking programme with participant banks.

- Called Laku Pandai, or "smart man", the programme offers banking and financial services to the under-banked, supported by mobile phones and IT facilities.

DBS Bank is collaborating with peer-to-peer (p2p) lending platforms to cross-refer clients.

- DBS will refer to the p2p lenders some of the smaller businesses that it is unable to lend to.
- In return, the p2p lenders will refer borrowers who have completed two successful rounds of fund raising to DBS for larger commercial loans and other financial solutions such as cash management.

The road to financial inclusion is neither short nor easy. But it is an important one.

- Broadening access to financial services will offer Asian banks – and FinTechs – the opportunity to grow their business while serving a social purpose.
- Financial inclusion will be a key priority in the economic co-operation agenda when Singapore assumes the chairmanship of ASEAN next year.

Conclusion

You will be discussing many of these issues in the days ahead. I look forward to hearing your insights.

It leaves me now to hand over to John Williams for his keynote address. He will speak on US monetary policy – a subject of evergreen interest to the financial industry and central banks around the world.

I look out for John's speeches not so much for clues to what the Fed might do next – though that is of course of great interest too – but for the original insights John provides on some of the deep, conceptual issues in monetary policy.

- John has made thought-provoking contributions in areas such as the natural rate of interest, or r*, and nominal GDP or price level targeting for monetary policy.

It is my pleasure now to invite John to share with us his insights on how we should view monetary policy in a changing world.