MAS Annual Report 2017/18

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Remarks at MAS Annual Report 2017/18 Media Conference
4 July 2018

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

GLOBAL ECONOMY

Let me begin with three broad statements about the global economy.

- One, the current expansion in the global economy is likely to be sustained this year.
- Two, the global growth cycle has matured and is probably past its peak.
- Three, tail risks to growth have grown significantly over the last six months.

The current expansion in the global economy is likely to be sustained through this year.

- Last year, global GDP growth was at its strongest since 2011, at 3.8%. This momentum has carried into this year and is expected to persist.
- The strength of the global economy is anchored on three mutually reinforcing upturns – in manufacturing, in trade, and in investment.
- Global manufacturing is still expanding.
  - Industrial production rose by 3.4% in 2017 and leading indicators like new orders for capital goods remain healthy.
- World trade has kept pace with GDP growth.
  - Emerging Asia in particular is experiencing healthy expansion in trade, on the back of stronger demand in the G3 economies.
- Investment growth has picked up.
  - Business capital expenditure in the G3 and Asia increased by 3.6% in 2017.
  - Capex spending in the US is expected to be sustained, on the back of corporate tax cuts, deregulation, and positive business sentiment.

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The global economy is also being supported by accommodative macroeconomic policies.

- Monetary policy remains highly accommodative in the Eurozone and Japan.
- Fiscal stimulus in the US will more than offset the gradual unwinding of monetary accommodation.
- Across the major economies, labour markets are strengthening and wages are rising, underpinning consumer demand.

The global growth cycle has matured and is probably past its peak.

- While growth remains healthy, it has ceased to accelerate, particularly in the Eurozone and Japan.
    - In the Eurozone, the initial spurt in domestic spending last year has stepped down to a more sustainable pace.
    - In Japan, the fiscal boost is over.
- The US economy, albeit still growing strongly, is already at full employment.
    - At least part of the fiscal stimulus is likely to be dissipated through higher inflation.
- In China, investment growth has slowed, with the shift in policy focus to addressing the country's vulnerabilities, such as high levels of indebtedness and excess capacity.
- From a sectoral perspective, the global tech cycle has moved into a consolidation stage, with inventory build-up fading.
    - The Global Manufacturing PMI has eased in recent months to 53.1 in May, although it remains in the expansionary zone.

Tail risks to global growth have grown significantly over the last six months.

- Earlier this year, I described the "Goldilocks" state of the global economy—healthy growth, low inflation, and easy financial conditions.
- I had then also warned that the "three bears"—inflation, protectionism, and financial instability—could make an appearance any time to spoil the party.[1]
- Six months later, we can say that at least two of the three bears have been sighted—inflation and protectionism.

First, the risk of more rapid inflation has heightened.

- Inflation is on an upward path globally, and in the US has reached the Fed's 2% target amidst a tightening labour market.
- Accordingly, last month, the Fed indicated a faster pace of monetary policy normalisation.
- The expectation now is for two more rate hikes this year.
- But if inflation surprises on the upside, the Fed could be compelled to hike more.
- This would tighten global financial conditions by more than currently anticipated.

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Tighter global financial conditions could trigger market volatility and dampen corporate spending.

- As interest rates rise, some firms could face debt-servicing problems, especially in emerging market economies with relatively high levels of leverage.
- And besides the risk of faster rate hikes, two things are happening that threaten to tighten global financial conditions even more:
    - first, the unwinding of the Fed's balance sheet which withdraws US$ liquidity from global markets; and

[1] "The Goldilocks Economy – Will the Three Bears Return?", Speech by Mr Ravi Menon, Managing Director, Monetary Authority of Singapore, at UBS Wealth Insights Conference, 15 January 2018.

- second, the increased issuance of US Treasury bills to fund fiscal expansion, which accentuates tightness in US$ funding.

- We are already seeing some capital outflows from emerging market economies, alongside some tightness in US$ liquidity and funding markets.
- This is to be expected. But if the withdrawal of US$ liquidity becomes more acute, some emerging market economies could face serious bouts of financial volatility.

But Asian economies are in a relatively stronger position to absorb these financial shocks.

- Economic fundamentals in Emerging Asian economies are stronger since the taper tantrum in 2013.
- Foreign reserves and bank capital buffers are larger while financial regulatory frameworks are more robust.
- And policymakers in Asia are more prepared to make macro-policy adjustments as needed, including pre-emptive interest rate hikes to support exchange rate stability.

The second risk to the global economy is rising protectionism.

- Protectionism is rearing its ugly head on three trade fronts: US-China; US-EU; and US-Mexico-Canada.
- Thus far, the US has imposed tariffs on solar panels, washing machines, steel and aluminum imports from all major trading partners. It has announced tariffs of 25% on US$50 billion of imports from China, and has threatened tariffs of 10% on another US$200 billion of imports from China.
- Both China and Europe have announced retaliatory tariffs.

The immediate effect of these trade restrictions is limited and does not threaten global growth … yet.

- The announced tariffs are estimated to shave around 0.1% point off China's growth, with the US economy similarly impacted by China's retaliatory measures.

The real risks from the tariffs are spillover effects, escalation, and economic uncertainty—all of which could severely undermine global growth.

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- First, spillover effects.
  - The impact of the tariffs will be felt not only in the countries involved but across the value chains that span several countries.
- Second, escalation.
  - If tariffs are applied to a much broader range of goods, trade flows would be severely impaired and the impact on growth would be greater.
- Third, uncertainty.
  - The threat of further escalation is beginning to dampen business confidence and unsettle financial markets.
  - If businesses around the world take a wait-and-see approach, the global recovery in investment could be curtailed.

The world has clearly moved from trade tension to trade conflict.

- If this escalates into a trade war, all three engines of global growth—manufacturing, trade, and investment—will stall.

Bottomline: the global economy is still in good shape but the momentum has started to flag and tail risks have grown.

- So while global growth should be good this year, it may not be quite as good as last year.

SINGAPORE ECONOMY

Against this global backdrop, the Singapore economy is expected to remain on a steady expansion path in 2018.

- Overall GDP growth is expected to come in at around 2.5–3.5% in 2018.

The trade-related cluster—manufacturing, wholesale trade, transport and storage, making up about 45% of GDP—will continue to benefit from external demand and the global tech cycle.

- There is a structural upshift in the end-demand for semiconductors globally.
- Chips are now being used across a wide range of applications beyond computers - including in smartphones, automotives, and "Internet of Things" (IoT) devices.

The modern services cluster—financial, ICT, and professional services, making up 30% of GDP—will continue to benefit from firm regional demand and ongoing digital transformation among corporates.

- Regional demand for financial intermediation, and wealth and asset management will support growth in financial services.
- Growing adoption of ICT and automated customer platforms by corporates are expected to boost demand for various ICT and business services, including cloud storage, data security, and IT consultancy.

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The domestic-oriented cluster—construction, retail and food, health and education services, making up 25% of GDP—has lagged somewhat but is expected to catch up in the quarters ahead.

- In 2017 and Q1 2018, this cluster contracted, as the drag from construction offset the modest growth in health, education and other essential services. The retail and food segments were largely flat.
- But part of the weakness should dissipate.
    - Contracts awarded for public infrastructure projects and the pace of private residential en-bloc activities indicate a recovery in construction works in the quarters ahead.
    - And firm labour market conditions and healthy consumer demand should support a recovery in retail & food services.

While the central prognosis for the Singapore economy this year remains intact, spillovers from global trade conflicts bear close watching.

- These spillovers arise from Singapore's role as a node in the regional electronics production value-chain, as well as a hub for air and sea transport and financial intermediation services.
- These are important intermediate inputs to the main trade flows between the US and its trading partners.
  - Bilateral trade between the US and China indirectly contributes to about 1.1% of Singapore's GDP.
  - Flows between the US and EU contribute about 0.5% to Singapore's GDP.
  - NAFTA trade contributes 0.6%.

INFLATION AND MONETARY POLICY

Inflation in Singapore has been within expectations—on a modest uptrend but still below historical norms.

MAS Core Inflation this year is expected to average in the upper half of the 1–2% forecast range.

- Core inflation averaged 1.5% in the first five months of 2018, up slightly from 1.4% in Q4 last year, mainly due to higher retail inflation.
- It is projected to rise gradually over the course of 2018, with the gradual absorption of remaining slack in the labour market and the attendant pickup in domestic demand.

CPI-All Items inflation is similarly projected to be in the upper half of the 0–1% forecast range for 2018 as a whole.

- Accommodation costs are forecast to decline less sharply than last year, while private road transport inflation is expected to fall.
- MAS' inflation forecasts are robust to alternative outcomes for key external prices, including the upsides to global oil prices.
  - MAS has revised its global (Brent) oil price assumption to an average of US$72 per barrel for the year as a whole, up from US$66 previously.

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MAS undertook a measured tightening of monetary policy in April this year after keeping to a neutral stance for two years.

- The slope of the S$ nominal effective exchange rate policy band was increased slightly, consistent with a modest and gradual appreciation path.
- The gradual normalisation of monetary policy was appropriate in the context of the continued mild ascent of core inflation since H2 2016.
- Core inflation is now around 1.5% at mid-year and we expect it to rise further, approaching 2% by year-end as the labour market continues to tighten.

Monetary policy is predicated on baseline projections of growth and inflation. It does not aim to pre-empt tail risk scenarios.

- While we are closely monitoring the global risk factors mentioned earlier, our baseline forecast is for continued economic expansion and gradually rising inflation.
- The threat of a disruptive trade war has risen, but remains a tail risk for now.
- Our approach therefore has been to begin monetary policy normalisation but to do so in an incremental fashion in view of still-benign inflation and growing trade-related tail risks.
- In the short term, the policy band provides sufficient room for the S$ nominal effective exchange rate to accommodate modest shocks to the Singapore economy.
- Future adjustments to monetary policy will depend on how the economy evolves and our updated assessments of inflation and growth prospects.

PROPERTY MARKET AND MACROPRUDENTIAL POLICY

The Singapore property market has seen a resurgence in prices and transactions over the past year.

- Prices of private housing have increased 9.1% since the trough in Q2 2017. This has mostly offset the cumulative price decline of 11.6% during the four-year period between mid-2013 and mid-2017.
- The number of property transactions over the last 12 months was around 25% higher than during the previous 12 months.
- New housing loans over the last twelve months have risen by 34% year-on-year.

The recovery in the property market is welcome but it should not decouple from economic fundamentals.

- If property prices rise too rapidly, they will outpace the growth in income.
  - Households will have to take on more leverage than they are able to manage; this risk will be compounded as interest rates rise over time.
- A rapid increase in prices also raises the risk of a destabilising market correction later when additional supply comes on-stream.
- MAS, the Ministry of National Development, and the Ministry of Finance, are closely monitoring developments in the residential property market, and remain committed to ensuring a sustainable market.

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FINANCIAL INDUSTRY TRANSFORMATION MAP: A MID-TERM REPORT CARD

I will now move on to the financial services sector.

The Financial Services Industry Transformation Map (ITM) sets out strategies co-created by MAS and the industry to make Singapore a leading global financial centre in Asia.

- We have set ambitious targets over the 5-year period from 2016 to 2020:
  - value-added growth in financial services of 4.3% p.a. and
  - creating 3,000 net jobs in financial services and 1,000 net jobs in FinTech p.a..

- We are now exactly at the half-way mark of the ITM; let me give a report card on how the industry has fared so far.

Financial services—defined as the finance and insurance industry excluding holding companies, slightly different from the DOS definition—grew an average of 3.3% per year during 2016 and 2017.

- This is below the 5-year target of 4.3% per annum.
- Financial services growth was very weak in 2016, at just 1.8%, reflecting slower regional growth and trade.
- Growth rebounded strongly to 4.9% last year, driven by the strong performance of the fund management segment and steady growth in financial intermediation.
- The growth momentum has been sustained in the first half of this year and we are looking at another good year for financial services.
- We remain confident of meeting the 5-year average growth target of 4.3%.

We saw a net increase of 7,800 jobs in financial services and FinTech over 2016 and 2017, close to our ITM target of 8,000 jobs.

- Job growth was mainly driven by the insurance and fund management industries, and to a lesser extent by the banking industry.
- IT has emerged as a key functional area driving hiring demand across financial services—some of the fastest growing job roles are in software development, cyber security, data analytics, artificial intelligence, and business process engineering.
- FinTech alone is estimated to have contributed close to 2,000 of the net jobs created during these two years.
- MAS expects job growth in financial services this year to exceed the ITM target.

Let me now take stock of progress in each of the three pillars of the ITM:

- business strategies
- jobs and skills; and
- innovation and technology.

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BUSINESS STRATEGIES

I will start with our business strategies.

Singapore continued to do well in asset management, with assets under management (AUM) increasing by an average 12.7% p.a. over 2016 and 2017.

- Growth was robust across both traditional and alternative assets on the back of higher valuations and continued inflows to Asian markets.
- We continued to anchor the operations of global asset managers in Singapore. *Example:* AIA set up its first group-wide regional investment hub here.

Efforts to grow the private financing market are also showing signs of promise.

- Alternative AUM grew by an average 16.9% p.a. over 2016 and 2017, led by venture capital and private equity.
- There are currently about 220 VC and PE managers located in Singapore with the majority of PE managers focused on growth and buyout strategies.
- Around 85% of their investments are across Singapore and the region, targeting higher growth sectors such as consumer and retail, healthcare and IT.

We are also doing well in wealth management, with private banking AUM expanding an average of 6.6% p.a. over 2016 and 2017.

- A growing number of Asia's wealthiest families have set up Family Offices in Singapore to access investment opportunities in Asia.
- Singapore's growth as a wealth management hub rests on its reputation as a clean and trusted jurisdiction.
- Singapore's activation of a broad network of Automatic Exchange of Information, or AEOI, relationships, reaffirmed its commitment to international standards of transparency and tax cooperation.

Singapore is emerging as a leading Asian bond market, with corporate debt issuance volumes rising by 22% p.a. over the last two years.

- MAS' Asian Bond Grant scheme has supported Asian companies to raise international capital in Singapore.
- Much of the increase in debt issuances here was by Asian issuers—mostly from China, Indonesia and India—raising debt capital in Singapore for the first time.
- Green bonds are also gaining traction, with local and foreign issuers issuing over S$2 billion of green bonds here.

The life insurance industry is doing well, with net premiums growing by 16% p.a. over 2016 and 2017.

- Growth was boosted by Asian consumers demanding more savings and investment products in search of yield.

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Non-life insurance business is, however, facing structural challenges and weak growth.

- Net non-life premiums grew by just 2% p.a. over 2016 and 17.
- Business conditions have been challenging globally, due to excess capacity and downward pressure on premiums.
- But Singapore remains attractive as the premier reinsurance hub in Asia.
    - Global reinsurance players such as Swiss Re and Munich Re have recently set up their regional headquarters here.
- And we are making a push into alternative risk solutions such as risk pools and insurance-linked securities or ILS.

Foreign exchange trading declined last year although we remain the third largest FX centre globally.

- Singapore's average daily FX trading volume grew by 20.5% in 2016 but declined by 6.7% in 2017.
- This was mainly due to lower volatility in key currencies such as the Japanese Yen; and some temporary trading desk turnover which has since been filled.
- We are making headway in our strategy to position Singapore as an e-trading hub for FX, facilitating better price discovery during Asian hours and better execution for players in the region.
  - XTX Markets, a global FX liquidity provider, has announced its plans to set up its pricing and trading engine in Singapore.
  - We are working with other key banks and e-trading platforms in the pipeline.

JOBS AND SKILLS

Let me move on to the second pillar of the ITM—jobs and skills.

More finance professionals are going for training and development.

- Some 27,000 financial industry professionals have benefited from SkillsFuture programmes during 2016-2017.

There remains, however, a shortfall of specialised talent in IT—which we are addressing in two ways:

- MAS, IMDA, the Institute of Banking and Finance and institutes of higher learning are working together to deepen the local IT talent pool at the entry level.
- IBF is engaging financial institutions on developing local IT talent through company-led training and professional conversion programmes (PCPs).

We have ramped up efforts to reskill and redeploy banking professionals into emerging roles.

- Job roles are changing as banks pivot towards digital banking models over time.
  - We must ensure that our banking professionals can take on these new roles.
- More than 3,000 consumer banking employees will be reskilled through a PCP over the next two years, acquiring relevant skills in sales, product development, and digital engagement.
- PCPs are also in the works for two more areas in banking –
  - wealth management (which is rapidly growing) and
  - operations and support (which is undergoing disruptive change).

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IBF will launch a dedicated career centre next month, to offer integrated support across career planning, skills development, and job placement.

- While the financial industry continues to create jobs on a net basis, there is a lot of churn and movement in the industry.
- Skills development, career pathways, and job placements need to be looked at holistically.

- IBF will leverage on its strong network with financial institutions to help professionals navigate and make their career transitions.
- IBF will also work closely with partner agencies – e2i, NTUC and WSG – to support financial sector professionals looking to move into other sectors.

INNOVATION AND TECHNOLOGY

The third pillar of the ITM is innovation and technology.

- Singapore has global mindshare today as one of the leading Fintech hubs in the world.
- Our FinTech agenda is well known and there will be other occasions to talk about the various initiatives.
- Today, I want to emphasise the central role played by regulation in promoting innovation and technology.

To get innovation right, we must get regulation right.

- This is a creative tension – managing risk while facilitating innovation. It calls for a pragmatic and flexible approach; there is no one-size-fits-all approach.
- Sometimes, it means not rushing to regulate so that we do not front-run innovation
  - e.g. in the case of block chains or distributed ledgers where the technology is still evolving.
- Sometimes, it means updating regulation to take account of new technologies and new risks
  - e.g. in the case of cloud computing and robo-advisers, where we issued special guidelines.
- Sometimes, it means being specific about the risks we want to address and taking a targeted approach to regulation
  - e.g. in the case of crypto assets where we focus on the crypto intermediaries for anti-money laundering purposes rather than the crypto assets.
- Sometimes, it means taking an activity-based approach to regulation, setting rules for specific activities rather than the entity as a whole
  - e.g. in the case of the proposed Payment Services Bill, where licensees will be regulated according to the activities they conduct because different activities pose different risks.

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The trick is to identify the risks we are most concerned with and finding the most targeted way of regulating those risks so that the business has maximum latitude to innovate and grow.

Now, there is one more approach in MAS' tool kit and that is the "regulatory sandbox".

- The regulatory sandbox facilitates live experimentation of innovative financial services and business models within pre-defined boundaries.
- MAS is probably the second jurisdiction in the world to introduce the regulatory sandbox and it is one of the most comprehensive ones around.

- It has attracted much attention here and abroad and I thought I will end off with a quick progress report on what has been happening in the sandbox.

The sandbox basically provides a conduit for both regulated and unregulated firms to engage MAS with innovative ideas and proposals.

- Since its launch in June 2016, MAS has provided guidance to more than 140 firms and individuals.

We have received more than 40 sandbox applications, covering a broad range of financial services and technologies.

- The services offered include investment management, broking, crowd funding, cross-border funds transfer, insurance, and financial advisory.
- We see interesting applications of big data, distributed ledgers, machine learning and artificial intelligence, to increase efficiency or derive new insights.

Of the 40 over applications we received:

- **Nearly half withdrew their applications for various reasons**, exemplifying the fluidity of innovation and the natural volatility in the business of start-ups.
- **About a third proceeded without the need to be tested in the sandbox.**
  - o We take this as a positive reflection of our existing regulations, which provide sufficient flexibility for innovative models while safeguarding against risks.
  - o It is not necessary that innovation needs to happen only in a sandbox.
- **The remainder of the applications—about one in five—were approved or are under review**. To cite a few experiments in the sandbox:
  - o Kristal Advisors, is experimenting with machine learning to determine and recommend suitable investment portfolios for its customers.
  - o Thin Margin, a start-up that offers online money-changing at competitive exchange rates, is creating a hassle-free experience for its customers.
  - o LumenLab, is experimenting with distributed ledgers on gestational diabetes insurance, which can trigger claims payout automatically to the insured upon meeting certain conditions.

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This has been a learning journey for MAS too and we have been trying to improve how we manage the regulatory sandbox.

- We have streamlined our internal processes and made the sandbox application form more straightforward, reducing the processing time for sandbox applications.
- We are now exploring the idea of "pre-defined sandboxes" where firms can start their experiments more quickly without going through the rigorous review with the current case-by-case approach.

CONCLUSION

Let me wrap up.

The global economy has had a good run so far and signs are that the rest of the year will be reasonably good.

- But as you know from following the World Cup, things do not always turn out as expected.
- The risks that could derail economic growth have heightened somewhat and bear close watching.

The financial sector has been doing well.

- Not only growing in importance as a global financial centre, but also serving Asia's economic development, and facilitating Singapore's transition to an innovative and digital economy while creating good jobs for Singaporeans.

And Singapore has been able to do this, not only because of the strong partnership between the industry and MAS, but also the stability and trust that underpin the financial system.

Maintaining financial stability and trust are central to MAS' mission.

- The annual report summarises our many regulatory and supervisory initiatives – to make derivatives markets safer, to enhance cyber security, to promote a good risk culture in our financial institutions.
- The annual report also devotes two pages of infographics to the enforcement actions MAS has taken against those who breach our regulations or fail to meet our standards.
- MAS does not tolerate:
  - abuse of our financial system for money laundering or tax evasion;
  - misconduct or manipulation in our securities markets; or
  - mis-selling to consumers who place their trust and money in our financial institutions and their representatives.

But being a no-nonsense regulator does not stand in the way of being also business-friendly.

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- For financial institutions who want to grow their business in Singapore, build up the skills of their employees, or want to innovate or experiment with new technologies, MAS is a happy partner and collaborator.