Singapore ready, London resilient

Post-Brexit London will retain key strengths

by Ravi Menon in Singapore

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While uncertainties over the terms of Britain's withdrawal from the European Union will pose challenges to financial institutions, post-Brexit London will retain many of its strengths. The City will still benefit from the free movement of capital, sound and predictable regulation, strong rule of law, and international connectivity. In the East, Singapore offers the same benefits to the financial industry as a global Asia hub. [Full text of Menon interview]

Many institutions maintain a presence in both London and Singapore to serve cross-border flows in the European and Asian markets respectively. The latter has particular strengths in offshore banking, reinsurance, asset management, foreign exchange, and fintech. But the scale is different: London is much bigger. I do not expect its position to weaken significantly. And, to the extent that there is any shift of financial activities out of London, it is unlikely Singapore will be the main beneficiary.

Growth in the euro area will continue to be supported in the near term by accommodative monetary policy. But fading support from low energy prices and European Central Bank stimulus, uncertainty surrounding Brexit, and weak external demand will weigh in the opposite direction. Likewise, the outcome of elections in key EU members states, including France, Germany and the Netherlands, could heighten political uncertainty and dampen business sentiment.

In the US, it is expected that the Federal Reserve will continue to raise interest rates in 2017. This — as well as the normalisation of rates in Europe and Japan — would be in line with stronger economic growth and waning deflation risks. Faster growth in advanced economies will provide a lift to others, including those in Asia. A rise in interest rates will restore room for manoeuvrability, stem the accumulation of debt, and reduce financial stability risks relating to inflated asset prices.

But interest rate normalisation is not without its challenges. It will weigh on the debt servicing capacities of corporates and households in Asia, which have taken on more leverage amid the accommodative interest rate environment. Faster than expected rate rises could result in currency volatility amidst high capital outflows. For overextended borrowers, stress points could emerge as a result of an increase in interest servicing costs and a rise in the foreign currency risks of unhedged debt. These could have implications on the asset quality of banks with Asia exposures. That said, the region is on a stronger footing to cope with these risks.

Asia has been proactive in implementing macroprudential measures to limit the build-up of financial imbalances. The Monetary Authority of Singapore's top-down reverse stress tests show that the Asian corporate sector would require shocks far greater than those seen in the 1997 Asian financial crisis or 2008 global crisis to come under significant stress. Our tests also show that banks in Singapore can withstand a stress scenario of steep regional currency depreciation and sharp increases in interest rates.

Anxiety over China's near-term growth prospects — in particular the risk of a 'hard landing' — ebbed significantly over the course of 2016, with good reason. The Chinese authorities have carefully managed the country's growth while trying to address the structural vulnerabilities in the economy. Capacity in the over-supplied heavy industrial sectors is being gradually cut back while lending to unviable enterprises is being curbed. Private investment has started to recover alongside growing profits, and producer prices appear to have stopped declining.

However, debt levels in China remain substantial. Recent measures, such as dampening property market exuberance and reducing corporate leverage, have been steps in the right direction but must be more pronounced this year. The structural reform process appears to have slowed somewhat. But there has been some progress on the fiscal and financial fronts, including implementation of value added tax. Plans have been announced to allow more foreign investment in banking, insurance and securities firms, as well as in telecommunications and education. It is important that China presses on with structural reforms which will provide the basis to lift productivity and put the country on a sustainable medium-term growth trajectory.

Ravi Menon is Managing Director of the Monetary Authority of Singapore. This is an abridged version of an OMFIF interview with Menon, which will be published in the February edition of The Bulletin, OMFIF's monthly publication.