Centre of connectivity

Ravi Menon, Monetary Authority of Singapore

Following the launch of OMFIF's Singapore office in November, we asked Ravi Menon, managing director of the Monetary Authority of Singapore, about the state's role in Asia Pacific and the impact of international developments such as China's slowdown.

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OMFIF: In London last year you said the Chinese slowdown was manageable and called on the Chinese government to accept greater market orientation, including in readiness to liquidate companies in cases of overcapacity. Nine months on, are you more or less optimistic about the Chinese outlook and the authorities' ability to handle the debt overhang?

Menon: Anxiety over China's near-term growth prospects — in particular a 'hard landing' — ebbed significantly over the course of 2016, with good reason. The 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.

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.

OMFIF: The renminbi entered the International Monetary Fund's special drawing right on 1 October. As China continues to internationalise its currency and liberalise its capital markets, what opportunities do these present to investors globally? And what role do you envisage Singapore playing in this?

Menon: China's capital markets are too large to be ignored by global investors. Its bond market is roughly the same size as the rest of the emerging markets bond universe combined, but international investors hold less than 2% of it. The recent liberalisation of China's interbank bond markets is welcome news for global investors looking for diversification and yield. Singapore is one of the largest offshore renminbi centres. The range of renminbi investment and hedging products in Singapore to serve the needs of investors with exposure to China continues to broaden. Cross-border renminbi flows between Singapore and China will continue to grow, notwithstanding the pause witnessed in 2016 as Beijing sought to limit capital outflows. The growth in other offshore renminbi centres will support the increased use of the currency in different regions.

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OMFIF: What is your view of prospects for the euro area? Brexit represents a major shock for the European economy. Do you think withdrawal will harm London's status as a world financial centre? Can Singapore gain rewards?

Menon: Euro area growth 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. The outcome of elections in France, Germany and the Netherlands could heighten political uncertainty and potentially dampen business sentiment.

While uncertainties over the terms of British withdrawal will pose challenges to the financial industry, post-Brexit London will retain many of its strengths as a financial centre – breadth of markets, depth of financial expertise, and connectivity with other centres. 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.

Many global institutions maintain a presence in both Singapore and London to serve cross-border flows in the Asian and European markets respectively. Singapore's value proposition as a financial centre is its connectivity as a global Asia hub. It serves as a gateway between Asia and the rest of the world. Like London, Singapore benefits from political stability, free movement of capital, sound and predictable regulation, strong rule of law, and global connectivity. Singapore is strong in offshore banking, reinsurance, asset and wealth management, foreign exchange and derivatives trading, and fintech. But the scale is different: London is much bigger.

OMFIF: Singapore is a leader in fintech. A milestone was the inaugural Singapore FinTech Festival in November, which attracted 13,000 participants. How do you see future developments? What are the challenges to the industry and regulators?

Menon: Fintech is transforming the financial industry. We are seeing promising developments in areas such as digital payments and distributed ledgers. The biggest potential may be in advanced data analytics and machine learning. Financial institutions are beginning to aggregate and analyse large data sets to gain richer insights into customer behaviour and needs, detect fraud or anomalies in financial transactions, and improve surveillance of market trends and emerging risks.

We want to create a 'smart' financial centre in Singapore, where innovation is pervasive and technology is used widely. But a smart centre must also be a safe centre, which includes regulation that is conducive to innovation while fostering safety and security.

Introducing regulation prematurely might stifle innovation and derail the adoption of useful technology. So it is important that regulators keep pace with what is going on, assess risks, and evaluate whether it is necessary to regulate or leave things to evolve further. Regulation should come in only when the risk posed by new technology becomes material or crosses a threshold, and the weight of regulation must be proportionate to the risk posed.

We encourage experimentation with innovative fintech solutions. As with all experiments, there will be risks. We hope to strike a balance with our 'regulatory sandbox' for financial institutions to test solutions. This provides an environment where if an experiment fails, it fails safely and cheaply within controlled boundaries.

Strengthening cybersecurity is an important part of Singapore's fintech agenda. As digitalisation spreads and more financial services are delivered over the internet, there will be growing security and privacy concerns over cyber attacks. Users will have confidence in new technologies and innovative services only to the extent they have confidence in cybersecurity. MAS works closely with the industry to improve the resilience of the financial sector continuously. Technology risk management is an increasingly important dimension of our supervisory regime.

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OMFIF: Talent shortage is a perennial issue globally. How does Singapore deal with this?

Menon: Talent is indeed one of the critical issues we are addressing. Nationwide, we have a movement – SkillsFuture – to provide Singaporeans with opportunities for lifelong learning. The government provides subsidies to Singaporeans to help with course fees, as well as to corporates to encourage them to send their employees for training.

For the financial sector, MAS works closely with training providers, institutes of higher learning, and industry associations to identify skills gaps, shape the curriculum, and achieve better alignment with the industry's needs for job-ready graduates. Skills development will always be work in progress. The availability of talent is a continuous challenge, and we will need to work at ensuring that our financial sector workforce remains relevant and competitive.

OMFIF: In the next four years, we're likely to see a fiscally expansionary and economically stronger US. But it would be a US that is more inward-looking. What are the opportunities and challenges?

Menon: It is too early to comment on the economic and financial market impact of policies under the new US administration. It is critically important that the US does not reverse its long-standing commitment to international trade and investment. Global trade and growth ultimately benefit from an economically stronger and open US. A more inward-looking US will introduce great uncertainty to the global outlook, and impede investments, trade, and consumption. The outcome would almost certainly be one that is poorer for all.

OMFIF: Monetary policy worldwide has reached an inflection point. Rates in the US will continue to rise in 2017, and easing policies appear to have reached the limit in both Europe and Japan. The next move in both regions may be upwards. What impact will these changes have on Singapore and Association of Southeast Asian Nations economies more generally?

Menon: We have consistently taken the line that the gradual normalisation of monetary policy is a good thing and should be welcomed. Normalisation of rates in the US — as well as in Europe and Japan later — 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 interest rate rises could result in a surge in currency volatility amidst strong capital outflows. For over-extended 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, Asia is on a stronger footing to cope with these risks. The region has been proactive in implementing macroprudential measures to limit the build-up of financial imbalances. MAS' 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. We do not wish for these things to happen, but we must be prepared if they do. ■