

Monetary Authority of Singapore

Financial Stability Review 2020

1 Dec 2020

Macroprudential Surveillance Department
Economic Policy Group

Key Messages



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FSR 2020:
Key Messages

- **The COVID-19 pandemic has raised risks to global financial stability.**
  - Corporate leverage has continued to climb from already elevated levels, increasing credit risk.
  - Higher sovereign debt levels amid COVID-19-related fiscal stimulus have raised debt sustainability concerns.
  - Market sentiment remains fragile, and emerging market economies could be susceptible to a resurgence of capital outflows.

- **Global and domestic financial conditions remain supportive.**

- **Singapore corporates, households and the financial sector continue to be generally resilient.**

- **Given the uncertain economic outlook, continued vigilance and prudence is warranted.**
  - Uneven trajectory of economic recovery will impinge on jobs and corporate profits.
  - Within the corporate sector, smaller firms and those in sectors more impacted by COVID-19 remain vulnerable.
  - Banks face challenge of prolonged low interest rate environment and asset quality deterioration; they should maintain strong underwriting standards and healthy capital buffers.
  - While the non-bank sector has thus far withstood volatility, stresses from further adverse global market conditions bear monitoring.

Global Financial and Economic Environment



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The COVID-19 pandemic has severely impacted global growth and raised risks to global financial stability

High Corporate Indebtedness



- While accommodative financial conditions have made credit more readily available and forestalled even greater economic damage, it has also fuelled further corporate indebtedness.
- Accumulation of corporate debt could increase credit risks, discourage bank lending, and tighten financial conditions.

Rising Sovereign Debt



- COVID-19-related fiscal stimulus has widened fiscal deficits.
- Sovereign debt levels have also risen and could continue to do so should further fiscal support be deemed necessary, raising public debt sustainability concerns.

Capital Flow Volatility in Emerging Markets



- Capital flows to EMEs remain volatile, suggesting that market sentiment remains fragile. EMEs could be susceptible to a resurgence of capital outflows.
- This could exert further downward pressure on currencies and tighten financial conditions, further reducing the debt servicing ability of corporates and sovereigns.

Domestic: Corporates, Households, and Property



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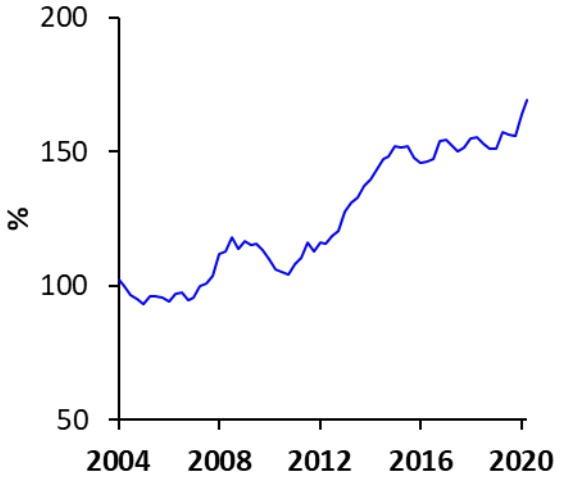
Corporate balance sheets are relatively resilient, though leverage risk is elevated

Corporate sector FVI (y-o-y changes)	Q2 2019	Q2 2020
Overall corporate FVI	→	→
Leverage risk	→	→

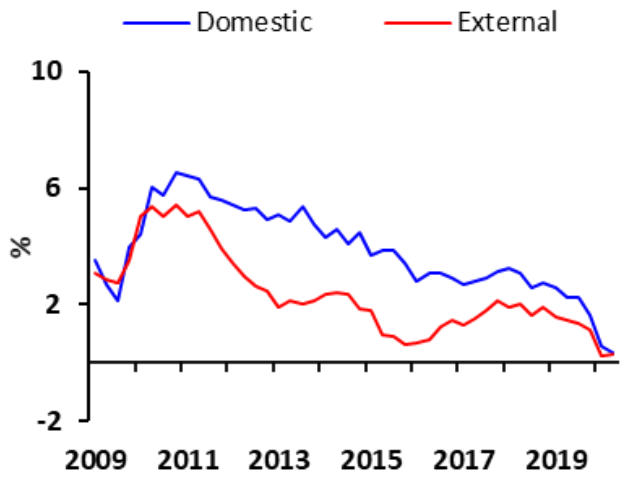
Y-o-y Changes in FVI

Decreased significantly | Broadly Unchanged | Increased significantly

Singapore's Corporate Debt as % of GDP



Median ROA of SGX-listed Firms

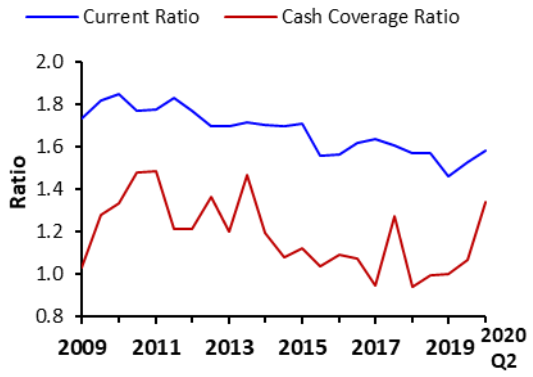


- The sector's overall FVI was broadly unchanged y-o-y, and most Singapore firms should be able to withstand short-term pressures on their financial positions.
- Leverage risk has increased with higher corporate debt, and remains within the same elevated band as in Q2 2019.
- Despite deterioration in profitability, debt servicing ability of SGX-listed entities remains manageable with median interest coverage ratio (ICR) above 1.

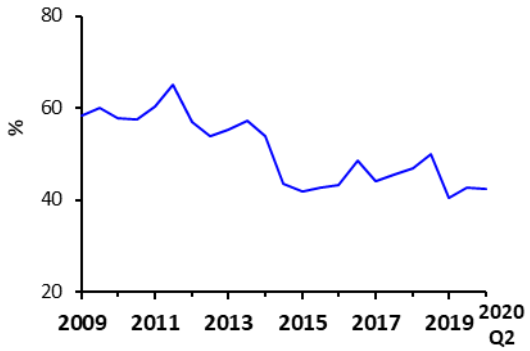
Efforts to increase cash holdings have been accompanied by worsening maturity risk, while foreign currency risk remained stable

Corporate sector FVI (y-o-y changes)	Q2 2019	Q2 2020
Overall corporate FVI	→	→
Liquidity risk	→	↘
Maturity risk	↘	↗
Foreign currency risk	→	→

Median Liquidity Ratios of SGX-listed Firms

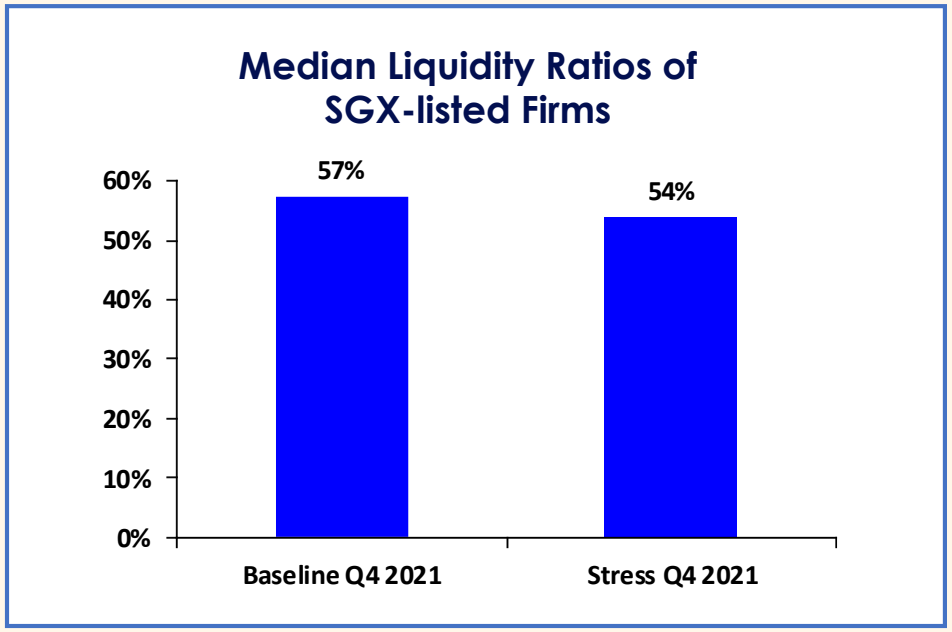


Median Short-term Debt to Total Debt Ratios of SGX-listed Firms



- As a response to the severe earnings shock from COVID-19, businesses have bolstered cash buffers, resulting in healthier liquidity indicators in 2020.
  - Singapore's corporate bond market remained accessible, with issuances in 2020 exceeding those in 2019.
- However, firms' efforts to ease cashflows have also increased short-term debt and maturity risks.
- Foreign currency risk has remained stable.

Singapore's corporate sector has sufficient cash buffers but pockets of risks remain

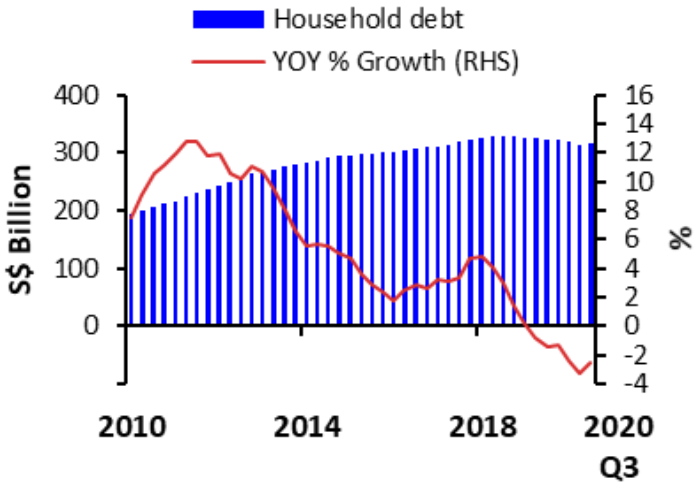


- MAS' simulations suggest most SGX-listed firms would have sufficient cash buffers to repay short-term debt without refinancing, with the majority of firms having cash cover ratios above 1.5 as of end 2021 even in an stress scenario.
- While the economy is expected to pick up next year, its uneven trajectory will impinge on corporate profits.
- Pockets of risks remain for smaller firms which tend to be financially weaker, and those in the domestically-oriented and travel-related services impacted by COVID-19.

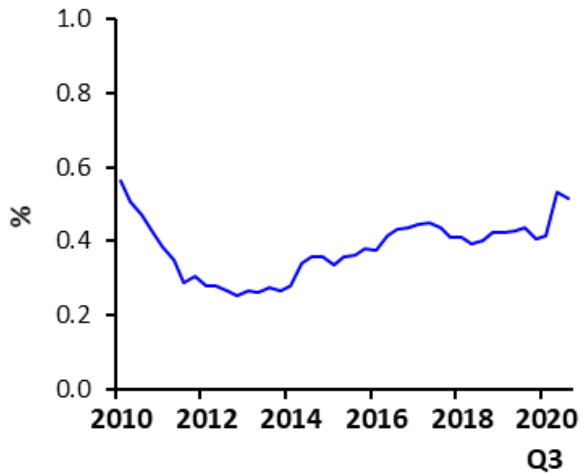
Household debt servicing burdens are manageable, although leverage risk has edged up

Household sector FVI (y-o-y changes)	Q3 2019	Q3 2020
Overall household FVI	↘	↗
Leverage risk	↘	↗
Maturity risk	→	↘

Household Debt in Singapore

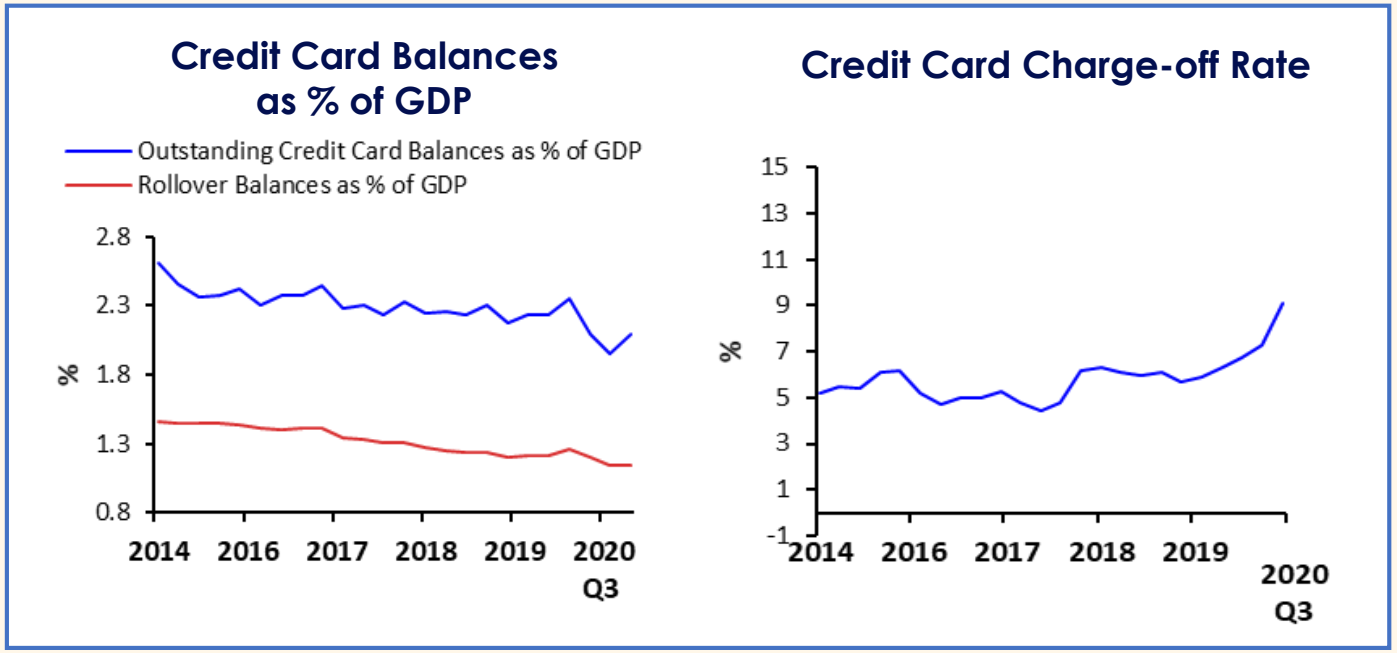


Housing NPL Ratio



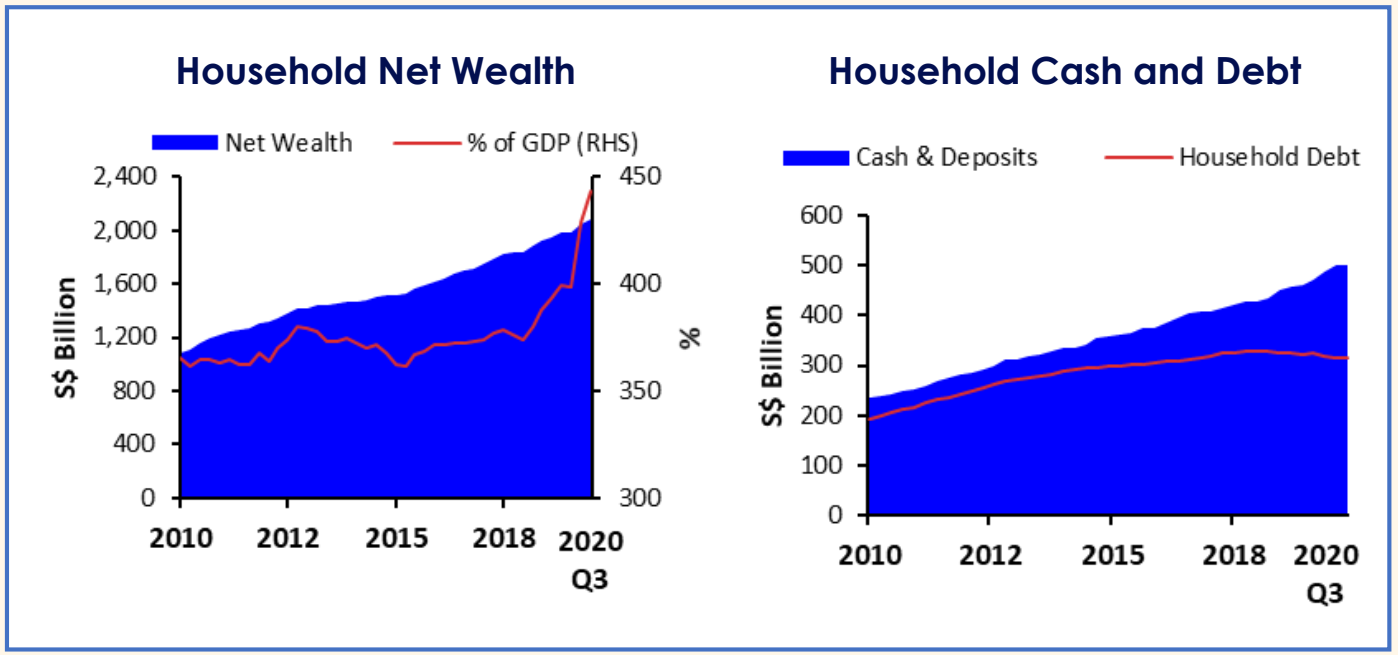
- Overall household sector FVI increased in Q3 2020 on a y-o-y basis. alongside leverage risk, as sharply-lower GDP resulted in a temporary rise in the household debt-to-GDP ratio, even though overall household debt fell.
- Household debt servicing burden remain manageable under stress
- Housing NPL ratios have increased slightly though remain below 1%

Household maturity risks decreased, alongside reduced outstanding unsecured debt



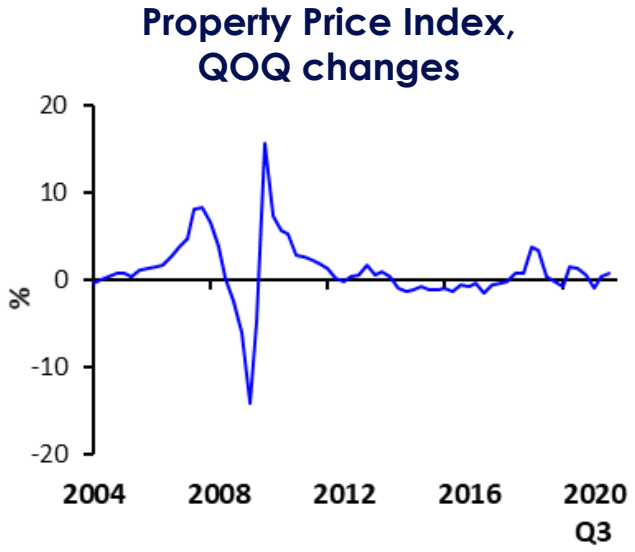
- Tighter unsecured credit rules in preceding years have mitigated risks during the COVID period, encouraging households to better manage their shorter-term liabilities.
- Outstanding credit card balances and rollover balances (as a percentage of GDP) has moderated further with reduced reliance on revolving unsecured debt.
- However, the credit card charge-off rate rose, suggesting a slight worsening of credit quality among vulnerable households.

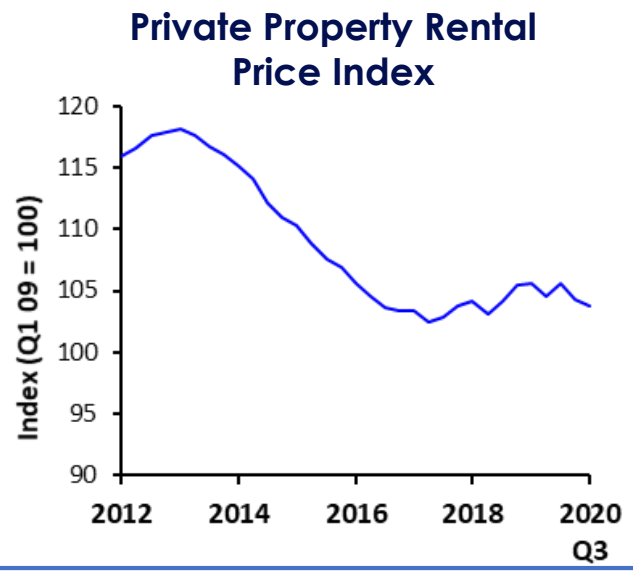
Overall, household balance sheets are relatively healthy, but households should remain prudent and enhance resilience against unexpected shocks

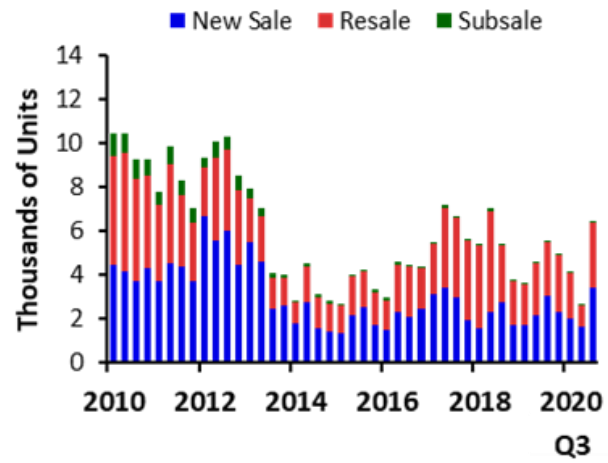


- Overall, healthy balance sheets reflect financial buffers built up in preceding years.
- Household net wealth has remained stable, with asset values holding up and liquid assets such as cash and deposits continuing to exceed total liabilities.
- Some households will continue to face challenges into 2021. Whenever possible, they should continue consolidating existing obligations, and enhance resilience against unexpected shocks.

Private residential property market has been stable in 2020 as prices and transaction activity recovered after initial declines







- Prices increased 0.1% cumulatively over the first three quarters, recovering from the initial decline in Q1.
- Transaction activity fell in Q2 due to the implementation of Circuit Breaker measures, but recovered following the reopening of sales galleries and home viewings, driven by resident purchases (Singaporeans and PRs).
- Given the uncertain economic outlook and weakness in rentals, potential buyers should proceed cautiously and factor in possible volatility in future income streams when considering large purchases and loans.

Singapore Financial Sector

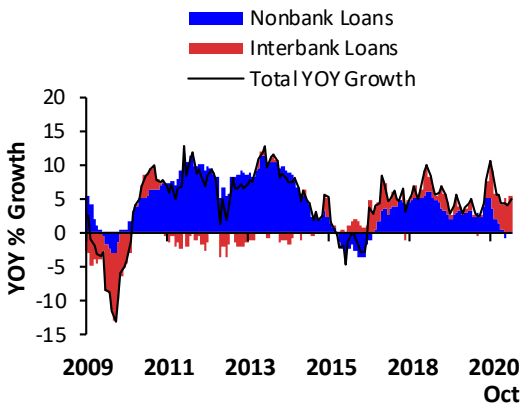


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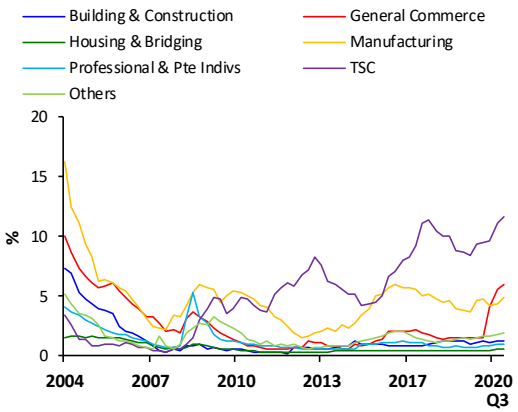
Banks' FVIs are stable, and leverage vulnerabilities are expected to ease as credit provisioning is increased

Banking sector FVI (y-o-y changes)	Q3 2019	Q3 2020
Overall banking FVI	→	→
Resident leverage risk	→	→
Non-resident leverage risk	→	→

Overall Loan Growth



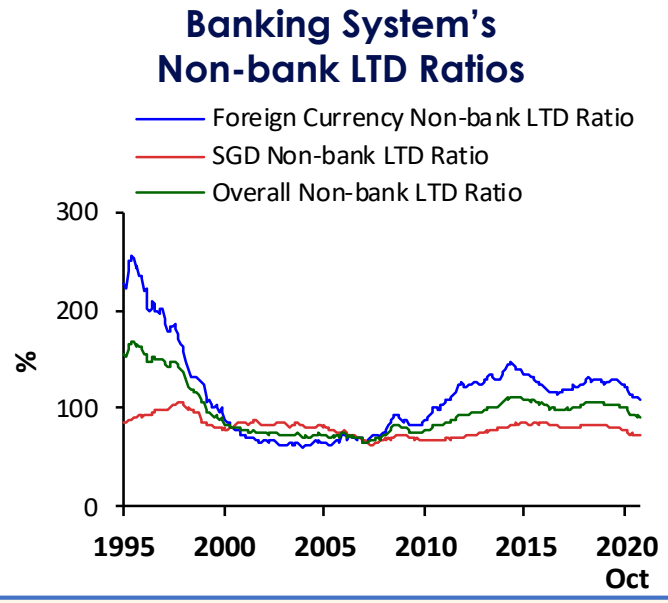
Banking System's NPLs by Sector



- Banks have continued to facilitate credit supply amid weakening economic conditions.
- Overall credit growth has remained firm, bolstered by a strong expansion in interbank loans.
- Asset quality has deteriorated but overall NPL ratio remains low. The high general commerce NPL ratio reflects firms adversely impacted by the COVID-19 pandemic.
- Banks have healthy capital buffers and pre-emptively increased their provisions, which have facilitated banks' role during the crisis in accommodating short-term credit demand.

Banks' overall liquidity positions continue to be strong

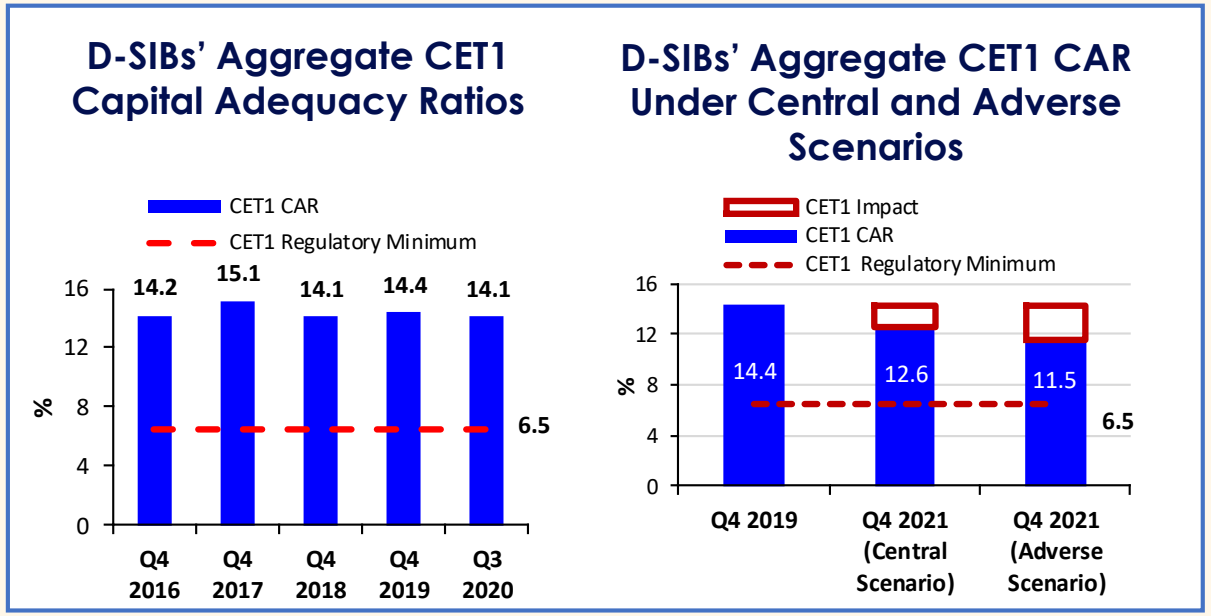
Banking sector FVI (y-o-y changes)	Q3 2019	Q3 2020
Overall banking FVI	→	→
Liquidity risk	→	→
Maturity risk	→	→



- Domestic systemically important banks (D-SIBs) continue to maintain healthy buffers over the minimum regulatory liquidity coverage ratio requirements.

- High deposit growth contributed to strong liquidity positions of banks. Foreign currency loan-to-deposit ratio improved to 108.1% in October 2020.

Singapore's banking system is well-placed to weather downside risks. Nonetheless, banks should maintain strong underwriting standards and manage their foreign currency risk



- Singapore's banking system is healthy, having built up sizeable capital buffers over the past decade and is well-placed to weather further downside risks.
  - MAS conducted a desktop stress test incorporating COVID-19 impacts for D-SIBs, simulating an adverse scenario of continued disruptions to economic activity in 2021 due to delays in vaccine development and deployment alongside a global resurgence in virus outbreaks. The results showed that all D-SIBs remained solvent, with their aggregate common equity 1 (CET1) capital ratios well above MAS' minimum regulatory requirements.

- Nonetheless, banks are likely to face challenging operating conditions in the near term.
  - Banks should continue to ensure strong underwriting standards and healthy capital buffers.
  - Banks should actively monitor and manage their foreign currency risk prudently.

Non-bank sector has thus far weathered market volatility but stresses from further adverse global market conditions bear monitoring

- **Funds in Singapore have weathered volatility in markets well.**
  - Fund managers took proactive steps to mitigate liquidity risk, including re-sizing their exposures, increasing cash holdings and reducing leverage.
  - Despite market volatility, fund managers were able to meet all redemptions in an orderly manner, without having to gate or suspend the funds.

- **Insurers remained resilient in the midst of an uncertain global outlook.**
  - Wider credit spreads have accentuated asset liability mismatches for insurers and lowered valuations on their corporate bond portfolios.
  - Stress tests conducted on selected life and composite insurers on the impact of low to negative interest rates showed that insurers were able to mitigate the impact of a “low for long” interest rate environment by taking a series of management actions to strengthen solvency positions.
  - Insurers should closely monitor their solvency positions and adopt a prudent and forward-looking view on capital management.

Special Features



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Special Feature 1: Implications of USD Dominance on Capital Flows and Financial Stability in EMEs

Background

- USD is the dominant currency in global trade and lending.
- This study highlights how fluctuations in broad USD exchange rates affect capital flows to EMEs and financial stability, providing insights to regional policymakers, based on data on 31 EMEs from 1996 to 2018.

Key findings

- Broad USD appreciation is associated with significant reversal of capital flows, particularly for:
  - Asian EMEs, compared to other EMEs;
  - Debt-creating flows intermediated by banks, compared to non-debt creating flows such as equity; and
  - High growth EMEs, EMEs with a high degree of financial openness, EMEs with large domestic credit spreads, and EMEs with large foreign exchange reserves.
- Broad USD appreciation is also associated with higher risks of banking and currency crises in EMEs.
- Pre-emptive macro- and micro-prudential measures that limit currency mismatches in EMEs are important, particularly for EMEs more exposed to fluctuations in capital flows.

Special Feature 2: Transitioning to a New Interest Rate Benchmark Landscape in Singapore

- **LIBOR is expected to be discontinued after end-2021. Financial markets globally have been ramping up efforts to transit away from LIBOR towards the use of near risk-free rates (RFRs).**
  - LIBOR is referenced in about USD 400 trillion of financial products globally.
  - Of this, an estimated 40–60% of assets and derivatives exposures will only mature after end-2021.

- **Singapore is moving to a SORA-centred SGD interest rate landscape.**
  - Singapore Interbank Offered Rate (SIBOR) and SGD Swap Offer Rate (SOR) are current key interest rate benchmarks in SGD financial markets.
  - As SOR uses USD LIBOR in its computation, the financial industry recommended a transition from SOR to the Singapore Overnight Rate Average (SORA).
  - The financial industry also issued a joint industry consultation recommending the discontinuation of SIBOR (in 3 to 4 years time) to focus on a SORA-centred approach, which is expected to enhance the overall functionality and efficiency of SGD interest rate markets.

- **Completing the transition from SOR to SORA before end-2021 is important to mitigate risks to financial stability**
  - Any delay in transition would inhibit the development of a sufficiently liquid market needed for price discovery which in turn impacts pricing efficiencies in the market.

Special Feature 2: Transitioning to a New Interest Rate Benchmark Landscape in Singapore

- **MAS established the industry-led Steering Committee for SOR Transition to SORA (SC-STS) to provide strategic direction on developing new SORA-based products and markets and to coordinate with relevant stakeholders.**

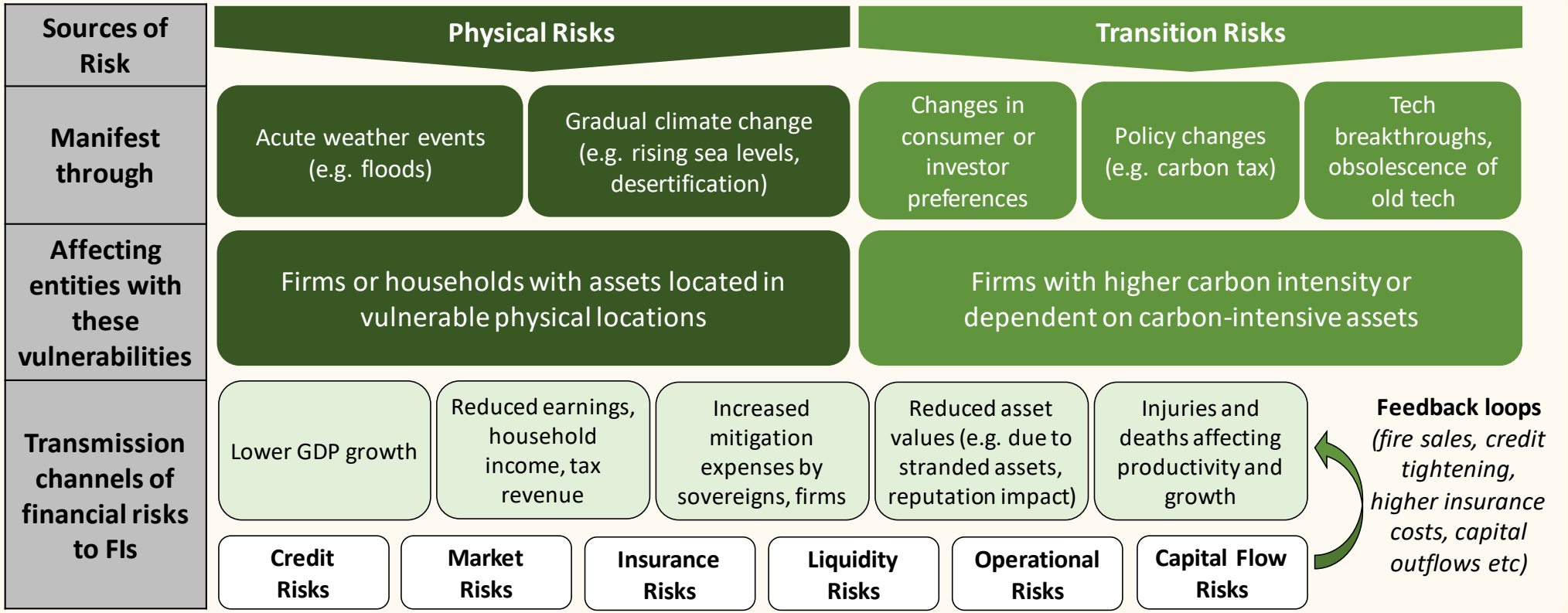
- **SC-STS and MAS has made good progress to: (a) establish market conventions & infrastructure; (b) build liquidity in SORA markets: and (c) facilitate legacy transition.**

- **As we approach the SOR endgame, FIs and end-customers will need to make necessary preparations**
  - FIs would need to enhance their systems and processes, to adapt to the use of overnight rates like SORA
  - FIs and customers will need to shift new business in loans and derivatives to SORA, and cease new SOR-linked originations, in line with the SC-STS recommended timelines .
  - Actively convert legacy SOR contracts to reference SORA and ensure widespread adoption of contractual fallbacks.
  - FIs would also need to engage customers in a clear, timely and transparent manner, when converting legacy SOR contracts to reference SORA.

- **The financial industry, together with MAS, has made good progress in its comprehensive and well-structured transition approach. However, further work remains in 2021.**
  - Industry timelines set out by the SC-STS is envisaged to steadily reduce exposures to SOR well before the end of next year, while ensuring that SORA-based products are available to meet the financing needs of customers.

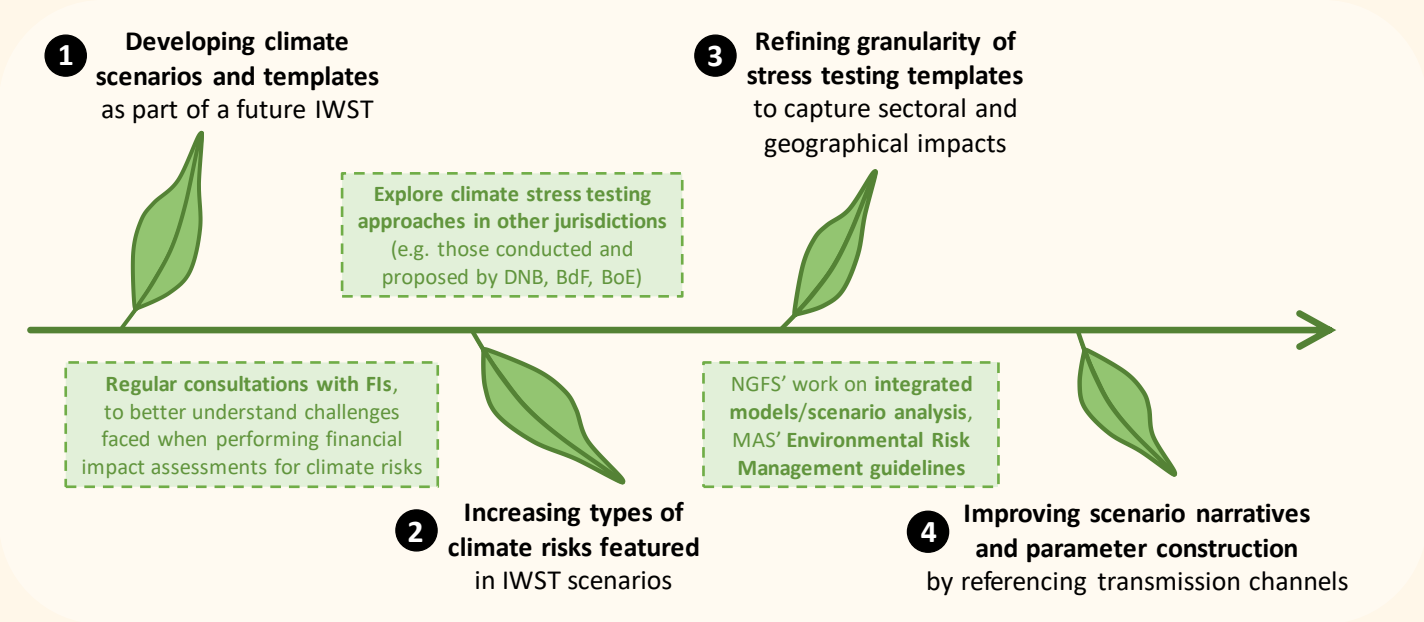
Special Feature 3:
Climate Change and Financial Stability

- Climate change presents an important source of risk to the financial system through physical and transition risks.
- This Special Feature outlines the channels through which such risks could impact financial institutions, and details MAS' planned approach in assessing these risks.



Special Feature 3:
Climate Change and Financial Stability

- Work done in assessing the financial stability impact of climate change remains at a nascent stage globally.
- MAS is undertaking further efforts to assess such impact:
  - Within the next two years, MAS will incorporate a broader range of climate risks in thematic scenarios as part of our stress tests for the financial industry.
  - MAS is also exploring how new/existing datasets can augment current surveillance approaches to better capture climate risks.



- Quantifying climate-related risks will require necessary data, expertise and models. MAS will continue to work in partnership with industry, academia, other regulators as well as international organisations to build up these resources and strengthen the resilience of the financial system to climate risks.

Special Feature 4:
S-REITs' performance during the COVID-19 pandemic

Background

- This Special Feature provides an update on how Singapore-listed Real Estate Investment Trusts (S-REITs) have fared during the COVID-19 pandemic, and assesses the resilience of S-REITs, under alternative adverse conditions.

Key Findings

- Along with most major REIT markets globally, S-REITs – particularly in the retail and hospitality segments – have experienced a decline in income leading to lower debt servicing ability.
- S-REITs remain resilient, with most taking proactive measures to preserve cash buffers. This has been supplemented by measures introduced by regulatory agencies to provide flexibility on timing of distributions and ensure continued access to funding.
- In an adverse scenario where the commercial real estate rental environment remains challenging for an extended period, S-REITs' debt servicing ability continues to be healthy, although shorter term refinancing pressures might persist due to low cash buffers.

Thank you



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