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The wicked problem of supporting households, businesses and banks

The higher cost of borrowing for homes, cars and business investments may mean stronger downside risks for the Singapore economy, but there are policy tools to deal with them.

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Policymakers must proceed with caution where the attendant policy remedies involve turning the wheel on another part of a national superstructure and potentially hurting a different segment of the population, say the writers. ST PHOTO: LIM YAOHUI

Singapore has experienced an unprecedented scenario of a double whammy – high inflation and interest rates.

The Consumer Price Index is expected to reach a two-decade high of 6 per cent and stay elevated. Interest rates have ticked up, as most loans are based on the Singapore Overnight Rate Average (Sora) or the Singapore Interbank Offered Rate (Sibor) which moves historically in tandem with the interest rates set by the US Federal Reserve. Singapore banks are also incentivised to keep up in the competitive fight for deposits, with UOB raising the maximum rate to a shocking 7.8 per cent.

From buying cars to houses, borrowing costs have surged. Local banks, including DBS, UOB and OCBC, have raised the interest rate on fixed rate mortgage packages to 4.5 per cent. This is unlike the 2008 global financial crisis recovery, where inflation jumped but the US Fed embarked on a quantitative easing strategy to keep interest rates low and spur growth.

PERFECT STORM

Singapore has little control over this perfect storm. Largely a price-taker in global economics and finance, Singapore is exposed to the same shocks, developments and trends facing other open, small economies.

Part of this reality arose from the overcompensation by governments around the world in pre-empting a collapse of confidence during the pandemic by hurriedly pushing out financial assistance to businesses and a slew of handouts to avoid a catastrophic loss of jobs. This aggressive expansionary fiscal stimulus created excessive liquidity in the economy. The US alone has been estimated by Moody's to have pumped almost US$5 trillion (S$6.8 trillion).

Part of this global macroeconomic environment was shaped by the post-Covid-19 recovery. The lifting of Covid-19 restrictions, accompanied by revenge spending, led to an explosion in demand for goods and services, with manpower shortages making it difficult to cope initially.

A third ingredient has been supply-side shocks: Covid-19-related restrictions, factory closures and slower port operations, coupled with Russia's invasion of Ukraine, choked up supply chains and multiplied bottlenecks.

A synchronised contractionary monetary policy adopted by central banks around the world to fight inflation has been a fourth contributing factor. Although primarily aimed at curbing consumer demand and raising the costs of doing business by hiking interest rates, a four-time increase in the US Federal Reserve's benchmark interest rates from near-zero in March to nearly 4 per cent today will undoubtedly impact the housing market.

HELPING HOME BUYERS

Will all these lead to housing loan defaults in Singapore in the same way the collapse of the US housing market triggered off a wider financial crisis in 2008? Most households in Singapore should be well positioned to ride out the double whammy of high inflation and interest rate, owing to the slew of macro prudential policies adopted by the Monetary Authority of Singapore (MAS) throughout the years.

This fear of a fragile housing market souring and the potential for contagion is understandable when the residential property market forms a huge proportion of household net worth. Residential property assets currently make up around 43.9 per cent of total assets owned by Singapore households, according to the Singapore Department of Statistics, while mortgage loans make up 71.7 percent of household liabilities.

But Singapore banks have strong fundamentals and healthy balance sheets. According to the MAS annual report, the percentage of non-performing mortgages was kept low at less than 1 per cent. Credit card defaults also fell from 6.3 per cent in the fourth quarter of 2019 to 4.1 per cent in the first quarter of 2022.

Indeed, this danger of overheating and over-leverage is one that predates the rise in interest rates. The private housing market has seen a 3.4 per cent surge in prices in the third quarter, while the HDB resale price index has climbed for 28 consecutive months.

The authorities understand this and have sought to cool the market and impose stricter rules on borrowing for housing in recent years. This includes lowering the total debt servicing ratio (TDSR) to limit mortgage borrowers to devoting a maximum of 55 per cent of gross monthly income to total debt repayments, which include car, home and credit card loans, and imposing a lower loan-to-value (LTV) limit of 75 per cent, restricting the amount people can take relative to the cost of a home.

Still, aspiring home buyers like newly-weds will find it tough to enter a hot housing market. They will have to wait years for an HDB Build-To-Order flat if they cannot afford a resale one. The worry is that the elevated costs of home ownership might push more to delay starting a family, putting further pressure on Singapore's low fertility rate of 1.12.

LEANER AND MORE EFFICIENT BUSINESSES

With the heightened costs of borrowing, the days of cheap money are over for businesses which will see lower profits, fewer new projects as interest rates outstrip returns on investments, and potentially a greater risk of default.

The strong Singapore dollar has mitigated these to some extent, in controlling the costs of imported materials and managing the costs of production for the manufacturing and industrial sectors. But there is no running away from this stricter environment of financial discipline.

We would urge businesses looking for additional financial assistance to take advantage of government assistance to relook their processes to reap additional cost savings.

Economic studies have documented the presence of rational inattention – where businesses tend to ignore transformation and new business strategies when money is cheap and profit margins are good. An environment where credit is costlier can be good to discipline and encourage continued transformation, the adoption of new IT solutions and process improvements to increase productivity through programmes like the Singapore Government's Enterprise Development Grants or the NTUC's Company Transformation Committees.

The Singapore Government has additional tools to extend credit while incentivising businesses to improve productivity. They can help small and medium-sized enterprises tide over this period of low lending appetite through special arrangements that co-share the risks with financial institutions, similar to those extended during the global financial crisis in 2008 – with qualifying commitments from businesses to demonstrate signs of innovation and productivity gain.

Temporary bridging loans, which provide working capital to businesses during a period of low liquidity, can also be considered if outcomes can be linked to business transformation. By leveraging existing public policy and initiatives to find new markets, lower costs and build business resilience, the most future-oriented businesses will come out of this episode leaner and more efficient.

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WELL-CAPITALISED BANKS

A third worry lies in whether Singapore's banks are sufficiently well-capitalised, ensuring the stability of the overall financial system.

Like most of their counterparts all around the world, banks in Singapore have benefited from higher margins and enjoyed higher rates of returns on deposits. Singapore's three largest banks, DBS Group Holdings, Oversea-Chinese Banking Corporation (OCBC) and United Overseas Bank (UOB) all reported record profits in the third quarter of the year.

The danger for banks lies in the risks of borrowers defaulting on loans, potentially damaging confidence in the banking system and fuelling a run on the bank as depositors withdraw deposits and consequently straining the banks' ability to cover withdrawals with existing reserves.

But this scenario has a very low likelihood as banks are well capitalised. Consumer and business confidence in Singapore's major banks remain strong, with long queues for promotional fixed deposit rates at banks. Singapore banks have also seen an uptick in the Banking Trust Index released by the Association of Banks in Singapore in April 2022, with 68 per cent of respondents indicating high trust.

Singapore banks have also benefited from a huge inflow of capital, with net new assets inflows into DBS Group Holdings exceeding $15 billion, a doubling from the previous year. DBS, UOB and OCBC are also regularly named among the World's Top 50 Safest Banks by renowned Global Finance Magazine.

HELPING VULNERABLE SEGMENTS

The twin factors of high inflation and high interest rates exerting downward pressure on the Singapore economy will undoubtedly hurt groups with tighter budgets than others – including retirees and low-income households. A targeted approach to redistribute financial support, such as the recently announced $1.5 billion support package to fight inflation, will be a key item many will look out for in the Singapore Budget in 2023.

The challenge also lies in striking a balance in pulling specific policy levers and understanding the implications of tweaking one part. There have been calls to raise Central Provident Fund (CPF) rates to ensure that retirement incomes for the elderly keep pace with inflation, on the back of the Government's announcement that interest rates for CPF accounts will remain unchanged in the first quarter of 2023.

But the public should bear in mind that adjusting one could have knock-on effects for other segments of society. HDB loan interest rates are currently pegged at 0.1 percentage point above the CPF Ordinary Account Interest rates, and raising the latter means home owners who have taken an HDB loan will have to pay higher interest rates.

In the final analysis, it turns out that high interest rates and inflation have complex effects that go beyond their immediate impact on the cost of living and doing business in Singapore. A holistic appraisal of Singapore's macroeconomic situation can give us a deeper appreciation of which segments need help more urgently and to what national ends. But where the attendant policy remedies involve turning the wheel on another part of a national superstructure and potentially hurting a different segment of the population, policymakers must proceed with caution.

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