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Given the challenges posed by the global banking business, the Republic needs to continue on the path of diversification of the financial sector away from just banking. PHOTO: REUTERS

Has global finance reached its peak?

What S'pore banking sector can do to cope. BY RAMKISHEN S RAJAN AND SASIDARAN GOPALAN

THE slight uptick in global export growth in recent times has helped alleviate some of the fears that the world economy is entering a prolonged phase of trade deglobalisation. Forward looking indicators such as the WTO's World Trade Outlook Indicator are suggestive of stronger trade growth in the first half of 2017. However, it may be too soon to pass a definitive judgement as global trade-to-GDP ratios have remained flat since 2008 after decades of steady growth, and many global trade and growth policy uncertainties persist.

Major trading hubs like Singapore have a keen interest in ensuring that international trade flows become buoyant again on a sustained basis. Singapore Prime Minister Lee Hsien Loong's urging of G-20 leaders in Hamburg to refocus attention on multilateral trade while ensuring a more even and durable spread of its benefits is timely amid a seemingly more mercantilist approach to trade being taken by the US and some other countries.

The Republic, being a major financial centre as well as an exporter of capital, must also be aware of the other potentially worrying trend, namely peak finance. Has global finance reached its peak and are we now witnessing a secular period of financial deglobalisation?

Unlike its trade counterpart, financial deglobalisation has not been as widely discussed partly because financial globalisation itself is a rather more complex and multidimensional concept that means different things to different people. At a broad level, it consists of at least three distinct dimensions – degree of internationalisation of currencies, extent to which financial institutions can operate across jurisdiction (primary banks, i.e. foreign bank entry) and cross-border capital flows.

FINANCIAL GLOBALISATION IN RETREAT?

Focusing specifically on the last aspect, global cross-border capital flows, which peaked at just over 20 per cent of global GDP in 2007, drastically dropped to 4 per cent of GDP in 2008 when the global financial crisis began and is yet to recover. Cross-border capital flows as a share of global output stood at just 2.6 per cent of GDP in 2015. This decline has given rise to concerns about financial deglobalisation.

A closer examination of the composition of capital flows data shows that there is significant variation in dynamics. Although there have been no dramatic changes in portfolio bond flows and foreign direct investments, cross-border bank lending (classified as "other" flows) experienced a significant decline between 2007 and 2015.

Thus, financial deglobalisation is more accurately termed cross-border bank deleveraging. In contrast, foreign monies into bond markets have accelerated as Asian and other emerging economies rapidly developed and opened up their bond markets. Indeed, in general, the nature of financial intermediation has shifted away from bank funding to bond markets. US dollar credit to emerging Asian borrowers has expanded quite significantly, according to the Bank for International Settlements (BIS).

CROSS-BORDER BANK DELEVERAGING

While this cross-border deleveraging is a relatively understudied area, some reasons for this decline include tightened global and country-level regulations (capital and liquidity requirements), weakness in individual bank balance sheet, reduced access to wholesale funding, large-scale taxpayer-funded or supported bailouts, higher risk aversion which results from losses that lowered bank wealth, breaking up of some large banks, along with reduced demand for loans following a period of deleveraging post-GFC (global financial crisis) including a decline in trade credit given the slowdown in international trade.

Given that the issue of financial deglobalisation is primarily related to the banking sector, one can investigate this phenomenon in more depth by looking at BIS data on consolidated bank-related assets (per cent of GDP). This data is helpful as it includes all foreign assets of banks around the world. Thus, it shows both actual cross-border bank lending as well as loans made by foreign banks domiciled overseas while avoiding double-counting.

The BIS consolidated data suggests that total foreign claims fell from about 50 per cent of global GDP in 2007 to around 35 per cent in 2016. A further examination of the data reveals that the discernible decline in bank flows is largely limited to the advanced economies, with flows to emerging economies remaining stable.

If we delve deeper we observe that the decline in bank flows is primarily concentrated in Europe. In particular, the consolidated claims of euro area, UK and Swiss banks have largely driven the drop in bank flows in the advanced economies. This is further seen in the fact that while US dollar lending has been on the rise, it is primarily euro lending (presumably done mainly by European banks) that is on the wane.

All in all, it is far from clear that financial markets are moving into an era of deglobalisation in general. Financial deglobalisation or peak finance may not be an accurate description of global finance as it primarily appears to date to have involved deleveraging of European banks' overseas operations in response to losses which in turn has had global repercussions.

Jaime Caruana, BIS general manager, is correct when he noted in a speech in Geneva in February this year: "It would be premature at the very least to declare that global financial integration has gone into reverse . . . (The) post-crisis deleveraging has been confined to certain sectors in certain economies amid a general march to higher levels of global leverage . . ."

IMPLICATIONS FOR SINGAPORE

From Singapore's perspective, given that the financial sector constitutes just under 15 per cent of its GDP and services exports and 6 per cent of employment, it is good news that financial deglobalisation is not yet broadbased.

However, the cross-border deleveraging that is occurring (at least among European banks) is exacerbated by other phenomena that some have argued has negatively impacted the Singapore banking sector. These include the tax amnesties by some regional economies as well as implementation by Singapore of the US-mandated Foreign Account Tax Compliance Act (FATCA), the OECD's Common Reporting Standard (CRS), and Competent Authority Agreements (CAAs) to exchange the information with several countries. In addition to much more intense worldwide attempts to combat tax evasion, there were notable lapses by some banks domiciled in Singapore in allowing illicit flows through Singapore's financial system.

While all this is true, the Monetary Authority of Singapore (MAS) is clearly working hard to safeguard the Republic's reputation as a resilient and trusted global financial centre by bolstering its enforcement and surveillance capacities as well as demanding higher standards of integrity from industry players. The creation of the Anti-Money Laundering and Countering the Financing of Terrorism Industry Partnership (ACIP) is an important step in this regard to ensure the Republic's role as a regional and international banking hub remains intact.

In addition, given the challenges posed by the global banking business, the Republic needs to continue along the path of diversification of the financial sector away from just banking to developing wealth management and insurance, focusing on capital markets, positioning Singapore as the key city in the region if not globally in the fintech space, developing itself as an alternative gateway for the renminbi, and continuing to aggressively explore opportunities to expand in the fast-growing emerging Asian markets in Asean, China and India.

Ramkishen Rajan is professor of economics at ESSEC Business School, Asia-Pacific, Singapore. Sasidaran Gopalan is a research fellow at Asia Competitiveness Institute, Lee Kuan Yew School of Public Policy, National University of Singapore

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