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Singapore companies, banks remain financially resilient even as borrowing costs rise: MAS

MAS said firms in Singapore, including SMEs, retained access to credit even as lending conditions moderately tightened in recent quarters. PHOTO: ST FILE

Ovais Subhani

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SINGAPORE – Businesses in Singapore have pulled through a challenging economic environment, keeping their financial positions intact even as growth slowed and interest rates rose, said the central bank in a report on Nov 27.

The report also stated that companies in the financial sector – which includes banks, investment firms and insurers – have maintained strong balance sheets through multiple shocks over the past year.

But risks from higher interest rates, tighter financial conditions and geopolitical uncertainty remain elevated, the Monetary Authority of Singapore (MAS) said in its latest edition of the Financial Stability Review 2023.

As borrowing costs rose, most companies opted to cut their debts to levels where their cash flow could support repayments, MAS said.

To manage the rising cost of borrowing, many companies also deployed interest rate hedging – a financial solution that allows borrowers to swap a variable interest rate for a fixed rate over a defined period of time, thus increasing their ability to meet their obligations in a timely manner.

Firms continued to have adequate liquidity buffers even as they deployed cash reserves built up during the Covid-19 pandemic to reduce interest expenses.

The corporate sector also moderated borrowings in currencies other than the Singapore dollar, easing some of the foreign currency mismatch risk – which refers to how a change in the exchange rate will affect future income and expenditure flows.

While financial ratios of externally oriented firms have stayed stronger than those of domestically oriented businesses, MAS warned that externally oriented firms remain generally more vulnerable to the risk of a global economic slowdown.

"The outlook for the Singapore economy is heavily dependent on external demand conditions, which continue to be weighed down by higher-for-longer global interest rates and geopolitical uncertainties," the central bank said.

Hence, the challenging external macro-financial environment could continue to place pressure on firms' profitability and debt servicing ability.

However, MAS said its stress tests – a computer-simulated technique to analyse how borrowers would fare in drastic economic scenarios – suggest that most firms have adequate buffers to manage earnings and interest rate shocks.

"There is, though, a segment of corporates that are highly leveraged with weaker cash reserves that are at greater risk," it said.

Singapore's economy lost momentum after a strong recovery in 2021 when it grew 8.9 per cent. As inflation rose worldwide in 2022, central banks hiked interest rates to control it and, in the process, weighed down economic growth.

The Republic's economy grew 3.6 per cent in 2022 and is now set to post growth of around 1 per cent in 2023, according to the latest forecast of the Ministry of Trade and Industry.

Interest rates in Singapore, as measured by the three-month compounded Singapore Overnight Rate Average, rose to more than 3.5 per cent in the second half of 2023, from less than half a per cent in the first half of 2022.

"In the coming year, SGD (Singapore dollar) interest rates are likely to remain at elevated levels based on market forward pricing," MAS said.

But despite the challenging global and local economic environments, the central bank said domestic financial conditions have remained relatively stable over the past year.

Financial conditions refer to the ease of money and credit flow through the economy via financial markets. Higher interest rates generally lead to tighter or worsening financial conditions, which would mean less money and credit are available for companies and households.

However, MAS said firms in Singapore, including small and medium-sized enterprises (SMEs), retained access to credit even as lending conditions moderately tightened in recent quarters.

Banks also continued to onboard SME borrowers, with the number of customers rising at a steady annual pace of nearly 5 per cent in June 2023, the central bank said.

In capital markets, the Straits Times Index was marginally higher at 3,238.1 points in the third quarter, compared with the fourth quarter of 2019 when it was at 3,188.7 points.

Even as borrowing costs rose and profitability weakened amid slower economic growth, the probability of default for listed firms and corporate non-performing loan (NPL) ratios remained at relatively low levels.

Meanwhile, the yield premium paid by Singapore investment-grade corporate bonds over sovereign debt of the same maturity has narrowed since the third quarter of 2022. Yet the premium, also referred to as spread, has remained above pre-Covid-19 levels, MAS said.

A stress test conducted by MAS showed that most Singapore Exchange-listed companies are resilient against a joint shock from lower demand and higher interest rates, such as a 10 per cent decline in earnings and a 3 per cent rise in interest rates from levels in the second quarter.

Looking forward, the central bank warned that the challenging economic and financial environment will continue to pose downside risks for companies with high levels of debt.

While business sentiment in the manufacturing and services sectors has improved slightly over the past year, according to business expectation surveys, the outlook is subject to considerable risks from a potentially prolonged high interest rate environment and geopolitical conflicts, it said. If debt repayment capabilities of borrowers weaken, banks could face higher credit costs.

However, banks in Singapore have remained resilient over the past year, with strong capital and liquidity positions supported by healthy profits, even as demand for loans fell.

MAS said the Industry-Wide Stress Test 2023 exercise affirmed that banks have adequate capital and liquidity buffers to weather potential downside risks arising from severe macro-financial stresses.

With tight monetary policy dampening credit demand, the risk that borrowers will not be able to service their interest payments has, in fact, subsided.

Accordingly, a survey of banks in September 2023 indicated that while loan demand from corporates had fallen over the past year, banks expect corporate loan demand to bottom out and remain relatively flat going into 2024.

"Indeed, MAS' econometric work shows that the current weakness in credit is in line with the slowdown in economic activity and higher interest rates," the central bank said.

While NPLs have remained low, there are early signs of potential asset quality deterioration – which refers to a decline in the value or creditworthiness of assets held by borrowers.

"To manage this risk, banks continue to maintain adequate provisioning against a potential decline in credit quality," said MAS.