Managing Capital Flows: The Case of Singapore

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Introduction

- Vagaries of global financial markets pose significant challenges to the regional economies. This presentation is on the experience of Singapore in managing capital flows, focusing on:

1. Trends in capital flows over the past 2 decades
2. Framework for Monetary Management
3. Monetary conditions during global financial crisis (GFC)

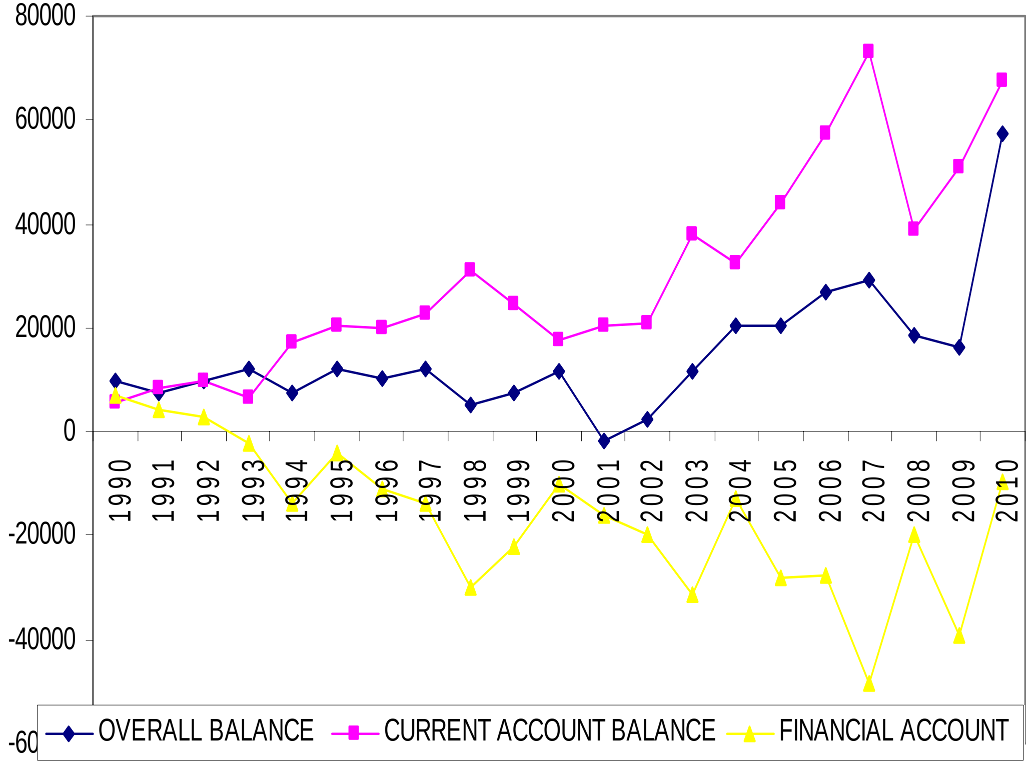
Trends in Capital Flows (1990 to 2010)

Overall Balance of Payments

- Overall BoP generally positive & trending up:

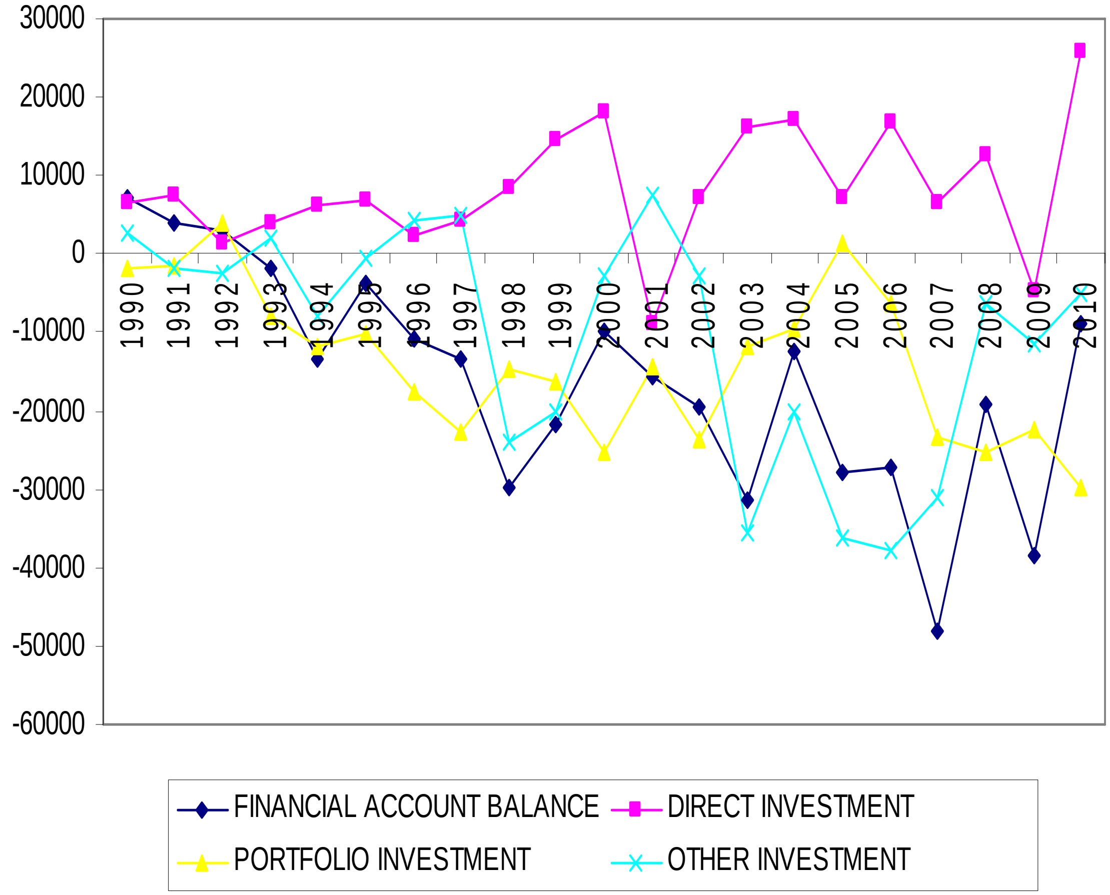
- Driven by expansion in current account surplus

- Offset somewhat by the persistent export of capital abroad



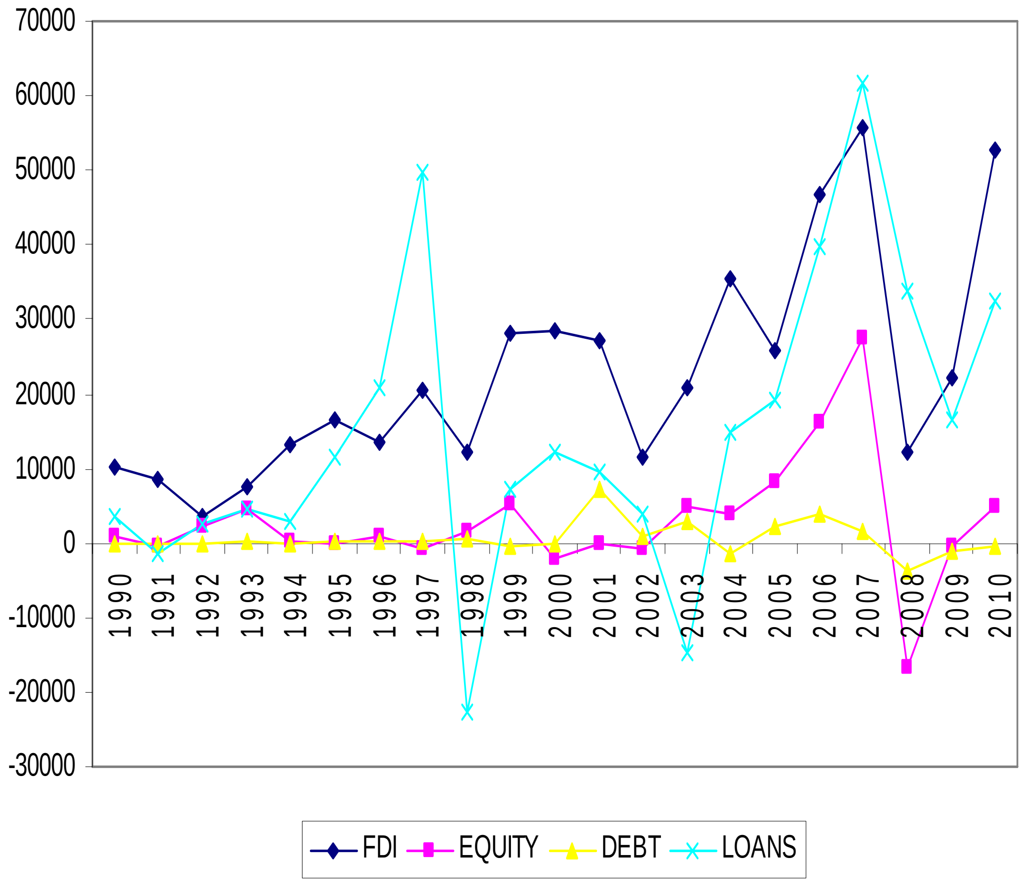
Components of Financial Account

- Important to differentiate amongst various types of capital flows.
- Net positive FDI consistently more than offset by net outflows in portfolio & other investment accounts.



Gross Capital Inflows

- Strong FDI inflows trend up; such long-term inflows are less prone to reversals.
- Inflows to equity & debt markets reversed during GFC; Such portfolio flows tend to accentuate crisis: relatively low volume helps.
- Bank Lending (not mitigated by price adjustments) most volatile: offset by large outflows thereby reducing net flows.



Resilience towards disruptive swings in capital flows

- What factors serve to attract beneficial long term FDI flows while inhibiting volatile speculative flows?

- Overall package of policies:
  1. strong economic fundamentals
  2. prudent policy management on fiscal/monetary side
  3. credible exchange rate policy aligned with underlying fundamentals
  4. having latitude to react promptly & on a sufficiently large scale to economic/financial developments

Monetary Management Framework

Exchange Rate Centered Monetary Policy Framework

- Monetary Authority of Singapore (MAS) stated objective for monetary policy is “to ensure low inflation as a sound basis for sustained economic growth”.
- Unique feature: use of exchange rate instead of interest rate as policy operating tool since the former is more effective than the latter for stabilizing inflation; reflecting the extreme openness of the economy.
- Value of S$ is monitored against trade-weighted basket of currencies (TWI) which is allowed to float within prescribed policy band.

Intermediate Exchange Rate Regime

- Under a managed float system, pertinent to have large foreign reserves ready for use to defend the currency. S$ is more than fully backed by foreign reserves.

- Market participants tend to keep within the band as they are mostly convinced of MAS' commitment to enforce it; in turn reduces the need for frequent intervention operations.

- Singapore's experience show that intermediate exchange rate regime can be viable, along with support of consistent economic policies & strong institutions.

Flexibility in Exchange Rate System

- Basket-Band-Crawl exchange rate system allows MAS to use exchange rate to accommodate shocks arising from capital flows

- Policy band can be widened to meet with increased uncertainty, to allow greater flexibility in managing S$.

- Realigning the center of the band or changing the slope of crawl is advantageous in aligning S$ with changing economic fundamentals, this contributes to credibility of system & will lessen severity of crisis.

Regulating Level of Domestic Liquidity

- Significant capital inflows tend to increase money base & appreciate the S$. FX intervention carried out to dampen excessive volatility by selling S$ would also lead to a rise in the monetary base unless sterilization is carried out.

- However, MAS is generally in the position to supply funds to rather than withdraw funds from the market due to 2 channels that drain substantial liquidity out of system:

1. Prudent fiscal management means MAS is usually in receipt of public sector surpluses.
2. Net positive contributions to CPF (government administered compulsory savings scheme)

Regulating Level of Domestic Liquidity

- MAS carries out money market operations to channel funds back to ensure sufficient but not excessive domestic liquidity and keep domestic interest rates stable.

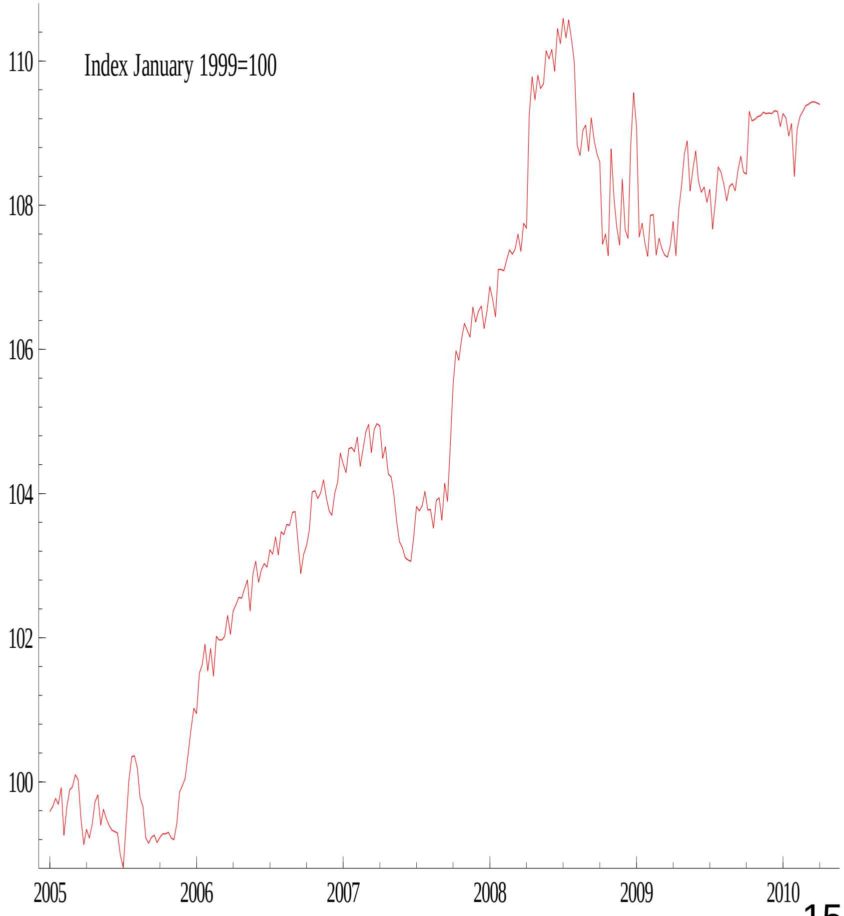
- Sterilization is not an automatic response to neutralize it's own forex market operations but depends on the balance of other factors affecting money liquidity at that time.

Monetary Developments during GFC

Exchange Rate Policy Stance

- Against a backdrop of fragile global economy. MAS adopted a neutral stance by flattening policy band in Oct 2008 & re-centered band downwards in April 2009.

- From April 2010, MAS repeatedly tightened policy as economy rebounded & amid upside inflation risk; band was widened in Oct 2010 to accommodate volatility in international financial markets.



Interest Rates

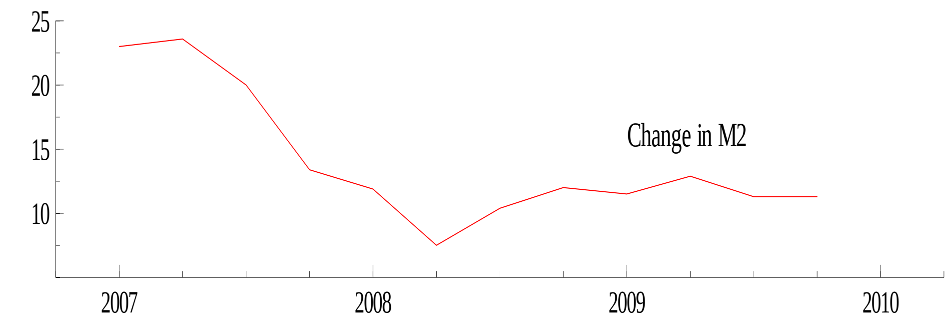
- Very close relationship between domestic banking system & substantially larger offshore Asian dollar market; domestic interest rates are in essence determined by world money markets.

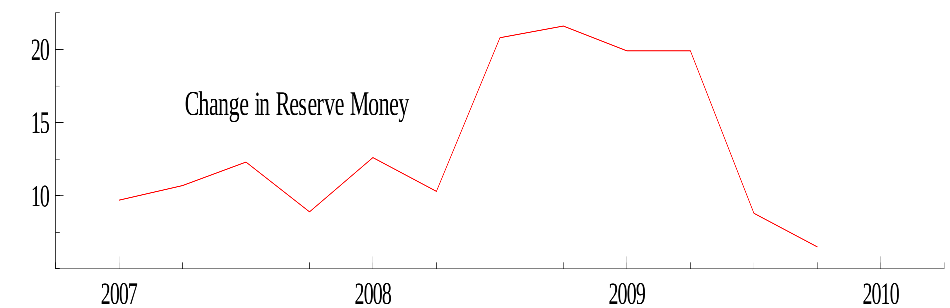
- S$ DIBOR fell sharply in line with US$ SIBOR that captures global interest rates which was pushed down by central banks in response to the credit crisis.

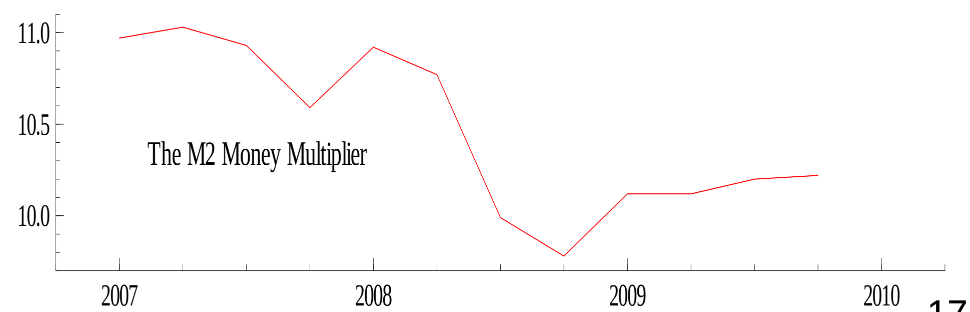
Monetary Aggregates

- Broad money M2 fell sharply in 2008 following contraction of output & rise in reserve balances.

- Although capital inflows rose in 2009, this did not lead to a corresponding rise in money base & M2. M2 stabilized in 2009 as economy recovered.





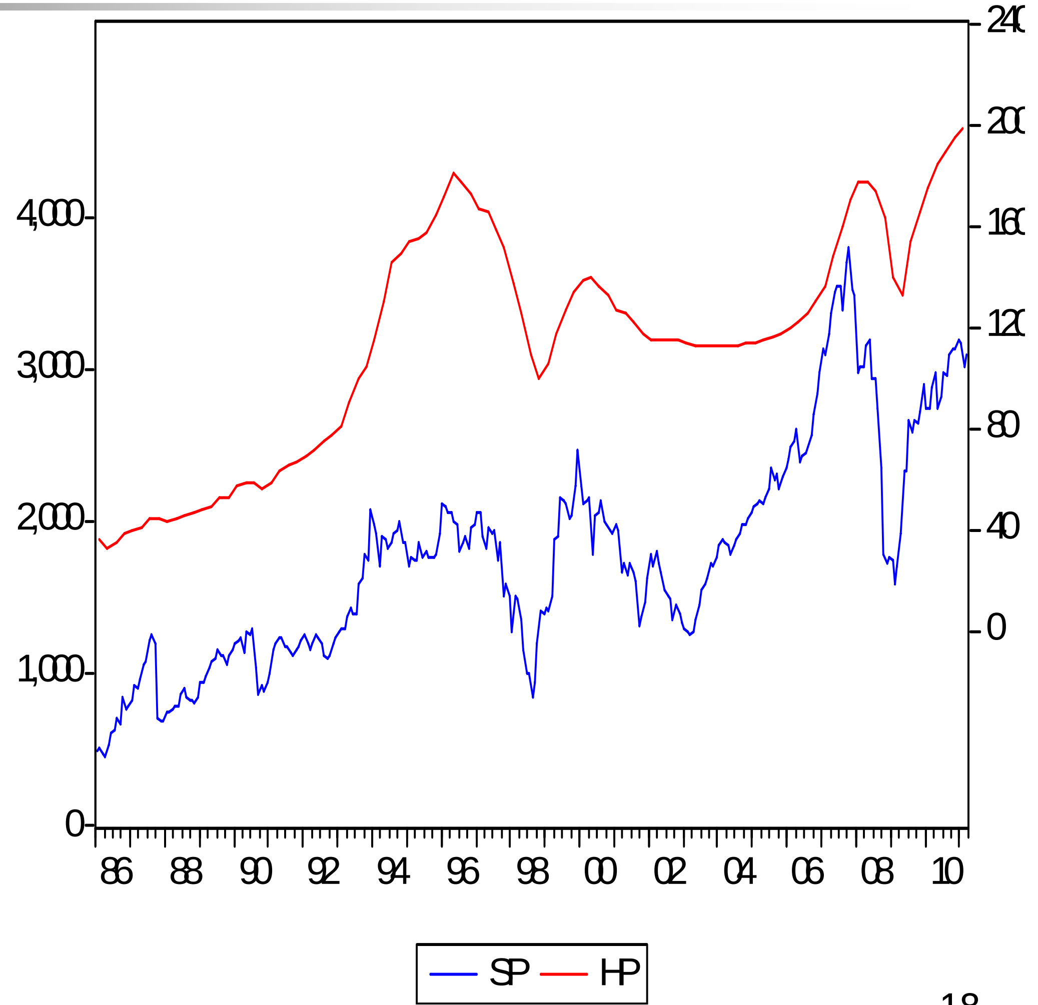


House Price & Stock Price Indices

- Swings in asset prices partly due to rise & fall of foreign investor interest in local property/stock market. 16% surge in house prices in 2009Q3.

- Direct prudential policy measures: disallowed borrowers from deferring payments; addition 3% stamp duty if property sold within a year; etc.

  govt released more land for development.



Conclusion

- Generally sound economic environment attract beneficial FDI flows, but do not completely shield an economy from the fallout of volatile capital flows.
- Flexibility in exchange rate system and having latitude to react promptly & on a sufficiently large scale to economic/financial developments are important.
- Monetary policy needs to work in tandem with fiscal, financial and prudential policies.

Thank You