Development of the government bond market and public debt management in Singapore

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Abstract

This paper describes the growth of the Singapore Government Securities (SGS) market. It elaborates on the balanced budget policy of the Singapore government, explains how SGS are issued unrelated to fiscal needs and describes how a liquid SGS market is used to establish a robust government yield curve for the pricing and development of the domestic corporate debt market. Recent developments in the SGS market, the issuance of central bank debt and future challenges are included in the paper.

Keywords: National Government Expenditures and Related Policies, National Budget, Deficit and Debt, National Debt, Debt Management, Macroeconomic Policy, Macroeconomic Aspects of Public Finance and General Outlook

JEL classification: H5, H6, H63, E6

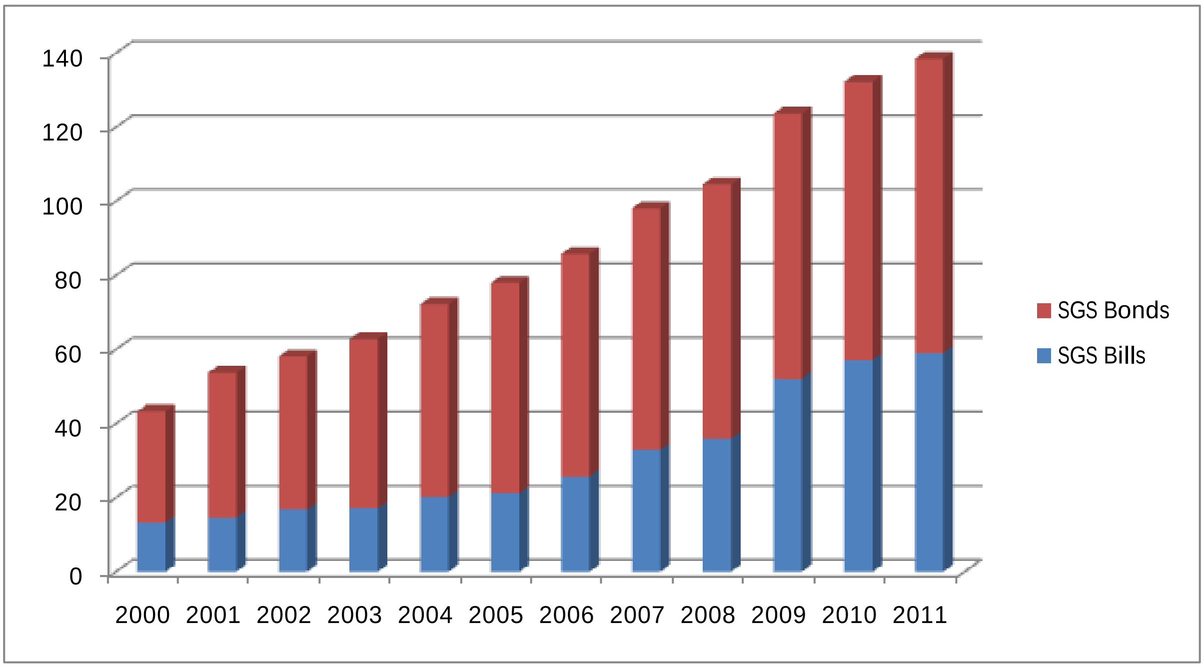
(A) Singapore Government Securities (SGS)

Overview of the bond market

The Singapore bond market has grown considerably in terms of size, depth and liquidity in the last decade. As an indication, market capitalization in the government bond (SGS) market has increased over three-fold from S$43.3 billion in 2000 to S$138.5 billion in 2011 (see Chart 1). The sovereign curve was also extended twice during this period, starting with a 15-year issuance in 2001 followed by a 20-year issuance in early 2007. As an indication of the market's maturity and demand for even longer benchmarks, the curve was further extended with the introduction of a 30-year issuance in April 2012, marking another critical milestone in the growth of the government bond market.

Chart 1

Growth of SGS (2000–2011) – in S$ billions



In line with its growth, the SGS has been gradually included in widely followed bond indices during this period. As an example, Singapore was entered in Citigroup World Government Bond Index (WGBI) in January 2005, and the SGS is similarly included in the Barclays Capital Global Aggregate Index and JP Morgan World Government Bond Index, amongst others.

(B) Singapore's fiscal strength and motivation for SGS issuance

Strong fiscal position

The Singapore government operates on a balanced budget policy and does not need to finance its expenditures via the issuance of government bonds. It has enjoyed healthy budget surpluses over terms of government in the past decades and does not have any external debt. The main focus of the government's expenditure is on the delivery of essential public goods and services to residents, with national security, education, public housing, health care and economic infrastructure development forming the key areas in the national budget.

Funding for government expenditure programmes is primarily dependent on Singapore's tax policies, which are among the most competitive in the world and are designed to enhance Singapore's economic competitiveness and promote long-term economic growth. This combination of fair tax policies and prudent expenditure programmes has made up the government's successful fiscal policy over the years. Embedded within this set of fiscal policies is the belief that the private sector is the engine of growth, with the role of the government being to provide a conducive and stable environment for it to thrive. Also, all tax and expenditure policies are justified on microeconomic grounds and focus on supply-side issues.

Against this backdrop, the government was able to ensure no build-up of net debt[1] while growing the pool of reserves to a state that allows it to be tapped in a sustainable manner to supplement the government's budget needs. As an indication of the government's fiscal rectitude, the Protection of Reserves Framework in the Constitution further stipulates that only reserves accumulated during each term of government can be spent, hence further ensuring that the strength of the government's fiscal position is not easily eroded.

The availability of a significant reserve pool also strengthens Singapore's financial standing, while giving the central bank the capacity to intervene in the FX market in support of the Singapore dollar (SGD). This is particularly important for Singapore given that its monetary policy is centered on the management of the trade-weighted basket of exchange rates of its major export competitors and sources of imports. Hence, rather than being constrained in any manner, Singapore's fiscal strength has actually helped the MAS in the management of the SGD in monetary policy implementation.

Catalyzing growth of the domestic bond market

SGS are marketable debt instruments of the government of Singapore, comprising short-term Treasury Bills (T-bills) as well as longer-term SGS bonds. As the fiscal agent of the Singapore government, the MAS is empowered to undertake the issuance and management of SGS on its behalf. The issuance of T-bills and SGS bonds is governed by the Local Treasury Bills Act (LTBA) and the Government Securities Act (GSA), respectively, with separate debt ceilings set by resolutions in Parliament and approved by the President. As of April 2012, the authorised borrowing limits (representing amounts that the Minister of Finance is able to borrow at any point) for T-bills and bonds were S$60 billion and S$490 billion, respectively. In accordance with the GSA, all proceeds from securities issuance, and any investment returns derived from the proceeds, are paid into the Government Securities Fund (GSF). Payments from this fund are limited to the payment of interest and repayment of principal, and are a statutory obligation. This framework ensures that the government borrowing is not used to fund the government's expenditures.

Given the strong fiscal position, the Singapore government is in a unique position where domestic debt securities are issued unrelated to fiscal needs. In fact, the SGS was originally issued to satisfy banks' needs for risk-free assets in their liquid asset portfolios; the focus subsequently shifted to developing the domestic debt market after the Asian financial crisis. A focused issuance program was introduced aimed at building large and liquid benchmark bonds, primarily through larger issuance of new SGS bonds and reopening of existing issues to enlarge the free float and re-channel liquidity from off-the-run issues to benchmark bonds,

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[1] The Singapore government has assets well in excess of its liabilities, which includes investments in the Government of Singapore Investment Corporation and Temasek Holdings.

which helped catalysed the growth of the market. With the improvement of liquidity to the market, the provision of a robust government yield curve was possible, thus stimulating the growth of the domestic corporate debt market which was able to price off the benchmark curve. This is important as growth of the corporate debt market will facilitate greater financial disintermediation towards direct financing (via the financial markets) instead of indirect financing (via bank credit), hence providing an avenue of matching savers and those in need of capital outside the banking system and lowering the borrowing costs for domestic corporates.

In view of these considerations, Singapore is able to continue enjoying short- and long-term credit ratings from international credit rating agencies, despite the significant growth in government debt over a short period of time. The three main international rating agencies (Moody's, Standard and Poor's, and Fitch) continue to accord Singapore the highest, AAA, credit rating.

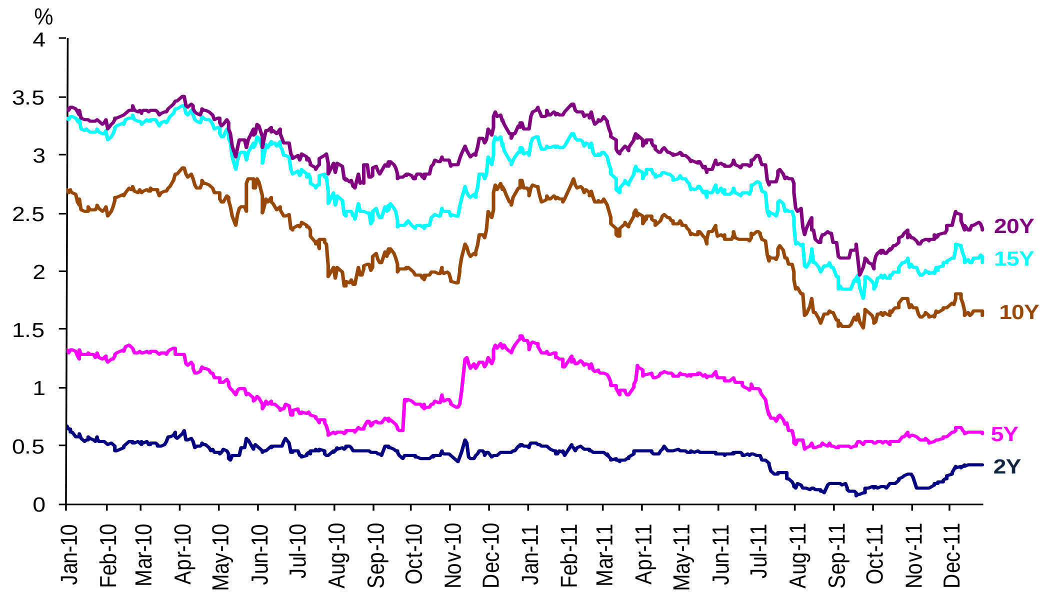
(C) Recent development in the SGS market and issuance of central bank debt

Global capital flows and their impact on SGS yields

Towards the end of 2011, Singapore saw strong capital inflows, similarly to Japan and Switzerland, largely motivated by the global risk aversion from the uncertainty over the debt crisis and policy uncertainties in both the US and the EU. As these flows end up largely invested in highly rated safe haven assets such as the SGS, yields have declined sharply since the start of 2011 with a bull-flattening bias (see Chart 2). This is also broadly in line with price movements in global safe haven assets, which highlights sustained confidence in the resilience of Singapore's economy and the government's fiscal discipline.

Chart 2

SGS Benchmark Yields since Jan 2010



Looking ahead, increased volatility in domestic financial markets cannot be ruled out if economic and financial conditions in the advanced economies become markedly weaker, resulting in contagion shocks. However, the impact of any sudden capital outflows from the SGS market would likely be mitigated since the SGS remains one of the few highly rated sovereign assets and local institutions continue to be dominant investors in the SGS market.

Central bank debt security – MAS bills

In addition, since April 2011 the MAS has issued MAS bills, which are central bank bills for money market operations aimed primarily at financial institutions to help increase the availability of high quality liquid assets and manage banking system liquidity. While similar to the T-bills in many ways, these central bank bills are essentially money market instruments, with shorter tenors ranging from four weeks to three months.

MAS bills are negotiable, so banks needing liquidity can sell them or pledge them as collateral in the interbank repo market or enter into repo transactions with the MAS through the Intraday Liquidity Facility and the Standing Facility. The initial issuance will be kept to S$20 billion to start, which can be increased based on subsequent sterilization requirements. The development of MAS bills is particularly apt in the face of the changing regulatory landscape, which has seen greater demand for government and central bank debt securities along with a growing banking system and higher liquidity requirements. In this regard, MAS bills will help to meet the needs of banks in Singapore for more regulatory and liquid assets.

(D) Challenges and key policy considerations

While the government bond market has grown significantly in the last decade, developments in the recent global environment and regulatory landscape have also highlighted a couple of areas for review and policy considerations. Firstly, given the current low yield environment, which is likely to persist, the implication of negative yield auctions for short-dated SGS is a particular cause for concern, in terms of both its implications and its potential impact on institutional as well as retail investors. Another area is how the use of the central bank debt (MAS bills) can be further expanded as an instrument for sterilization requirements over the use of T-bills, which will alleviate the need for the government to raise more debt in managing capital inflows. This is likely to be explored gradually in the next few years as the issuance of MAS bills continue to grow and reach a steady state.