Koh Yong Guan: The economic outlook and monetary policy in Singapore

Statement by Mr Koh Yong Guan, Managing Director of the Monetary Authority of Singapore, delivered at the MAS Annual Report 1999/2000 Media Conference in Singapore on 27 July 2000.

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Introduction

We have had an eventful year as we supported Singapore's recovery from the Asian crisis and persisted in our efforts to liberalise the financial sector. The economy turned in an impressive performance in 1999 compared with the year before, showing clear signals that we have emerged from the crisis. Having weathered the crisis, the economy is now more resilient and better prepared for external shocks.

Let me first highlight some pertinent points on our outlook for the domestic economy as well as our monetary policy stance.

The economic outlook and monetary policy

In July last year, MAS had noted that the Singapore economy was picking up faster than expected, although recovery had not extended to all sectors. Manufacturing had posted strong growth in the first half of 1999, but construction, commerce, and most financial services remained weak. The economy was still operating below potential, and the inflation outlook was benign. MAS therefore took a neutral exchange rate policy stance, to reinforce the government's cost reduction measures and facilitate economic recovery.

The trade-weighted S$ remained roughly unchanged over the past year, fluctuating within its usual band, although the S$ bilateral exchange rates varied significantly against individual major currencies on account of volatility in the global currency markets. Reflecting the strength of the US dollar, the Sing dollar, along with most other major currencies, depreciated against the US dollar in the first half of this year. However, the Sing dollar appreciated against the euro, the Australian dollar, pound sterling and some of the regional currencies over the same period.

The external environment has since strengthened. The industrial countries except Japan are enjoying strong economic growth. The regional economies have shown more vigour and resilience than was expected. Against these positive developments, Singapore's GDP rose by 5.4% in 1999. The economy grew further by a robust 8.4% in H1 2000. Both external and domestic demand have expanded strongly. Real non-oil domestic exports grew by about 12% in the first six months of 2000, boosted by the continued strength of global electronics demand.

The turnaround in the regional economies has underpinned strong service exports and boosted the commerce and transport and communications sectors. Domestic consumption has grown steadily in tandem with labour market conditions and overall sentiment, while investment spending has recovered strongly on the back of a surge in investment in machinery and equipment.

Despite the robust economic recovery, inflationary pressures remain subdued. CPI inflation was 0% in 1999, rising moderately to average just 1% in the first six months of 2000. (Based on the old CPI basket before the revision introduced early this year, measured CPI inflation in 1999 would have been slightly higher at 0.4%.) Inflationary pressures have been held down by greater competition in several segments of the economy, particularly in the supermarkets and telecommunications industry. Strong productivity growth has also helped neutralise the inflationary effects of increases in nominal earnings and the partial restoration of the employers' CPF contribution rate.

Looking ahead, we expect the growth momentum to be sustained for the rest of 2000 and to moderate only slightly next year. This is underpinned by the favourable outlook for the external economic environment. Economic activity will be led by steady growth in the manufacturing sector and a strong pick-up in the services sectors. Domestic spending is also expected to remain strong. We expect the remaining slack in the economy to be taken up within the next 12 months.

As the labour market tightens further, wage pressures will begin to emerge. Imported CPI will also rise, as higher commodity prices filter through to higher import prices of consumption goods. We expect CPI inflation to edge up slightly, to about 1-2% in 2000 and 2001.

MAS is, therefore, prepared to allow a gradual and modest appreciation of the Sing dollar on a trade weighted basis in the coming year, in line with the strengthening of economic fundamentals. This would contain any incipient inflationary tendencies without exerting undue pressure on our competitiveness, bearing in mind the tightening labour market and the progressive restoration of employer CPF contributions. This stance will however be subject to continual review, depending on developments in the domestic economy and external environment.

Financial services sector

Performance of financial services sector

The financial services sector saw an improved performance last year, rebounding from a negative 8.1% growth rate in 1998 to register flat growth in 1999. The recovery was largely fuelled by the surge in the stock market and fund management activities over the year, reflecting buoyant market sentiments and a brighter regional economic outlook. The upturn is likely to be sustained for the rest of the year. For the first quarter of 2000, the sector has already turned in an encouraging 6.9% growth.

Review of financial reforms and key priorities

MAS has continued apace with our financial sector reforms over the last year, introducing a series of strategic policy changes to foster a more transparent, innovative and dynamic financial sector. We have taken measures to fine-tune and update our legislation and guidelines to keep pace with the changing market environment.

To further strengthen the domestic banking sector, we recently announced regulations to separate the financial and non-financial activities of our local banking groups, and to require the rationalisation and unwinding of cross-shareholdings. Last week, MAS also unveiled our policy on internet banking, whereby we affirmed that the existing prudential regulation and supervision framework will apply to such new business models.

On the insurance front, we have liberalised the entry into the direct insurance industry and adopted an open policy for admission of insurance brokers. We have also abolished the foreign shareholding limit on local insurers to make way for strategic mergers and alliances with reputable international players.

Earlier this month, MAS announced plans to introduce a new modular licensing framework for market intermediaries in the securities and futures industries. In addition, MAS will streamline the regulation of financial advisers and require them to comply with standards of market conduct and practices. MAS is also stepping up its review of the policy issues of the securities and futures legislation, to consolidate and streamline the requirements into a proposed Omnibus Securities and Futures Act.

In the coming year, the key priority for the MAS is to follow through the reforms that have been introduced over the past year, and ensure that the implementation is carried out effectively. MAS will continue to review and refine our legislation and regulatory framework to keep pace with global developments. The challenge for us is to sustain the momentum and persevere in our efforts to build Singapore into a world-class financial centre.

International relations

Let me now turn to MAS' efforts in the international fora. With the recovery in crisis-affected economies, the focus has shifted from crisis management to ensuring the sustainability of the recovery and reform of the international financial architecture.

Singapore has participated actively in the Financial Stability Forum, established over a year ago to monitor international financial market developments for potential vulnerabilities. As one of four non-G7 financial centres represented on the Forum, we play a useful role in providing insights and perspectives from the region on financial market developments. We participated in the FSF's work on Offshore Financial Centres. We also hosted a meeting of the FSF earlier this year during which the three FSF reports were adopted.

Singapore also participates actively in IMF initiatives to enhance transparency as a means to minimising risks to the global financial system. In particular, we are in general compliance with SDDS (Special Data Dissemination Standards), including the new requirements for more detailed breakdown of data on official foreign reserves of member countries. We also release regularly the IMF's assessment of our Singapore economy and policies; the latest report was based on the annual consultation that ended in June of this year.

MAS annual accounts

Assets & liabilities

On MAS' annual accounts, total assets increased by S$6.2 billion to S$114 billion as at 31 March 2000, of which S$3.9 billion was in the form of foreign assets and S$2.2 billion in our holdings of Singapore Government Securities (SGS). The increase in SGS holdings reflects a conscious effort to build up our portfolio of SGS to engage in more repo transactions for our money market operations, thereby broadening the range of money market instruments that we use. On the liabilities side, there was a reduction in deposits of banks by about S$3.3 billion, reflecting the repayment of deposits previously placed by POSB with MAS prior to its merger with DBS. However, this was more than offset by increases in Government deposits with MAS and our borrowings from the money market, again due to the diversification of our money market instruments from mainly swaps to include money market borrowings and repos.

Income & expenditure statement

For the financial year ended 31 March 2000, MAS made profits of S$3.6 billion (net of provisions), a decrease of 38% or S$2.2 billion compared with the previous year. The lower return was due mainly to translation losses, as the Singapore dollar strengthened against major foreign currencies such as the US dollar and euro during the financial year.

The organisation

To support MAS' expanded roles and functions in building a central bank of excellence, we have taken steps to strengthen our human resources. Over the last two years, we have increased our headcount by 30%. Of these, a substantial number were early- and mid-career officers from a wide range of professional and academic backgrounds. The increase in mid-career employees has encouraged greater diversity in perspectives and views within the organisation as we address the increasingly complex issues in monetary policy and financial sector supervision and development. MAS will continue to build up our internal capabilities and human resources, and actively consult the industry participants in our efforts to meet the challenges in the coming year.