Lim Hng Kiang: Impact of current issues to Asia's growth and the global environment ahead

Ministerial statement by Mr Lim Hng Kiang, Deputy Chairman of the Monetary Authority of Singapore and Minister for Trade and Industry, on Government Guarantee on Deposits, Singapore, 21 October 2008.

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Singapore remains stable and sound

The global economy is slowing and the international financial system is still under significant stress. Amidst the current turmoil, the financial system in Singapore remains stable and robust. Financial institutions in Singapore continue to be sound and to operate normally. Our local banks and finance companies are financially strong and well-capitalised. They meet capital adequacy ratios in excess of MAS' requirements, which are in turn higher than international standards. Foreign banks in Singapore are subject to strict licensing and admission criteria, and are required to maintain assets against their liabilities by an appropriate margin. Our financial markets remain stable and calm, and financial institutions in Singapore do not face funding difficulties in the interbank market. Public confidence remains high, and we have not had to take extraordinary measures.

Why the need for Government guarantee

Nevertheless, the Government has carefully assessed the international situation and its implications for Singapore. The actions taken by governments and central banks over the last few weeks in Europe and the US to recapitalise banks, purchase bad assets and guarantee bank borrowings in the wholesale markets have improved confidence in the international financial system, even though there remain significant problems and stresses. However, the announcement in the past week by a few jurisdictions in our region of blanket government guarantees on all bank deposits could potentially have a more direct impact on Singapore. Last Thursday the Singapore Government announced a guarantee on deposits of individuals and non-bank customers with banks, finance companies and merchant banks in Singapore until 31 December 2010. We have decided that such a guarantee is necessary for the following reasons.

First, the guarantee ensures a level international playing field for banks in Singapore. The recent announcements in the region of blanket government guarantees on deposits set off a dynamic that puts pressure on other jurisdictions to respond or else risk disadvantaging and potentially weakening their own financial institutions and financial sectors. If Singapore had not introduced a similar guarantee, there was a real risk that depositors would have shifted some of their deposits out of Singapore banks, to banks in other jurisdictions which guarantee deposits. This would have weakened financial institutions here. The Government has therefore taken a precautionary step to pre-empt and avert any such possibility.

Second, the guarantee bolsters the confidence that the public has in Singapore's financial system. It provides certainty to Singaporeans during such challenging and uncertain times in the international environment, notwithstanding that in Singapore our institutions are fundamentally sound.

Third, financial services are an important pillar of Singapore's economy, accounting for 12% of GDP and 5% of Singapore's employment. Beyond this substantial direct contribution to GDP, the financial sector plays a critical role in intermediating credit for the economy, and in providing other critical financial services to companies and depositors in Singapore. It is therefore important for the whole economy that the financial sector continues to function normally. Should financial institutions in Singapore become less competitive or credit become less readily available, it would hinder the financing of economic activities and raise the borrowing costs of businesses. This would aggravate the already challenging economic situation and thereby adversely affect our growth and jobs.

Fourth, this financial crisis is not confined to any country or region, but is a global one. Singapore's guarantee of deposits demonstrates our confidence in the soundness of our financial system, and helps contribute towards restoring confidence in the international financial system.

Why the guarantee is sufficient and prudent

The deposits of individuals and non-bank customers with banks, finance companies and merchant banks in Singapore amount to about S$700 billion. In view of MAS' stringent regulations and close supervision of financial institutions in Singapore, their strong capital and asset positions, and the potential support that foreign institutions in Singapore can avail themselves of where necessary under the government guarantees provided by their home jurisdictions, MAS and the Ministry of Finance have assessed that the backing of S$150 billion of the Government's reserves provided to the guarantee would be more than sufficient.

Let me explain. First, the likelihood of a bank failure as a result of problems in Singapore is small as our banking system is sound and closely supervised, even though it is possible that problems elsewhere will affect a bank's operations in Singapore.

Second, even if a bank were to fail here, it should still have substantial assets to meet its liabilities to depositors. Under the law non-bank depositors enjoy priority in being paid, ahead of other unsecured creditors. This makes it more likely that the failed institution will have sufficient assets to pay out to depositors. Hence, for the guarantee to be called, two things have to happen: a bank has to fail, and at the same time its assets must be worth so little that there is not even enough to repay its depositors. Even then the draw on the guarantee should only be for the shortfall, which should be a fraction of the deposits outstanding.

Hence we have calculated that the S$150 billion backing is an amount that will be ample to meet any eventuality except the most remote. S$150 billion does not in any way reflect an estimate of the likely draw over the two years of the guarantee. On the contrary, we expect the actual draw to be small or if we are fortunate even zero. Instead, the S$150 billion reflects the Government's confidence in the banking system, and its intention to give all depositors that same confidence.

Singapore is in a good financial position to provide this guarantee because of the fiscal discipline of successive governments. We are in a strong fiscal position, having accumulated surpluses during good times for exigencies like this. In contemplating making this guarantee, the Government has carefully assessed that it is well within our means, does not impair our ability to meet all government obligations and will not jeopardise Singapore's financial standing. We are using our reserves to back this guarantee. In the event of a payout, past reserves may be drawn upon. The Minister for Finance has sought and obtained the President's concurrence to issue the guarantee, as required by the Constitution because of the President's role in safeguarding our reserves.

I should also make clear that this guarantee does not impact at all on MAS' ability to defend the Singapore dollar. That is because even after giving this guarantee, the government still has ample means, with the full backing of our not insignificant reserves, to safeguard our currency if this should prove necessary.

To prevent financial institutions abusing the guarantee by expanding aggressively and taking on excessive risks, MAS has emphasised to financial institutions in Singapore the need to remain prudent in this current operating environment. MAS will continue to supervise financial institutions in Singapore closely. It will take the necessary actions to see to it that they operate in a sound manner, and do not put at risk the stability of our financial system or the Government's reserves.

Conclusion

Let me reiterate that Singapore's financial system remains sound and we are well-placed to meet the challenges facing us. This global crisis is unprecedented, and requires Singapore to respond effectively, decisively but also prudently. The provision of a Government guarantee on deposits is a necessary temporary measure to protect the interests of Singaporeans and the economy, which are in turn dependent on a strong and competitive financial sector. The risk of drawing on the guarantee and potential impact on Singapore's reserves are low. This is a measured, precautionary action that will help us to weather the global economic slowdown and the ongoing financial crisis in international financial markets.