Singapore's policy of non-internationalisation of the Singapore dollar and the Asian dollar market

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1. Introduction

This paper provides a brief review of Singapore's experience with its policy of non-internationalisation of the Singapore dollar (SGD policy) and the development of the Asian dollar market in Singapore. However, it needs to be emphasised at the outset that neither of these are capital account restrictions, as the last vestige of exchange controls in Singapore was repealed in 1978. Even prior to their removal in 1978, residents and non-residents alike were free to remit funds into and out of Singapore. This was predicated on Singapore's outward-oriented economic development strategy.

2. Policy of non-internationalisation of the SGD

2.1 Background and rationale of the SGD policy

The Monetary Authority of Singapore (MAS) has a long-standing policy of not encouraging the internationalisation of the SGD. This stems from MAS's use of the exchange rate as the principal tool of monetary policy. The policy is aimed at ensuring that the growth of the SGD market is commensurate with the development of the economy and that the effective conduct of MAS's monetary policy is not compromised. Monetary policy in Singapore is centred on management of the trade-weighted SGD exchange rate.

The high import content of Singapore's domestic expenditures means that domestic inflation in Singapore is largely determined by changes in foreign prices and the exchange rate. Traditional monetary policy instruments, such as money supply and interest rates, are therefore less effective in controlling output and prices given the openness of our economy. Hence, a strong and credible currency is a key pillar of Singapore's macroeconomic policy. Moreover, in Singapore's earlier stages of development, a hard currency was an important sign, and also direct outcome, of the Singapore government's pursuit of sound, disciplined and consistent macroeconomic policies. This differentiated Singapore from the many developing countries with chronic budget deficits.

In line with Singapore's open economy and its emergence as an international financial centre, Singapore progressively dismantled exchange controls in the 1970s, until all restrictions were removed in 1978. The absence of exchange or capital controls, coupled with the small size and openness of our economy, made the conduct of monetary policy that much more difficult when Singapore shifted to an exchange rate centred monetary policy in 1981.

Hence, MAS maintained an explicit policy of not encouraging the internationalisation of the SGD, ie the use of the SGD outside Singapore for activities unrelated to its real economy. Under the policy, the extension of bank credit in SGD to non-residents was limited except for the purpose of funding economic activities. In addition, some restrictions were placed on interbank SGD derivatives, such as FX, currency and interest rate swaps and options, which could facilitate the leveraging or hedging of SGD positions. These restrictions made it harder for potential speculators to short the SGD, and signalled unambiguously our disapproval of such speculation.

The SGD policy has served Singapore well. The strength and stability of the SGD have instilled confidence and kept inflation low. This in turn has provided the foundation for sustained economic growth as well as continued strengthening of the SGD.

2.2 Limitations of the SGD policy

While our SGD policy has been a valuable and effective deterrent against speculative attacks on the SGD, no restrictions can render the SGD, or any other currency, completely impervious to speculative attacks.

Indeed, our best defences against such attacks have been Singapore's sound economic fundamentals and a credible exchange rate policy that is aligned with underlying fundamentals. These conditions render it unattractive for would-be speculators to bet on a major appreciation or depreciation of the SGD. As highlighted by the IMF,[1] Singapore's success in maintaining internal and external balance also owed much to the Singapore government's steadfast pursuit of a set of sound and prudent monetary and fiscal policies.

2.3 Impetus to liberalise the SGD policy

The SGD policy is not without cost. The safeguards we had put in place under the policy might have hindered the development of our capital markets, in particular the bond markets. In addition, despite the SGD being freely convertible, some potential foreign investors might have been deterred from investing in Singapore as they did not fully understand the policy.

Changes in our economic and financial environments have also created the impetus to liberalise our SGD policy. As Singapore's financial industry matures and its economy becomes more internationalised, corporate players and financial institutions have a greater need for SGD and its derivatives for commercial transactions. At the same time, the domestic economy and financial system have grown and become more mature and resilient. This has strengthened our ability to manage the exchange rate and given us room to liberalise our policy.

2.4 Initiatives to liberalise the SGD policy

Hence, since 1998, MAS has undertaken four major reviews of the SGD policy to keep it updated and relevant in the face of changing economic and market conditions, and liberalised the policy where warranted.

Table 1 below traces the evolution of Singapore's SGD policy over the past 20 years.

2.5 Existing SGD policy

Following the revisions to MAS 757 in March 2002, only two core requirements of the policy remain. First, financial institutions may not extend SGD credit facilities exceeding SGD 5 million to non-resident financial entities where they have reason to believe that the proceeds may be used for speculation against the SGD. This continues to be necessary to prevent offshore speculators from accessing the liquidity in our onshore FX swaps and money markets.

Second, for a SGD loan to a non-resident financial entity exceeding SGD 5 million or for a SGD equity or bond issue by a non-resident entity that is used to fund overseas activities, the SGD proceeds must be swapped or converted into foreign currency before use outside Singapore. This guideline is unlikely to stand in the way of market development, as the SGD is not a currency commonly used for transactions abroad, and non-resident entities will in any case wish to swap or convert the SGD proceeds into a currency of their choice for overseas use.

With this latest review and liberalisation, all impediments to capital market developments have been removed and the policy is reduced to its essence of discouraging speculation on the SGD through the above two requirements. These are unlikely to hinder the activities of legitimate players, while providing us with some basic safeguards against funding of speculative activities on the currency.

[1] IMF Country Report No 01/177, "Singapore: Selected Issues", October 2001.

Table 1

Evolution of the SGD policy of Singapore

Period	Events
1983	Issue of MAS Notice 621, which codified the policy of discouraging the internationalisation of the SGD.
1992	Amendment to MAS Notice 621 to allow the extension of SGD credit facilities of any amount to non-residents where the SGD funds were used for activities tied to economic activities in Singapore.
13 Aug 1998	The new MAS 757 replaced MAS 621. MAS 757 reaffirmed the basic thrust of the SGD policy, but contained clearer and more explicit provisions than MAS 621. This would minimise the need for banks to consult MAS. Some activities under the SGD policy, specifically in relation to arranging SGD equity listings and bond issues of foreign companies, were relaxed to foster the development of the capital market in Singapore.
26 Nov 1999	Key changes were made to MAS 757 to allow banks to: (1) transact all SGD interest rate derivatives with non-residents freely. This followed the launch in September 1999 of the SGD interest rate futures on SIMEX (now Singapore Exchange) where participation was open to residents and non-residents; (2) arrange SGD equity listing for foreign companies freely, provided the proceeds were converted into foreign currency before being used outside Singapore.
6 Dec 2000	Key changes were made to MAS 757 to allow banks to: (1) lend SGD to non-residents for investment purposes in Singapore. This would allow non-residents to obtain SGD funding for investment in SGD equities, bonds and real estate, and broaden the investor base for SGD assets; (2) extend SGD credit facilities to non-residents to fund offshore activities, as long as the SGD proceeds were first swapped into foreign currency before being used outside Singapore.
20 Mar 2002	Key changes were made to MAS 757 to: (1) exempt all individuals and non-financial entities from the SGD lending restrictions of MAS 757. This recognised that such entities were not usually the prime drivers of destabilising currency speculation; (2) allow non-resident financial entities to: (i) transact freely in asset swaps, cross-currency swaps and cross-currency repos. Previously, such transactions were treated as forms of SGD lending; (ii) lend any amount of SGD-denominated securities in exchange for both SGD and foreign currency denominated collateral. Previously, lending of SGD securities exceeding SGD 5 million had to be fully collateralised by SGD collateral; (iii) transact freely in SGD FX options with non-resident entities. Previously, such transactions were allowed only if they were supported by underlying economic and financial activities in Singapore.

3. The Asian dollar market

3.1 Background

Most banks in Singapore operate both a domestic banking unit (DBU) and an Asian currency unit (ACU). The segregation between the ACU and the DBU within a bank is essentially only in accounting terms, ie the ACU and DBU are but separate accounting books. Banks are allowed to deal with any currency in the DBU. In the ACU, they are allowed to deal in all currencies except for the SGD.

3.2 Rationale for allowing banks to operate ACUs

Singapore first allowed the establishment of ACUs in 1968 as part of its initiatives to develop Singapore as a regional financial centre. Singapore had a time zone advantage, bridging the gap between the close of markets in the United States and the reopening of business the next day in Europe. In addition, Singapore was well placed, with its good infrastructure and political stability, to serve as a point of intermediation for fund flows in an industrialising Asia. The development of an offshore Asian dollar market (ADM) also took cognisance of the limitations of Singapore's small domestic banking market.

The ACU is subject to fewer regulatory rules and requirements than the DBU. Banks are therefore able to accept non-SGD deposits and lend out non-SGD funds more freely through the ACU, paving the way for the creation of the ADM in Singapore (the counterpart of the eurodollar market in London). In addition, unlike in the DBU, statutory reserves need not be maintained for deposit liabilities in the ACU.

Notwithstanding the existence of separate ACUs and DBUs in the banking system in Singapore, there are no restrictions on residents or non-residents moving their funds between the ACU and DBU.

3.3 Analysis of ACU assets and liabilities[2]

From its modest beginning, the ADM expanded, reaching total assets of USD 463 billion in July 2002. The total asset size of the ADM peaked in November 1997 with a total asset size of USD 560 billion, but shrunk subsequently in tandem with the Asian crisis (see Graph 1).

The strength of the DBU market could have reflected the continued confidence in the SGD from investors. The bulk (more than 99% in July 2002) of DBU non-bank deposits are in SGD. From the beginning of 1990 to end-2001, the non-bank deposits of the DBU grew annually by 10.8%, exceeding the 6.9% on the ACU side (see Graph 2). Pre-Asian crisis, from the beginning of 1990 to end-1996, the annual growth rates in non-bank deposits of the DBU and ACU were 12.0% and 8.2%, respectively.

The DBU has been able to maintain its share of funds that non-bank depositors place with banks in Singapore, despite the rapid development of the ADM. At end-1989, resident and non-resident non-bank depositors held 80% and 9%, respectively, of their total deposits with banks in Singapore in the DBU. At end-July 2002, the corresponding proportions for both groups of depositors increased to 83% and 12%, respectively.

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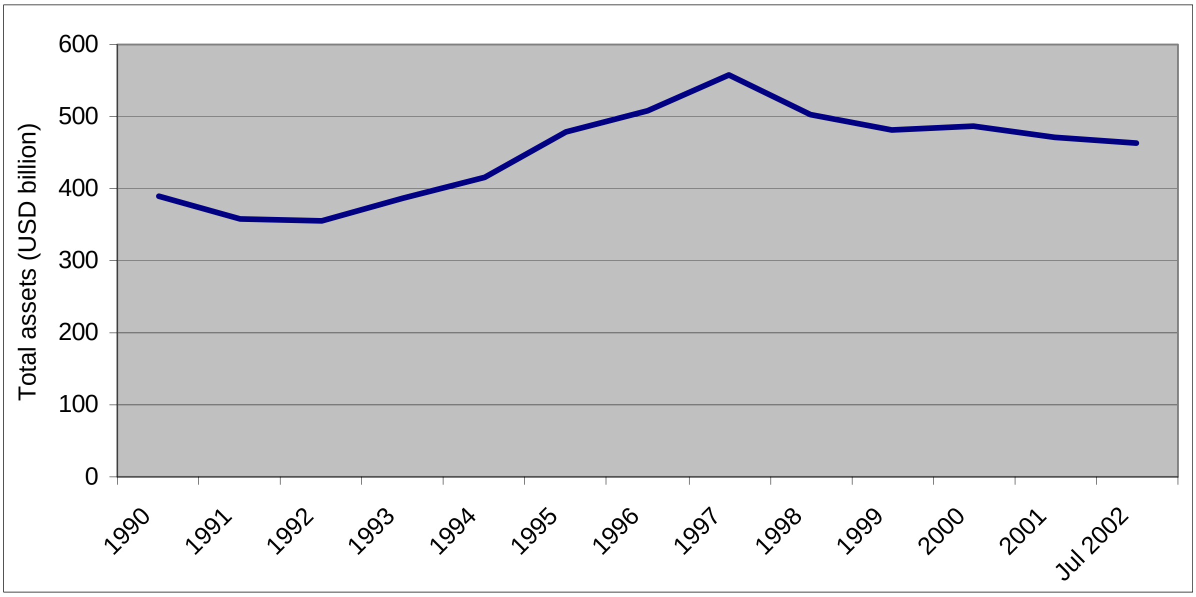
[2] Figures used in this section are extracted from the MAS Monthly Statistical Bulletin.

Graph 1

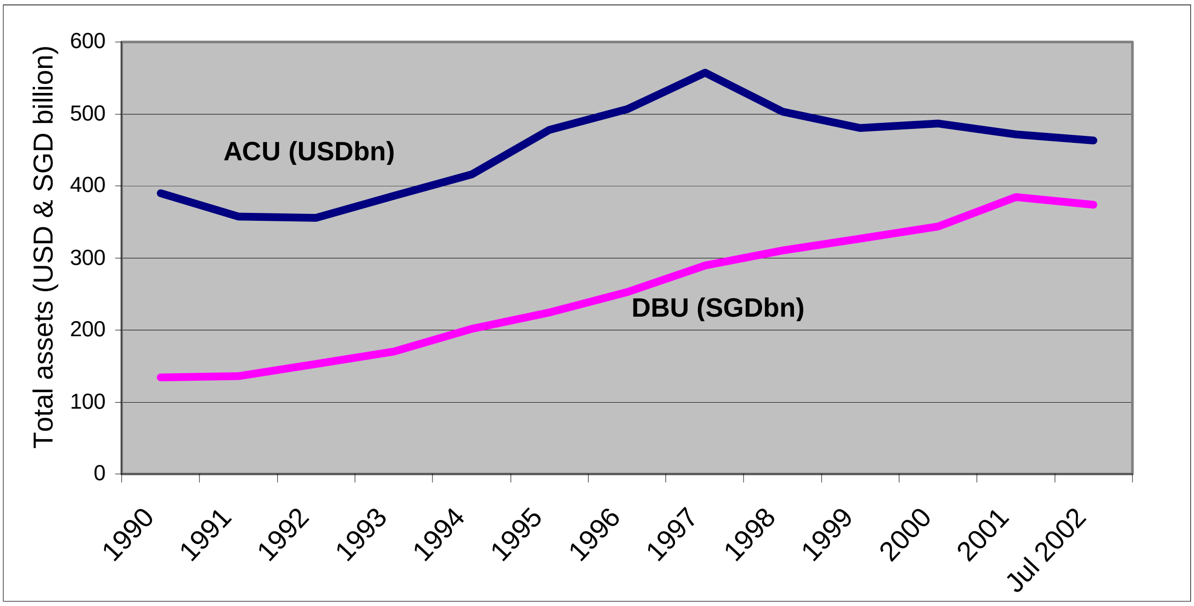
Total asset size of Asian dollar market (1990 to July 2002)



Source: Monthly Statistical Bulletin, MAS.

Graph 2

DBU vs ACU total asset size (1990 to July 2002)



Source: Monthly Statistical Bulletin, MAS.

Funds raised in the ACU from overseas bank and non-bank depositors are largely re-channelled out of Singapore through placements with banks and loans to non-bank borrowers outside Singapore, as shown in Table 2 below. In July 2002, only USD 2.5 billion or 1% of funds raised in the ACU from bank and non-bank depositors outside Singapore was retained in Singapore. Hence, although there are no restrictions which specifically limit the amount ACUs can lend to domestic borrowers, the net impact of ACU activities on the capital account of Singapore has been limited.

Table 2

ACU assets and liabilities in July 2002

ACU items	Amount (USDm)
Amount due to banks outside Singapore	246,760
Deposits from non-bank investors outside Singapore	86,079
Sub-total: amount raised from banks and non-banks outside Singapore	**332,839**
Less:	
Amount due from banks outside Singapore	251,670
Loans to non-bank borrowers outside Singapore	78,711
Sub-total: amount lent to banks and non-banks outside Singapore	**330,381**
Total: net amount retained in Singapore	**2,458**

Source: Monetary Authority of Singapore, September 2002.

References

For additional information, please refer to the following documents, which are available on the MAS website (www.mas.gov.sg):

Lee, H L (1998): "Improving the hardware and software of the financial sector", speech by Deputy Prime Minister Lee Hsien Loong, Chairman MAS, at the Official Launch of the MAS Electronic Payment System, 13 August.

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