Singapore Government
PRESS RELEASE
Information Division, Ministry of Culture, City Hall, Singapore 0617 • tel: 328191 ext.352,353,354 / 362207 / 362271.

National Archives and
Records Centre, Singapore.
16 JUN 198
Acc No. NAR
80 0032 8

08-1/80/06/06.

ADDRESS BY MR HON SUI SEN, MINISTER FOR FINANCE,
AT THE ASSOCIATION CAMBISTE INTERNATIONALE (ACI) CONGRESS
TO BE HELD AT THE SHANGRI-LA HOTEL ON FRIDAY, 6 JUNE '80 AT 10.45 AM

On behalf of the Government and the financial community in Singapore, I would like to extend a very warm welcome to all delegates and guests to this Conference. We in Singapore are very pleased to host this Congress, especially since this is the first time it has been held outside Europe and the United States. We view this occasion as important in the recognition accorded to Asian foreign exchange markets in general and the Singapore market in particular.

As we meet, now already five months into the new decade of the Eighties, the world economic scene looks far from satisfactory. Interest rates and inflation levels have earlier scaled unprecedented peaks which will never look quite as invulnerable again. The United States is going into a recession, and other industrial countries are also slowing down, with no assurance that inflationary pressures will correspondingly ease. The increases in oil prices and the uncertain supply situation continue to exert a negative influence on business expectations. Unemployment in most industrial countries remains stubbornly high, yet the demand for high wage increases persists as workers strive to maintain living standards. The mechanism for restoring economic equilibrium cannot work as long as political considerations interfere with the pricing of essential commodities and resources regardless of the underlying economic forces. Because of the interdependence of nations, the disequilibrium can adversely affect countries both developed or developing, producers and non-producers.

Nearer home, in Asia, there is perhaps some light amidst the encircling gloom. The past decade has, for some countries at least, been a period of steady growth. In particular the performance of Japan, Korea, Taiwan and Hong Kong has attracted attention because above average rates of growth were attained with relatively moderate rates of inflation. Our neighbours in ASEAN have also recorded impressive rates of growth. Those of you who can find time to visit Indonesia, Malaysia, the Philippines and Thailand will feel the strong pulse of economic activity. During the Seventies, the annual rate of economic growth, in real terms, of ASEAN countries was 7.3% whereas in OECD countries, it was only 3.4%.

Not having a crystal ball, I hesitate to forecast whether for the world economy the coming decade will be as favourable even as was the last. Certainly, given the prevailing economic and political climate, pessimists outnumber optimists - and the frequency with which the media employ the words "recession" and "Third World War" undoubtedly colours the environment and thinking of many of you who are in the forex markets of the world.

On the monetary scene, developments have also been far from tranquil. We have just gone through an eventful period which has experienced something resembling a competitive interest rate and exchange rate war. Interest rates started to surge in the latter half of 1979. US banks' prime rate rose from 11.5% in June to 15.75% at end-December. An unrelenting escalation early this year brought the prime rate to 20% in early April. With each round of interest rate increase by the US, country after country adjusted their own interest rates, not only to curb inflationary pressures, but also to counter the disruptive outflows caused by a strengthening

US dollar. The raising by the Federal Reserve of its discount rate from 12% to 13% in mid-February touched off a new round of interest rate increases. The Japanese discount rate was raised from 6.25% to 7.25%. West Germany raised its rate by 1% to 7% and the Swiss rate was adjusted from 2% to 3%. Following the later monetary tightening measures by the US, Japan had to increase its discount rate, the fifth in a year, by 1.75% to a historic high of 9%. In parallel with the interest rate developments, the US dollar strengthened by 9.8% against the DM, 10.9% against the Swiss Franc and 7.9% against the Yen.

Interest rates have plunged just as dramatically as they have risen. After reaching a peak of 20% in early April, the US prime rate dropped steeply to 14% at the end of May 1980. As US interest rates continue to decline, pressure will be building up for rates in major industrialised countries to be adjusted downwards. The effects of reductions in US interest rates have been reflected in foreign exchange markets where the US dollar weakened.

Singapore, as an open economy with financial flows unrestrained by exchange control, has not been insulated from the worldwide escalation and subsequent decline of interest rates. Our interest rates move closely in line with international interest rate trends. When the US prime moved up in the second half of 1979, our prime rate moved up from an average of 8.12% to 9.42%. Similarly, in 1980, the local prime rate was adjusted upwards to 12% in late April. In line with the decline in external rates, our local prime rate moved down to slightly below 12% at the end of May.

In recent years, under the growing influence of monetarists, there has been a movement by major industrial countries towards setting monetary targets. In view of rapidly rising inflationary pressures, much emphasis has been placed on meeting money supply targets. As one concerned over many years with turning theory into practice, I believe the guide posts to beating inflation are not nearly as obvious or straightforward as some monetarists would have us believe. There are many, perhaps too many, varieties of money supply. It would be difficult to conceive that inflation could be resolved by a purely mechanistic application of controls based on acceptance of any particular version of M.

Judgement, commonsense, intuition and intelligent appraisal of monetary aggregates and other variables (which need not only be of the economic variety) must also be taken into account. An element of psychology must often be wedded to economic policy if the overall economic strategy is to succeed. Monetarism alone is not enough.

Indeed, there seems now to be some general recognition, for example, of the virtue in governments having balanced budgets. But it is remarkable, still, how many governments exhort their citizens to increase their savings while the public sector runs large budget deficits.

Nevertheless, I note with interest the emphasis which the Fed now places on money supply as reflected in bank reserves rather than on the Fed Funds rate. The recent sharp movement in US interest rates appears to reflect this shift in emphasis. This prompts us to question whether we should not re-examine the various monetary tools for a more effective combination of techniques to achieve our monetary objectives. A recent consultative paper by the Bank of England which

proposed a monetary base indicator takes into account the need to control both the monetary base as well as interest rate movements. Under the scheme, the interest rate changes automatically in line with changes in money supply, thus triggering movements pegged to a desired monetary growth path. Their experience with this new scheme should be interesting.

There is undoubtedly scope for improvement in monetary management. In this respect, the US decision to impose reserve requirements on some assets held outside the banking system, namely types of consumer credit, is an interesting development, which has implications for the traditional emphasis on controlling liabilities. As these new controls are discussed, we may expect to see fresh approaches to monetary management.

Domestic monetary management has often been said to have been complicated and made ineffective by the Euro dollar market. The unregulated or unlimited expansion of international liquidity facilitated by the market is often blamed for problems which countries face. Calls for the control, regulation and supervision of the market are loudest when monetary targets are not met. In the last year, therefore, as in 1972 and 1973, renewed concern was expressed over the potential disruptive impact of Euro dollar type activities. While there is some basis for concern and I accept that a greater degree of surveillance may be desirable, I do not see the need for restrictive controls, such as through the imposition of reserve requirements. The Asian dollar and Euro dollar markets play a useful and important role and their functioning should not be stifled by overly restrictive measures. As a consequence of the Herstatt-related developments in 1974,

banks involved in Euromarket activities have improved their prudential controls. The authorities have begun and are continuing their efforts to improve information flows and standards of supervision. I welcome the role played by the Bank for International Settlements in this respect. There seems to be a growing acceptance that banks should consolidate their balance sheets to cover their worldwide operations. Most well run banks already do this, anyway.

There has been surveillance of the Asian Dollar Market since the earliest days. We have sought from banks operating in this market regular returns giving information which we believe any prudent bank would require for itself even if there were no regulatory body.

While we have often been flayed in the media for the degree of surveillance we exercise, I believe that secretly most bankers are appreciative of our efforts. It is as much in the interest of the entire banking industry as of ourselves that the integrity and stability of the financial system be preserved and protected.

I suppose that we must expect a love-hate relationship between the banks and their supervisory or associated authorities

On an international plane, for example, this is manifested by those who make loans to countries with balance of payments difficulties. Nobody forces international banks to make such country loans. However, if from such loans any problem of default then arises, a surprising number of banks are only too ready to remind the IMF and the World Bank of their responsibilities and to ask them to mount a rescue. It would not be surprising if they should find a somewhat less than sympathetic

reaction from IMF officials, especially if the IMF had failed previously in imposing its conditions for a loan to correct the cause of imbalances in a count / because the country concerned found a more accommodating banker.

During the past ten years, we have moved from one monetary crisis to another. There is no assurance that for the next decade we shall be any better equipped to meet the problems that are being carried over or are re-emerging. The basic structural problem in the international financial markets remains unresolved. There is no system yet which is anywhere near acceptance.

We have endured years of floating exchange rates and in this period the financial markets have had to cope with the massive recycling problem created by the several-fold increase in the price of oil. The Herstatt failure all but precipitated a major breakdown of the international financial system. Volatility in the exchange markets has become the norm rather than the exception. While the world has had to live with floating rates of exchange, most efforts being exerted to find a more suitable system point to a desire to return to a more stable regime.

First, there are many supporters of the IMF created Special Drawing Right (SDR). The growth in the number of banks which accept SDR denominated deposits is one manifestation of the search for a stable store of value.

Second, those who do not believe in the SDR have turned to the hard currencies such as the Swiss Franc and the Deutschemark. This trend has gathered momentum despite the resistance of the German and Swiss Central Banks.

Third, the re-emergence of gold in the last twelve months has been most spectacular.

Fourth, the arrangements in the European Monetary System (EMS) make up an interesting effort to co-ordinate intervention so as to maintain stability of rates in the participating member countries.

Finally, the recent efforts by the IMF to promote a Substitution Account represent yet another attempt at stabilisation.

Have floating exchange rates been able to accommodate the diversity of domestic policy objectives and the autonomy in economic management desired by countries? I doubt if any other alternative could have coped with the violent upheavals which financial markets faced in the last ten years. Interest rate and exchange rate developments indicated a need for collaboration and exchange of views among countries to reduce conflicts arising from divergent economic objectives. Encouraging steps were taken in cooperation and greater coordination of action to reduce volatility in exchange markets, such as through swap arrangements, issues of Carter bonds and the proposed offering by the Swiss authorities of Swiss Franc facilities directly to central banks.

Though all currencies are technically operating in a floating exchange rate regime, exchange rates have in effect not been floating freely. Central banks have found it necessary to intervene at times rather heavily. Such intervention has often reflected the need to offset the effect of massive destabilising capital flows. In the absence of official intervention, it is questionable whether market forces alone could have brought about the necessary adjustment without undue damage.

Efforts to coordinate intervention to introduce greater stability in the exchange markets have included setting desired margins within which exchange rates may move, an arrangement closely resembling the fixed but adjustable exchange rate system. The European Monetary System and other regional efforts towards monetary union demonstrate a desire for greater discipline within a generally floating exchange rate regime.

Obviously, the floating rate system has its limitations. Many look back nostalgically to the golden era when the Bretton Woods System functioned for a quarter of a century after its inception in 1945 and the steady and comfortable profits which foreign exchange traders made with very little risk. That era ended because the United States was in danger of losing more gold than she was prepared to lose, and the Bretton Woods System was suspended by President Nixon in 1971. The world was then told that gold was no longer important - that the system was flawed because of gold.

Were we justified in phasing out the monetary role of gold? The non-monetary role in future for gold is now legally enshrined in the Articles of Agreement of the IMF. It is legitimate to question the wisdom of the IMF in supporting the demonetisation of gold. Opposed to those doing everything possible to phase out gold's role in the monetary system, there are now some beginning to be convinced of the need for retaining it. The recent upsurge in the gold price to a peak of 20 times the last "official" price of US$42.2/oz clearly demonstrated that gold still has a wide following. Demand came not only from private but, it is understood, also from official sources, notwithstanding the official lip service to gold demonetisation.

A return to a modified gold or a gold exchange standard would be facilitated perhaps if current gold prices could be taken as official prices somewhat along the method of valuation in the EMS. I recognise that this is not the most fashionable or orthodox view on gold and its role in the monetary arena at the moment. I am also aware that there are political and other difficulties in going back to gold. But a trend was set by the demonstration of belief in gold in the European Community's decision to have gold backing for the unit of account in the European Monetary System (EMS). This, I believe, is an element of great strength in the EMS system.

Given time to eliminate the technical problems of operating the system, it would not be surprising to find the EMS growing in influence. If the ECU (European Currency Unit) is allowed to evolve and develop in usage so that it can be freely transacted in international markets, it may well end the financial world's search for an alternative to the dollar.

Similarly, the preservation of the IMF's holdings of gold would go a long way towards maintaining confidence in the IMF as an international financial institution or in any of its creations such as the SDR or the Substitution Account. If the IMF were to sell all its gold, its credibility could be irreparably damaged.

On a national basis, I am sure countries which have built up their gold holdings are better able to meet present day political and economic problems and other uncertainties. The discipline of gold is salutory, especially for governments.

The man in the street has refused to accept the propaganda that gold should be demonetised. In this part of the world the value of gold as money was vividly demonstrated by the experience of the Vietnamese boat people. Without gold, they could not have escaped their unhappy lot in Vietnam.

So in those countries where governments show a disinclination to persevere with stabilisation policies, there should be no surprise if the man in the street turns away from paper currencies - to that much abused barbarous relic.

Perhaps what is surprising is that when the Bretton Woods System was cast aside, so many believed that gold no longer mattered. It was only last year that the penny dropped - and the rush into gold became widespread.

Meanwhile, like the search for the philosopher's stone, learned academics and economists and, I may add, most central bankers and Ministers of Finance, strive valiantly for a new international monetary system which would still be without gold as an important, if not the major, element. I wish them well but have little hope of their success.

I would like to end by wishing all participants a fruitful and successful meeting of your Congress. With so much happening around us, by far the most rewarding discussions will be in the corridors outside of the formal sessions.