

Data Response Questions: N1997

MONETARY DEVELOPMENTS IN SINGAPORE

The following are extracts about the Monetary Authority of Singapore (MAS)

Extract 1

THE Monetary Authority of Singapore is clamping down on unsecured personal credit and car loans, in a move to stem explosive growth in lending and ensure greater prudence in the banking system.

Giving its rationale for these measures, MAS said it was concerned with the sharp jump in bank loans to individuals last year, given the availability of easy credit terms.

Left unchecked, this could lead to excessive credit expansion in the economy and an over-concentration of the banks' business on loans to individuals – two problems which could affect adversely the soundness of the financial system here, MAS said.

Extract 2

THE Monetary Authority of Singapore (MAS) said on Wednesday it expected Singapore's gross domestic product (GDP) to grow by only 7.8 per cent this year, suggesting that the economy may be slowing down faster than previously anticipated.

MAS said that with the economy now running close to its potential output, inflationary pressures should be dampened.

The 'potential output' measures the maximum amount of goods and services that the economy can produce, given its supply-side conditions, without triggering inflation.

However, MAS noted that exchange-rate management would continue to be targeted at domestic price stability this year.

"With full employment, any attempt to hold down the Singapore dollar artificially would only buy a temporary improvement in competitiveness. It would be quickly undermined by higher inflation," the report said.

Source: The Straits Times (Singapore)

- (a) (i) By what name are organizations such as the MAS usually known in most economies? [1]
- (ii) Explain how
1. Excessive credit expansion and
 2. an over-concentration on loans to individuals might affect the health of the economic system of Singapore. [4]
- (b) Consider the possible link between the MAS action in Feb 1995 (extract 1) and the predictions for economic growth reported in July 1995 (extract 2) [3]
- (c) Explain how higher inflation might result from holding down the exchange rate. [2]
- (d) Explain why any attempt to hold down the Singapore dollar artificially would only buy a temporary improvement in competitiveness. [2]
- (e) 'MAS noted that exchange-rate management would continue to be targeted at domestic price stability this year.' Explain why MAS uses exchange-rate management to achieve domestic price stability instead of monetary policy. [4]
- (f) Evaluate two ways in which the 'potential output' of an economy may be expanded. [4]

(a) (i) By what name are organizations such as the MAS usually known in most economies?

[1]

Central Banks

(ii) Explain how

a. Excessive credit expansion and

b. an over-concentration on loans to individuals might affect the health of the economic system of Singapore.

[4]

1. Volume of credit – affects the overall money supply. It can be potentially inflationary if the economy runs out of capacity.

⇒ money supply ↑ ⇒ interest rate ↓ ⇒ C and I ↑

⇒ AD ↑ and this might lead to **inflation** if the current output is near or at the full employment level

2. Direction of credit – it can threaten the survival of banks if consumers default on these unsecured loans in the event of e.g. slump in the property, share market or slump in the economy. In the long run it could also hurt the economy if it encourages over-consumption [i.e. under-saving].

An over-concentration on loans to individuals:

⇒ crowding-out loans available for firms which are funds for investing on capital goods which increase a country's productive capacity

⇒ too risky for banks to over-depend on just personal loans; danger of individuals' bankruptcy and banks will run into liquidity problem; better to diversify into many types of investments

(b) Consider the possible link between the MAS action in Feb 1995 (extract 1) and the predictions for economic growth reported in July 1995 (extract 2)

[3]

In Extract 2, we read that Singapore is near full employment (potential output) and it is predicted that economic growth would slow down. This means that any excessive increase in AD left unchecked will result in inflation and not much change in real GDP. Thus to reduce AD, MAS, in Extract 1 has adopted deflationary measures by clamping down on personal and car loans thus reducing consumption.

The anti-inflationary stance taken by MAS was meant to preempt/forestall a potential threat to sustaining economic growth. If aggregate demand rise too fast, the economy might overheat and growth would be stalled. The MAS has acted to moderate demand by curtailing credit.

The idea is to ensure a stable monetary environment to support sustained growth.

Note: A fall in the rate of GDP growth ≠ a fall in GDP.

(c) Explain how higher inflation might result from holding down the exchange rate.

[2]

A weakening of the exchange rate would mean that imports would be more expensive in terms of the domestic currency. This is called import-price push inflation; Also, exports will be relatively cheaper and thus net exports may rise and thus AD rises and will be inflationary if the economy is experiencing tight capacity.