



Monetary Authority of Singapore



Singapore's Exchange Rate-Based Monetary Policy

Since 1981, monetary policy in Singapore has been centred on the management of the exchange rate. The primary objective has been to promote price stability as a sound basis for sustainable economic growth. The exchange rate represents an ideal intermediate target of monetary policy in the context of the small and open Singapore economy. It is relatively controllable through direct interventions in the foreign exchange markets and bears a stable and predictable relationship with the price stability as the final target of policy over the medium-term. There are several key features of the exchange rate system in Singapore.

First, the Singapore dollar is managed against a basket of currencies of our major trading partners and competitors. The various currencies are assigned weights in accordance with the importance of the country to Singapore's trading relations with the rest of the world. The composition of the basket is revised periodically to take into account changes in trade patterns.

Second, MAS operates a managed float regime for the Singapore dollar. The trade-weighted exchange rate is allowed to fluctuate within a policy band, the level and direction of which is announced semi-annually to the market. The band provides a mechanism to accommodate short-term fluctuations in the foreign exchange markets and flexibility in managing the exchange rate.

Third, the exchange rate policy band is periodically reviewed to ensure that it remains consistent with underlying fundamentals of the economy. It is important to continually assess the path of the exchange rate in order to avoid a misalignment in the currency value. The length of the policy review cycle is typically six months. A Monetary Policy Statement (MPS) is released after each review, providing information on the recent movements of the exchange rate and explaining the stance of exchange rate policy going forward. An accompanying report, the Macroeconomic Review, provides detailed information on the assessment of macroeconomic developments and trends in the Singapore economy, and is aimed at enhancing market and public understanding of the monetary policy stance.

Fourth, the choice of the exchange rate as the intermediate target of monetary policy implies that MAS gives up control over domestic interest rates (and money supply). In the context of free capital movements, interest rates in Singapore are largely determined by foreign interest rates and investor expectations of the future movements in the Singapore dollar. Domestic interest rates have typically been below US interest rates and reflect market expectations of a trend appreciation of the Singapore dollar over time.

The exchange rate has emerged as an effective anti-inflation tool for the Singapore economy. Over the past twenty years or so since the exchange rate framework has been in place, domestic inflation has been relatively low, averaging 1.9% per annum from 1981 to 2010. As a result of the long record of low inflation, expectations of price stability in Singapore have become more entrenched over the years. The exchange rate system has also helped to mitigate the adverse effects of short-term volatility on the real economy, while at the same time ensuring that the exchange rate remains aligned with economic conditions and fundamentals. The success of the system owes much to the strong economic fundamentals of Singapore. These include prudent fiscal policy, flexible product and factor markets, sound financial system, and robust domestic corporate sector.