Monetary and fiscal responses

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Exchange rate policy: flexibility within a wider band

Singapore conducts monetary policy through the exchange rate, managing the Singapore dollar against a trade-weighted basket of currencies within a policy band.[1] Chapter C.V traces the origins of this framework. During the crisis MAS used the flexibility of the system in two ways. Having widened the policy band towards the end of 1997 in response to heightened volatility, it kept the wider band in place during 1998 as markets remained extremely volatile. It also eased its policy stance. Before the crisis MAS had allowed a trend appreciation of the currency to contain inflation in an economy running at full capacity. Once demand weakened and imported inflation disappeared, it stopped the appreciation.[2]

The result was a Singapore dollar that fell against the US dollar while remaining broadly stable in trade-weighted terms. In his first statement as chairman of MAS, Lee Hsien Loong explained that the authority had managed the currency with greater flexibility to maintain price stability and confidence in the Singapore dollar and the financial system without losing export competitiveness. A year later he described the policy as one that had kept the trade-weighted value broadly stable since July 1997.[3]

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MAS rejected a deliberate devaluation to restore competitiveness. In September 1998 Lee Hsien Loong told a Tokyo audience that pushing the exchange rate down would undermine confidence in the currency, with grave consequences. The authority remained ready to intervene against speculation that pushed the exchange rate in directions not justified by fundamentals.[4] This combination allowed the market to adjust the bilateral rate against the US dollar while protecting the anchor of confidence in the currency.

Interest rates and liquidity

Since the exchange rate is the principal instrument of monetary policy, interest rates in Singapore are largely determined by foreign rates and by expectations about the Singapore dollar. During the crisis these expectations produced sharp swings in the money market. The three-month interbank rate rose to 10.25 per cent on 19 December 1997. On 8 January 1998 the overnight rate peaked at 20 per cent and the three-month rate at 14 per cent, before both fell back as the currency recovered. The banks raised their deposit and lending rates by about half a percentage point at the end of November 1997, for the first time since June 1995, and twice more in January 1998.[5]

MAS did not attempt to hold interest rates down by force. It allowed the money market to absorb the shock, which signalled that it would defend the value of the currency. As confidence returned during 1998, domestic interest rates fell substantially, which MAS interpreted as a sign of the market's confidence in the Singapore dollar. The authority also eased the liquidity rules for banks. The chairman's statement of 1999 mentions that the minimum cash balance requirement had been halved to 3 per cent.[6]

No capital controls and no support purchases

Two decisions distinguished Singapore from several of its neighbours. It kept its capital account open, because its policy was to allow free capital flows and to remain plugged into the global economy. It also refused to conduct what Lee Hsien Loong called price-keeping operations in the stock market.[7] Investors could therefore leave

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Singapore at any time and at market prices. This openness made the city more vulnerable in the short term. It also preserved its reputation as a place where capital is free to come and go, which proved decisive for the financial centre in the years that followed.

The off-budget package of June 1998

Fiscal policy came into play in mid-1998. On 29 June 1998 the Minister for Finance announced an off-budget package of S$2 billion to cut business costs and support the economy. Among its measures were the lifting of the 3 per cent limit on tax deductions for general provisions by banks and merchant banks for the year of assessment 1999 and the suspension, for one year, of stamp duty on contract notes for share transactions. The package also aimed to build economic infrastructure and to help stabilise specific sectors, among them property and finance. Public construction, such as the North East MRT line and the reclamation of Jurong Island, supported domestic demand.[8]

The tax treatment of provisions shows how fiscal and prudential goals were combined. The budget of July 1997 had already raised the limit on tax deductions for general provisions to 3 per cent. The budget of February 1998 liberalised tax incentives to encourage banks to build up reserves against bad loans.[9] The state thus used the tax system to encourage the banks to recognise their regional losses early.

The Committee on Singapore's Competitiveness and the CPF cut

The decisive fiscal measure followed in November 1998. A committee chaired by the Minister for Trade and Industry had studied reductions in taxes, government charges, land and utility costs and wage costs, including contributions to the Central Provident Fund. On 23 November 1998 the government responded to the recommendations of the Committee on Singapore's Competitiveness with a cost-cutting package of S$10.5 billion. MAS estimated that the fiscal boost in 1999 would be about 3 to 3.5 per cent of GDP, similar to that of the mid-1980s.[10]

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The centrepiece was a cut in the employers' contribution to the Central Provident Fund, the compulsory savings scheme that Chapter D.I examines. By the mid-1990s employers and employees each contributed 20 per cent of wages. The employers' share was cut by ten percentage points in January 1999, to 10 per cent of wages. The CPF Board's own history records that the authorities considered deeper cuts unsustainable, because many members depended on their CPF savings to pay their monthly mortgages.[11] The cut lowered labour costs directly without reducing take-home pay. It used the CPF as an instrument of macroeconomic adjustment, as Singapore had done in the recession of 1985.

Wage flexibility and the labour market

The experience of 1985 shaped the response of 1998. Lee Hsien Loong explained in Tokyo that the earlier recession had been harder to manage because fixed wage increases could not be reversed. Since then a flexible wage system had been introduced, under which variable components made up 16 per cent of total wages. Wage costs were therefore expected to fall by 5 to 8 per cent on average in 1998. The National Wages Council, which had recommended wage restraint in June 1998, was reconvened to revise its guidelines.[12]

The tripartite system of government, employers and unions made these cuts politically possible. Union leaders had to explain the reduction in CPF contributions to members whose jobs were not at risk, as the CPF Board's history recalls.[13] The willingness of workers to accept lower costs in exchange for the protection of jobs became part of the national account of the crisis. It also confirmed a lesson that Singapore would apply again in later downturns: in a small open economy, adjustment through costs is faster and less damaging than adjustment through unemployment.

Notes

1. MAS, *Annual Report 1997/98*, p. 49 (MAS "will continue to manage the Singapore Dollar flexibly against a trade-weighted basket of currencies");

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MAS, *Annual Report 1998/99*, section "Exchange Rate Policy" ("the exchange rate is the principal monetary policy tool in Singapore"). ↩

2. MAS, *Annual Report 1998/99*, section "Exchange Rate Policy": "the policy band, which was widened towards the end of 1997 in response to heightened foreign exchange volatility, remained in place as financial markets continued to be extremely volatile through 1998"; MAS, *Annual Report 1998/99*, section "Exchange Rate Policy". ↩
3. MAS, *Annual Report 1997/98*, Chairman's Statement, p. 9: "On a trade-weighted basis, the exchange rate has appreciated slightly since mid-1997"; MAS, *Annual Report 1998/99*, Chairman's Statement, p. 9. ↩
4. Lee Hsien Loong, speech of 30 September 1998, para. 13; MAS, *Annual Report 1998/99*, section "Exchange Rate Policy". ↩
5. MAS, *Annual Report 1997/98*, pp. 53–54; MAS, *Annual Report 1997/98*, p. 54. ↩
6. MAS, *Annual Report 1998/99*, section "Exchange Rate Policy": "the substantial abatement of domestic interest rates over 1998 up to the present reflects the market's confidence in the Singapore Dollar"; MAS, *Annual Report 1998/99*, interview with the Chairman, p. 14: "halving the banks' minimum cash balance requirements to 3%". ↩
7. Lee Hsien Loong, speech of 30 September 1998, para. 10. ↩
8. MAS, *Annual Report 1997/98*, calendar of events, p. 22 (29 June 1998); MAS, *Annual Report 1997/98*, p. 48: package of $2 billion "aimed at reducing business costs, building economic infrastructure and capabilities, and helping to stabilise specific sectors", among them "the property and financial sectors"; MAS, *Annual Report 1997/98*, p. 40 (public investment in "the Northeast MRT line and the land reclamation project for the petrochemical complex on Jurong Island"). ↩
9. MAS, *Annual Report 1997/98*, calendar of events, pp. 20–21 (11 July 1997 and 27 February 1998). ↩
10. Lee Hsien Loong, speech of 30 September 1998, para. 15; MAS, *Annual Report 1998/99*, Chairman's Statement, p. 9 ("a $10.5 billion cost-cutting package last

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November") and section on fiscal policy: response to the CSC recommendations "on 23 November 1998 with a $10.5 billion package of cost-cutting measures on top of the $2 billion off-budget package in June", with a fiscal boost "of about 3-3.5% of GDP". ↩

11. Central Provident Fund Board, *Save & Sound: 70 Years of CPF*, Singapore, 2025, chapter 4, "Protecting the Nest Egg": contributions calibrated at 20 per cent each from employee and employer; during the crisis of 1997/98 the rate "was snipped by 10 percentage points in January 1999", as deeper cuts "would be unsustainable", since "many members depended on their CPF to pay their monthly mortgage"; Wikipedia, "Central Provident Fund" (accessed November 2026), section on history: the employer rate was "lowered to 10% for workers 55 years or younger" after the Asian financial crisis. ↩
12. Lee Hsien Loong, speech of 30 September 1998, paras. 17–19; Lee Hsien Loong, speech of 30 September 1998, para. 14. ↩
13. CPF Board, *Save & Sound: 70 Years of CPF*, chapter 4, account of a union leader at the then National University Hospital Employees' Union explaining the CPF rate cut during the Asian Financial Crisis. ↩

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