

Zeti Akhtar Aziz: Enhancing financial integration in the new Nusantara

Luncheon address by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the Malaysia-Indonesia Investment & Finance Summit, Jakarta, 18 June 2007.

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Ladies and Gentlemen:

There has been a long history that transcends several centuries in which international trade flourished in the Malay archipelago. The South East Asia region contained the important maritime routes for the trade between the East and West. This had brought with it, robust economic growth and regional prosperity.

Today, the South East Asian region – the Nusantara region continues to be one of the world's most dynamic regions. Since the turn of this century, our economies have re-emerged to be amongst the fastest growing in the global economy, amidst new challenges and fundamental economic and financial developments. Our steadfast reform and restructuring efforts have rewarded us with strengthened macroeconomic fundamentals and sound and stable financial systems. These efforts continue to be augmented by the strong foundations that the region possesses, namely abundant natural and human resources, high savings rates and the ingrained aptitude to persevere and rise to the challenge.

The ASEAN 5 group of economies that includes Indonesia, Malaysia, the Philippines, Thailand and Singapore have now for an extended period of time been on a steady growth path.

A more recent phenomenon in this decade, has been the increased economic and financial linkages within the region spurring further regional economic and regional financial integration. The geographical proximity and cultural similarities have been reinforced by the diverse strengths that exists in the region. These factors have been important in enhancing the integration process.

As this greater regional economic and financial integration is advanced, it will serve as a powerful catalyst for the future expansion of intra-regional trade and investment, creating a self-sustaining and mutually reinforcing economic growth in the New Nusantara region.

Ladies and gentlemen:

It is my pleasure today to speak on the potential role of an integrated economic and financial platform within the Nusantara region, a region of rapid economic growth in which almost 300 million Muslims resides. My remarks will focus on the potential generated by a collaborative platform and the significance of building linkages between the Nusantara region with other parts of the world.

The region's current economic progress, prosperity and financial stability has now accorded us a new strategic window of opportunity to develop new value propositions to unleash the full potential accorded by the accelerating economic and financial integration process. There are already encouraging formal and informal inter linkages between our respective financial markets as well as a higher level of engagement between the respective corporate communities, the market participants and the authorities.

A collaborative platform that is based on the diverse comparative advantages of the Nusantara economies can benefit from the complementarities between our respective economies. Essentially, these opportunities will increase the potential to expand markets, increase products lines and deepen the research and development capabilities. In this regard, the emergence of Islamic finance into the mainstream of the financial system is an opportunity for the Nusantara financial intermediaries, in particular, for Malaysia and Indonesia and other neighbouring countries, to open new frontiers and in so doing strengthen further the economic and financial linkages.

The building of a Nusantara financial platform would not only facilitate and mobilise the pool of investable funds from the respective economies but also allow for the more efficient allocation of the funds into the productive investments in other parts of the region. This would not only contribute towards lowering the cost of funds but it would also allow for greater diversifications of risks.

More recently there has been growing interest in cross border participation in investment activities in our respective economies. Malaysia's capital inflows into Indonesia has increased by three-fold totalling USD2.2 billion in 2006 compared to the previous year. It is estimated that Indonesia requires

approximately an annual investment of USD22 billion for the next several years for the development of its infrastructure, with a large part of the funding to be provided by the private sector. In the same way, the Ninth Malaysia Plan for the period of 2006 to 2010 has a financing requirement of RM107.6 billion. The development of our regional financial intermediaries and markets will facilitate the mobilisation of resources towards financing these potential activities and thus contribute to sustaining development in the Nusantara economies.

Ladies and Gentlemen:

The profound changes in the global economic and financial environment, has created a greater urgency for the Southeast Asian markets to achieve a greater degree of financial integration. This is so as to provide the scale and increased efficiency of the financial intermediation process. As the ASEAN economies move towards the formation of an economic-bloc by 2015, the pace of financial integration will need to accelerate, to better facilitate achieving this goal. The wide spread distribution of innovative hybrid financial products and regional cross selling activities will however increase the multi-dimensional dynamics of the markets and the risks across national borders. There will be increased complexity in identifying the risks which will in turn complicate the process of risk management. The increasingly integrated and liberalised markets will also expose our porous economies to greater external influences and to contagion risks. A higher level of vigilance is thus required to allow for pre-emptive policy measures in a timely manner. This will require adequate levels of cooperation among the regional regulators in addressing potentially contagion systemic risks and ensuring regional financial stability.

The deepening of co-operation between the Nusantara's monetary and regulatory authorities is thus a key factor in the development of a robust integrated platform. Enhanced cooperation will promote greater resilience and reduce regional vulnerability to external developments. There are now various regional mechanisms in place to undertake regional surveillance, to facilitate the exchange of information, to enter into greater engagement on issues affecting the region and in developing regional financial markets. In addition, frameworks for enhanced regional risk management, crisis management and resolution are also being put in place.

With greater financial integration, the region will be able to leverage on the advantages of economies of scale, innovation and more importantly place greater reliance on the cumulative strengths that resides within the region including our financial resources, skills and knowledge. It will also better position the region to collectively address emerging issues and challenges faced by the region taking into consideration the region's socio-economic context.

Ladies and Gentlemen:

While Islamic finance is gaining global interest and acceptance, the world's most populated Muslim region in the world, the New Nusantara offers opportunities for the accelerated expansion of Islamic finance. The intrinsic nature of Islamic financial structures encourages stability. Islamic principles require that the financial transaction be supported by genuine economic transactions. To further reinforce this, the governing Shariah principles also serve as a built-in self-regulatory mechanism that insulate Islamic instrument issuers from unproductive, speculative and unethical elements and thereby contributes to the stability of the financial system.

Historically, capital financing and investment flows into the Nusantara region have generally been sourced from the developed financial markets. While we may see continued growth in short term capital inflows from these traditional sources, the more competitive global environment provides no assurance of the sustainability of such longer term investment flows. Meanwhile, our own South East Asian region and that of North Asia and the Middle East countries continue to have high surplus savings seeking opportunities for investment and new asset-classes for greater risk diversification and improved returns on their investments.

Hundreds of years ago, the ports of Nusantara were destinations for the spice trade to Europe via India and the Middle East . In this context, Islamic finance can serve as a bridge that links the Nusantara region to the capital surplus economies. Already, our financial institutions are venturing to have a presence in the Middle East and we welcome their presence in our financial system. This has now in fact resulted in the cross-pollination of talents and resources, giving rise to innovative products and services, creating depth and breadth to the respective financial markets.

Just as the Straits of Malacca served as an important maritime conduit for the Nusantara region, Malaysia and Indonesia has the potential to serve as an important intermediary for mobilising capital to meet the requirements of the Nusantara region, and to be a distribution centre for shariah compliant

securities and to extend the regional Islamic capital markets to other parts of the world. Of importance will be our joint efforts to promote the standardisation of the Islamic regulatory and compliance matters. In relation to this, Malaysia and Indonesia is already working jointly to promote research capabilities and the pool of talent and technical expertise in Islamic finance.

A critical success factor for the cross-border promotion of Islamic finance is the harmonisation of the governing shariah frameworks between our jurisdictions. In this regard, Indonesia's extensive history of scholarly achievement in the subject matter relevant to the principles of Islamic finance can be leveraged upon for the benefit of the region. We are most hopeful for substantive convergence of interpretation and application of the shariah laws and guidelines for the region. The greater collaborative engagement between our respective scholars would indeed facilitate the process.

Ladies and Gentlemen:

The large gathering of senior representatives of the public and private sectors here today hints to the significant interest to capitalise on potential of the Nusantara economies. The efforts of the private and public sectors in building a collaborative platform as a resilient base for a network of linkages to the wider world, with God's grace, *insyallah*, will contribute to advancing the Nusantara Agenda that would unleash the potential of the region for a greater shared prosperity. Thank you.