

Zeti Akhtar Aziz: Strengthening relations between Indonesia and Malaysia

Remarks by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the Launch of PT. Bank Muamalat Indonesia, The Malaysian Branch and First Islamic Investment Bank Ltd, Kuala Lumpur, 5 March 2009.

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It is my pleasure to be here this morning on this occasion of the launch of the Malaysian branch of PT. Bank Muamalat Indonesia, and its subsidiary, First Islamic Investment Bank Ltd., established under the Malaysia International Islamic Financial Centre (MIFC) initiative to operate foreign currency Islamic financial business in Malaysia. This is a significant development as it represents the first Indonesian financial institution in the Malaysian financial system. Indeed, this occasion signifies a further step forward towards strengthening the bilateral, financial and economic relations between Indonesia and Malaysia. The setting-up of these two institutions in Kuala Lumpur would contribute towards accelerating the financial linkages that will underpin the expanding trade and investment ties between Indonesia and Malaysia. As the largest Islamic bank in Indonesia, we will also have the opportunity to leverage on our respective strengths and expertise and to mutually reinforce the benefits to be gained from this development.

Potential of Islamic finance amid slower economic growth in the region

Cumulatively, the total output of the ASEAN economies amounts to USD1.3 trillion while total trade of the ASEAN region now amounts to USD1.4 trillion. The growth of the ASEAN economies is no longer only export driven but for several years now has been driven by a growing domestic economy. In this current environment, most ASEAN economies have been adversely affected by the spill over effects of the global financial crisis. Sharp declines in export earnings are being experienced. The economies of ASEAN and greater Asia, however, have the potential to strengthen further their domestic economies. Indeed, in doing so this would contribute towards reducing further the global imbalances. In addition, being diverse economies we are also able to take advantage of the complementarities that exists in the region. This is reflected in the increased intra-regional trade and intra-regional investment flows. Intra-regional trade as a ratio of total trade of the region has increased from 30% in 1990 to 40% in 2007. Intra-regional investment flows now account for 12% of the region's foreign direct investment. With a total population of 575 million, ASEAN also has greater potential to increase its economic interface with the larger economies in greater Asia.

The current financial crisis is expected to accelerate the financial and economic integration in Asia. This should be viewed positively, not only towards the unwinding of the global imbalances, but also because this has the potential to contribute towards global growth. The banking sector in ASEAN and the greater Asian region will have an important role in facilitating this trend. Islamic banking in particular, which is a form of financial intermediation that is directly linked to trade and investment flows, has significant potential to facilitate this process.

Islamic finance requires all financial transactions to be supported by an underlying economic activity. There is now a renewed focus in the global community on generating real economic activity, generating jobs and generating overall financial stability. Following the developments that have led to the current global financial crisis, there is a greater recognition for the need to reduce the decoupling of the expansion of financial transactions and the growth of the real economy. This is in fact a fundamental requirement in Islamic finance thereby resulting in a close link between financial and real flows.

In Malaysia, the Islamic banking sector continues to progress, recording double digit growth over the recent 8 years with an average annual growth rate of 20% in terms of assets. As at the end of 2008, Islamic banking has increased its share of assets in the banking sector to 17.4%. The assets share of the takaful industry grew at 23% per annum in the recent five years, with family and general takaful capturing 11% and 7% respectively, of the overall insurance sector.

The MIFC initiative has focused on promoting Malaysia as an international Islamic financial hub, in particular in sukuk origination, foreign currency business, takaful, research and talent development. There has been a growing number of MIFC players with diverse business activities that range from international Islamic banking business in foreign currency to Islamic fund and wealth management, takaful and sukuk origination. The global sukuk market has expanded by an annual growth rate of 40%. Despite a slowdown in the sukuk issuance in 2008, there was still an estimated USD20 billion issuance taking place, with Malaysia remaining as the main issuer in the global market.

The prospect of Islamic finance continues to remain positive despite the more challenging international environment. The global financial crisis has resulted in heightened calls for more transparent forms of banking that are subject to stricter governance and risk management practices. There are also greater demands for increased regulation. Following the financial reform that may take place, the world may see a banking system that is significantly different from before to the crisis. Many of the features currently being discussed are in fact explicitly embedded in the Shariah requirements. The in-built check and balances in Islamic banking avoids the excesses and over leveraging, a feature precipitating the current financial crisis. Ensuring that the Shariah requirements are embraced in its entirety is vital to ensuring the robustness and resilience of Islamic finance.

Islamic finance must also draw upon the lessons derived from the current crises. It is vital that the regulatory regime based on the prudential standards issued by the Islamic Financial Services Board be implemented. This will further ensure the stability and soundness of the system. Liquidity management in the Islamic financial system and the institutional arrangements for resolution are among the other areas that need further development. Of critical importance is for the board and management of Islamic financial institutions to institute higher standard of leadership and a comprehensive governance culture and framework.

Mutual recognition in Shariah and human capital challenges

On this occasion, I would like to touch on **two areas** confronting Islamic finance firstly on, the issue of **mutual recognition in Shariah** and secondly the **human capital development in the industry**. Malaysia takes cognisance of the diversity of Shariah views within the region and among jurisdictions. Although Islam welcomes diversity of views, there is also a need to promote greater harmonisation among jurisdictions on the specific issues relating to Islamic finance. Such convergence is important for the long-term sustainability of the sector. Malaysia has taken the initiative to organise Regional Shariah Scholars Dialogue in 2006 and 2008 as part of the efforts to foster greater engagement among the Shariah scholars in the region. Indonesia has been active in these dialogues. Moving forward, the newly established International Shariah Research Academy (ISRA) has been entrusted to intensify the regional Shariah Dialogues as well as to enhance further the international engagement among Shariah scholars in our pursuit for Shariah harmonisation. Most encouraging is the greater appreciation and understanding that has been achieved in these deliberations of the Shariah practices that are peculiar to the respective jurisdictions.

The demand for skills in Islamic finance throughout this region and other international financial centres has generated further growth in Islamic finance. In this regard, Malaysia has also embarked on several initiatives towards creating a supply of qualified human capital both in Shariah and Islamic finance. The International Centre of Education in Islamic Finance

(INCEIF) is established to be a premier university in Islamic finance, to offer postgraduate qualifications in Islamic finance as well as the Chartered Islamic Finance Professional (CIFP) qualification. CIFP is the world's first Islamic professional qualification and it is accredited as a Masters degree level equivalent. Recently, INCEIF produced its first batch of 32 CIFP graduates from nine countries, of which three are from Indonesia.

INCEIF has also entered into strategic partnership with Universiti Airlangga in Surabaya and Universiti Indonesia in Jakarta where the CIFP programmes are now being taught. Through these strategic alliances, the efforts would be directed to jointly produce high-calibre talent that have the combination of knowledge in Shariah and finance.

It is our hope that PT. Bank Muamalat Indonesia would consider Malaysia as a platform for securing foreign currency business ventures in the region and contribute to the development of Islamic finance in Malaysia. I am confident that the international Islamic banking segment of Islamic finance in both countries will continue to make significant strides, in particular to bring to the next level the development of an international money market platform that allows for greater participation from a wider international financial community offering product suites that are denominated in other currencies and structured in a manner that would meet a wider range of applications and purposes. On this note, I wish to congratulate PT. Bank Muamalat Indonesia on the official launch of PT. Bank Muamalat Indonesia of the Malaysian branch to conduct foreign currency business as an International Islamic Bank under the MIFC initiative. I also wish to congratulate the newly established First Islamic Investment Bank Ltd., licensed under the Labuan Offshore Financial Services Authority.