

Zeti Akhtar Aziz: Asia's role as an important growth centre in the global economy

Opening address by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the First Asian Central Banks' Watchers Conference, organised by the Official Monetary and Financial Institutions Forum (OMFIF) and the Lafferty Group, Kuala Lumpur, 1 November 2011.

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It is with great pleasure that I welcome you to the first Asian Central Banks' Watchers Conference organised by the Official Monetary and Financial Institutions Forum (OMFIF) and the Lafferty Group. Bank Negara Malaysia is very pleased to host this event here in Kuala Lumpur.

Central banks have generally been the most watched organisations given the significance and far reaching implications of their actions on financial systems, the economy and the economic well being of the public at large. This is even more so during periods of financial stress and economic distress. During such periods, central banks have generally been at the forefront in managing such crisis and its consequences. Indeed, this current global crisis has prompted central banks in the United States and Europe to be closely watched given the impact of their actions on not only their own national economies but also on the rest of the world.

With the growing significance of the emerging economies in the world economy, our policy actions have increasingly drawn significant interest. In particular, given Asia's role as an important growth centre in the global economy and the growing significance of the financial markets in Asia as a destination for global financial flows, there has been increased focus on central banks in Asia.

Asian economies for several decades have established strong financial and economic linkages with the rest of the world. In this recent decade in particular, Asia has experienced significant structural changes that have altered the dynamics of the global economy and growth patterns. Since 2000, per capita income levels in Asia have risen twofold. With a growing middle class population that will reach 3.3 billion by 2030, Asia is projected to become the world's largest market for consumer goods and services. Low unemployment and a resilient financial sector has reinforced this trend. Domestic demand has continued to strengthen while the growth in intra-regional economic and financial activities has been sustained. Intra-regional trade now represents more than 50% of total trade, increasing from 32% in 1995. Similarly, intra-regional portfolio investments have risen from 20% of total assets holdings in 2001 to 28% today. The growth in cross-border trade and investments in Asia has not only provided the impetus for the development of the domestic economies, but also enabled the region to emerge as an important economic bloc.

A more recent phenomenon is the effort to promote greater regional financial integration through increased cross-border banking and financial activities within the region. Financial institutions in Asia are increasingly turning their focus to strengthening their regional presence taking advantage of Asia's enormous growth prospects. Malaysian banks, for example, operate in 13 countries across Asia, with total foreign assets expanding from only USD1 billion ringgit to more than USD100 billion between the period 2002 and 2010. Our payment and settlement systems are also being linked to facilitate more cost-effective cross-border and efficient investment flows. Efforts are currently underway to establish a Pan-Asian Central Securities Depository Alliance which will provide seamless accessibility to Asian securities by international investors.

The acceleration of regional financial integration in Asia is contributing to the more effective intermediation of funds from the region to be channeled towards meeting the investment

requirements of the region. Over the next decade, Asia's projected infrastructure development expenditure alone will be twice the estimated savings within the region. This provides investors with new investment horizons and significant diversification opportunities.

In charting the future for a more integrated Asia, the developments surrounding the sovereign debt crisis in Europe provides us with important lessons. Despite having common rules and established institutional arrangements, achieving consensus and coordination have proven to be a major challenge in an environment in which there are also many national priorities. These differences in priorities become even more pronounced during a crisis. Given that Asia is a far more diverse region, a different approach to economic and financial integration is being pursued. The aim is to put in place elements that will facilitate the deepening of trade and investment linkages within Asia while also collectively working towards strengthening Asia's resilience and stability.

Asia's economic transformation, comprehensive financial sector reforms and fiscal prudence have provided important support to Asia's resilience and ability to withstand the destabilising spill-over effects of the current ongoing global financial and economic crisis. In addition, the regional surveillance mechanisms are being reinforced by financial support facilities and an integrated framework for crisis resolution.

Every financial crisis has prompted a review of the role, function and authority of central banks. Indeed, developments in this recent four years have had profound implications on the central banks of crisis affected countries. The mandate of central banks for financial stability has generally been strengthened considerably to deal more effectively with risks in the financial system and economy. This has been accompanied by a fundamental review of governance arrangements and regulatory reforms at the international level. At the extreme, responses of central banks to the crises in the US and Europe have ventured beyond conventional approaches.

In the area of surveillance, existing monitoring frameworks have been extended to capture risks and vulnerabilities emerging from areas beyond the traditional perimeters of regulated financial institutions and markets. In this respect, effective coordination between the macro-prudential and micro-prudential surveillance functions have become more important, given that supervisory interventions and crisis management measures are now being applied to a wider set of institutions and markets.

The need for central banks to have a broad range of instruments, including macroprudential measures, to achieve financial stability policy objectives is now generally accepted. Focus has also been on the efficacy of different policy instruments that are needed to preserve financial stability, the structure and design of decision making frameworks and the accountabilities in regard to financial stability.

For Asia, these considerations have been very much a part of the evolution of financial stability frameworks in the region in this recent decade, in particular following the Asian financial crisis. By virtue of being also responsible for bank supervision, the majority of Asian central banks have a clear mandate for financial stability, whether implied or explicit. In the case of Malaysia, this has supported the close coordination of the macro and micro surveillance functions, and more comprehensive assessments and analyses of the interactions between monetary and financial stability policies.

Many central banks in the region also have considerable experience in implementing macroprudential measures, such as lending concentrations, loan-to-value limits and some form of "dynamic" reserving or provisioning policies. The intensification of regional monetary and financial cooperation among central banks in the Asian region has also served to strengthen regional surveillance and crisis management arrangements, as well as in the supervision of financial institutions with cross-border operations in the region.

As Asia rises and expectations increase, the two billion Asians now at the margins of the consumption economy will radically transform global demand and supply for limited

resources. Considerations of climate change, environmental damage and the depletion of natural resources have become a higher priority, and therefore needs to be also integrated with financial and economic policies, for example through the implementation of policies on sustainable financing.

Finally, given the higher degree of connectivity not only within the domestic financial system and economy, consistent policies and coordination becomes key. Clarity on the governance process for greater interface among regulators becomes important, including that involving cross border interface. For the Asian region, the East Asian central banks have since 2007 established a Monetary and Financial Stability Committee to discuss assessments of risk and vulnerabilities to macroeconomic and financial stability in the region.

The strategy for policymakers in Asia has been to build a higher degree of resilience to be better positioned to withstand external shocks and to provide an enabling environment to achieve a sustainable economic performance. For central banks, the focus is on preserving monetary and financial stability. Of equal importance is the development of the domestic financial infrastructure.

Important in the policy design of central banks is that the policies are anticipatory. Delays in policy action or exit will invariably result in higher costs, over adjustment and other unintended consequences. A second aspect of policy is that rule based policies such as inflation targeting does not give the policy space to take into account sources of instability and other trends that may work to diminish the extent of such instability. Rigid parameters, imposed by multilateral agencies and sometimes by rating agencies and the market also contribute towards reinforcing these conventions. Current and future conditions are likely to be highly complex and varying and therefore not lending itself to rigid rules.

In an environment that will continue to remain challenging for some time, this Conference provides an important opportunity to discuss a wide range of issues from Asia's perspective, thereby contributing to the international discussions and understanding of the issues and their business and policy implications. Asia's experience will also provide additional insights in contributing towards the solutions for building a more resilient international financial system. I wish you an engaging and productive discussion.