

Zeti Akhtar Aziz: Strengthening our future

Speech by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the launch of the Financial Sector Blueprint at Sasana Kijang “Strengthening Our Future”, Kuala Lumpur, 21 December 2011.

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It is my great honour to welcome you to Sasana Kijang for the launch of Bank Negara Malaysia’s Financial Sector Blueprint. On behalf of Bank Negara Malaysia and the financial services industry, Yang Amat Berhormat Dato’ Sri, I wish to express our appreciation to you for your presence here this afternoon to launch the Financial Sector Blueprint. This Blueprint marks a new phase in the development of the financial system. It focuses on new areas that will strengthen the competitiveness and efficiency of the financial sector and its potential role in facilitating our ongoing economic transformation and greater regional economic and financial integration and thus to enhance Malaysia’s long term economic growth potential.

The Blueprint themed “Strengthening Our Future” builds on and reinforces the solid foundations that has been achieved in this decade. Malaysia has benefited from a well developed, more competitive and well regulated financial system. The financial system emerged from the global financial crisis strong and resilient, and has continued to support our domestic economy even during these most challenging of times.

The recommendations in the Blueprint has taken into account the expected changes in the international and domestic environment and its consequent demands on the financial system in this next decade. It also takes into account Malaysia’s aspirations to become a high value-added, high income economy.

Within the global economic landscape, emerging economies will assume a more significant role. While emerging economies will continue to be affected by global developments, most are able to demonstrate resilience and are expected to remain on a growth trajectory. By 2030, emerging economies are projected to account for 60% of total world output, from the current 40%.

At the same time, the economies and financial markets in the global economy and international financial system have become more interconnected as a result of greater cross-border trade and financial flows. The continued development and deepening of our financial markets and increased financial liberalisation in emerging economies will reinforce this trend towards greater interconnectivity.

More recently, the financial sector has been the target of a renewed focus and priority by the international community. Wide ranging financial reform measures have been introduced in the aftermath of the global financial crisis to address the weaknesses that have surfaced during the crisis.

Several changes are also transforming the domestic environment. New domestic sources of growth, the greater role of the private sector in the economy, demographic changes, rising incomes and a growing middle class, and the accelerated pace of urbanisation cumulatively will significantly change the demands on the financial sector. These trends will also be affected by initiatives taken by the Government to transform the economy in this next decade into a high value-added, high-income economy, the greater leverage on the advances of technology and the acceleration of the pace of regional financial integration in Asia.

The Malaysian financial system enters this new environment from a position of strength. The successful implementation of the first Financial Sector Masterplan in this recent decade has produced a financial system that is well positioned to respond to the new imperatives of the decade before us. Our financial institutions are well capitalised with strong buffers and improved risk management and governance practices. Significant efficiency gains have also

reduced intermediation costs in an environment of greater competition. This is largely arising from the cumulative efforts to building strong institutions, the development of the financial infrastructure, and the strengthening of the regulatory and supervisory framework.

This decade has also seen the enactment of wide ranging legislation that has given greater certainty and predictability in the financial system. This includes the Central Bank of Malaysia Act 2009 and the Financial Services Act expected to be tabled in Parliament in 2012 has strengthened the legal framework for the financial sector. It will also enhance the Bank's capacity to manage risks from financial intermediation activities that occur outside the banking system and provide enhanced powers for timely intervention actions.

The enhanced intermediation during this decade has benefitted access to financing, particularly for small and medium enterprises, has also improved, both in volume and efficiency. By leveraging on the distribution networks of commercial banks, enhanced product and risk management capabilities, access to financing by this sector has increased at an annual rate of almost 20% since 2005.

The financial infrastructure in Malaysia has also been significantly strengthened. Malaysia has an effective financial safety net that includes a comprehensive deposit insurance system and institutional arrangements that provide avenues for advisory, redress and rehabilitation. Innovations in payment systems and instruments as well as infrastructure for the issuance, trading and settlement of debt securities and the access improved market information has contributed to greater efficiency and has also enhanced the overall price discovery process. To support our liberalisation measures our payment infrastructure has also been enhanced to support cross-border trade settlements in local currency and cross-border liquidity support arrangements for financial institutions.

Today, Malaysia also has a deep and vibrant bond market which is the largest in South East Asia, and a comprehensive Islamic financial system that is recognised as among the most advanced in the world. The bond market comprising of the conventional and sukuk market has trebled in size, providing businesses with alternative access to financing solutions including in multicurrency to meet a diverse range of risk and maturity preferences. The strengthened Islamic financial institutions, the establishment of key financial infrastructure for Islamic finance including the regulatory and supervisory framework have positioned Malaysia at the frontier of Islamic finance.

The recommendations in the Blueprint aim to build on this progress towards resulting in the development of a financial sector that will meet the economic and financial realities of this new decade. The financial system envisaged

- will be firmly anchored in the real economy in providing financial services that contribute positively to growth;
- that offers a diverse range of products, services and institutions that cater to the financial needs of a broader spectrum of Malaysian households and businesses;
- will be reinforced by deep, liquid and efficient foreign exchange and money markets to complement the bond market;
- that is more engaged with the region and other parts of the world;
- that can contribute meaningfully to Malaysia's economic transformation; and finally,
- a financial system that is inclusive in reaching Malaysians across all social, geographic and economic stratas.

It is envisaged that by 2020, the financial system is expected to expand from the current 4.3 times to six times of GDP. Correspondingly, the financial sector contribution to nominal GDP is projected to rise from 8.6% to between 10 to 12% in 2020. More than half of total financing in 2020 will be raised through financial markets, while Islamic finance will continue to increase in prominence, growing at a faster pace to account for 40% of total financing.

The Blueprint has adopted an integrated approach that reflects a financial sector that has increasing linkages between the various sub-sectors in the financial system. The recommendations, in the Blueprint are thus centred on achieving nine major areas: (i) effective intermediation for a high value-added, high-income economy; (ii) the development of deep and dynamic financial markets; (iii) greater shared prosperity through financial inclusion; (iv) strengthening regional and international financial integration; (v) internationalisation of Islamic finance; (vi) safeguarding the stability of the financial system; (vii) achieving greater economic efficiency through electronic payments; (viii) empowered consumers; and (ix) talent development for the financial sector.

A strong focus in the Blueprint is on developing the financial ecosystem to enhance funding for innovation which represents a key transformative agenda in our new economic model. Ten initiatives in the Blueprint are devoted directly to nurturing sources of financing for innovative enterprises in all sectors and at various stages of development. Over the next ten years, steps will be taken to achieve a wider range of funding sources for new ideas, including new conduits for financing and investments in innovative industries.

With the foundations now in place for greater liberalisation, the Blueprint extends this path by assuming a more regional and international complexion. This will entail positioning our financial sector to participate more effectively in the mobilisation of regional surplus funds to productive investments in the region. The financial sector will also advance the country's external orientation by serving Malaysian corporations in their regional and international operations, as well as facilitating greater participation of international and regional corporations in our economy. Malaysia will also continue to spearhead the internationalisation of Islamic finance to facilitate greater cross-border Islamic financial activities. The Blueprint will also pave the way for the integration of the existing national-level Shariah Councils into a single apex authority on Shariah matters to be established for all institutions offering Islamic financial services in Malaysia.

In the Blueprint, financial liberalisation will be pursued in the best interests of Malaysia. The goals for financial liberalisation are twofold. Firstly, to improve allocative efficiency to productive economic activities, to increase the operational efficiency and lower further the intermediation costs, and to encourage greater financial innovation. Secondly, to strengthen further Malaysia's economic and financial linkages with the region and other parts of the emerging world. Key recommendations in the Blueprint include more flexible limits on foreign participation in financial institutions, the issuance of new licenses to financial institutions with specialised expertise that are able to contribute to Malaysia's economic aspirations and financial sector development. In implementing these strategies an assessment will be made on the factors contributing to the best interests of Malaysia. In addition to the prudential criteria that must be met, the presence of strong and well-managed domestic banking groups that will account for a significant share of resident deposits will remain important for the orderly growth and development of the financial sector and of the Malaysian economy.

As our financial sector continues to advance over the next decade, priority will continue to be accorded to ensuring that the regulatory and supervisory regime remains current and continues to foster a sound and stable financial system within a more dynamic landscape. Given the more complex nature of risks stemming from greater convergence in the financial sector, the proposed new financial services legislation will be to promote consistent approaches to regulation and supervision across the financial sector, strengthen the Bank's capacity to manage risks associated with financial intermediation including financial activities that currently outside the regulated system.

A national consumer credit law and improved arrangements for combating financial crime are also included in the recommendations. To ensure that cross-border financial linkages do not propagate risks across borders, the Central bank will intensify its coordination with other regional and international supervisory authorities, focusing in achieving more consistent

regulatory and supervisory standards, timely information exchange and effective supervisory colleges.

An important agenda under the Blueprint will be to accelerate the migration from paper-based payments to electronic-payments to generate significant economic efficiencies from more expedient, secure and cost-effective means of moving funds. A range of measures will be introduced to accelerate the pace of migration towards e-payments, including driving the adoption of the mobile phone banking and payment transactions, increasing the number of point-of-sale terminals, and introducing a pricing structure that incentivises the use of e-payments.

Conclusion

Let me conclude by expressing the Bank's appreciation for all the valuable contributions received from the industry, Government agencies and other stakeholder groups with whom the Bank engaged over the course of this year to develop the recommendations in the Blueprint. In total, the Blueprint sets out 69 recommendations to achieve the vision for the financial sector in 2020. The Blueprint provides the vision and direction to secure a financial system that will firmly support and drive Malaysia's long-term growth potential and aspirations. It will be our shared commitment that will result in its success.