

## **Zeti Akhtar Aziz: Asian money, bonds and derivatives in the new global economy**

Keynote address by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the 13th Annual Conference of Fixed Income, Money Market and Derivatives Association of India (FIMMDA) and Primary Dealers Association of India (PDAI), Kuala Lumpur, 27 January 2012.

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It has been more than half a decade since the beginning of the global financial crisis, and its ramifications continue to reverberate across the world. Currently, the global financial and economic landscape continues to be confronted with stress and uncertainty, stemming from the prevailing structural weaknesses, deleveraging of the private financial and non-financial sectors, and the escalating strains in public finances in the advanced economies. Despite these significant near-term challenges, the fundamental global economic and financial transformation that commenced prior to the crisis has continued unabated. A new global economy is emerging. The rise in significance of the emerging economies is resulting in a fundamental realignment in the global landscape as the balance of global economic strength shifts to the emerging economies, with its consequent implications on long-term global economic and financial flows. With the rapid growth in domestic demand, reinforced by the vast productive investment opportunities within and across the emerging economies, it is projected that the emerging world will account for 60 percent of total world output by 2030, higher by 20 percent from its current level.

It is my pleasure to welcome you to Malaysia for this 13th Annual Conference that is being organised by the Fixed Income, Money Market and Derivatives Association of India and the Primary Dealers Association of India. We are most pleased to host this conference here in Kuala Lumpur. The theme of this conference, “Asian Money, Bonds and Derivatives in the New Global Economy”, is a relevant topic to be discussed in this period of transition to an increasingly multipolar world, in which Asia together with other emerging regions will have an increasingly more important role.

### **Asia’s potential and regional integration**

While this recent global financial crisis has provided us with challenges, it has also seen the resilience of Asia in weathering a number of major shocks in the international financial markets. Asian financial systems have demonstrated the capacity to continue to function and to meet the demands of its significant investment requirements. Moreover, the trend towards greater regional financial integration will provide for a more effective and efficient channeling of the sizeable surplus funds to such activities within the region. This increased intra-regional economic and financial activities is already taking place. The economic integration is supported by the strong demand from the growing middle class Asian population, which is projected to reach 3.3 billion by 2030. The intra-regional trade in Asia now represents more than 50 percent of total trade in the region, increasing from 32 percent in 1995. Intra-regional investment activities have also been on a rising trend.

With the strong economic fundamentals and the positive growth prospects of Asia, international and regional financial institutions are also now shifting their focus into the region. With the high savings rate in Asia, and of its massive requirement for infrastructure development, the region would benefit significantly from more effective and efficient intermediation of Asia’s surplus funds. Indeed, intra-regional cross-border portfolio investments have already increased to 28 percent of total assets holdings in 2011 compared with 21 percent in 2001. The gains from greater regional financial integration will be far-reaching as it will not only bring about a more efficient allocation of resources in the region but it will act as a catalyst for greater regional economic growth. Over the coming years, as

growth experienced in the developed economies is expected to remain slow in the aftermath of the financial and debt crisis, the growth performance of Asia is expected to continue resulting in the region becoming a more important component of the global economy.

Asian funding markets have also remained highly accessible during this period with Asian names enjoying strong demand and attractive funding costs at a time when the developed countries funding markets have tightened. During this more challenging time, Asian sovereigns such as Indonesia, Philippines, Thailand, Sri Lanka, Vietnam and Malaysia continue to successfully tap the market and to issue bonds with tenure up to 30-years. In addition, as financial markets in Asia become more developed, the markets now have the capacity to transact large quantities with cost effective pricing. In 2011, Malaysia issued the first 10 year global sovereign USD Sukuk, with the issuance size of 2 billion, under an innovative Shariah principle of Wakala which recorded the lowest absolute yields achieved by an Asian sovereign for a new USD issuance. Another recent landmark issuance on the domestic front is by PLUS Berhad, the largest toll operator in Malaysia, with the issuance of a record size of RM30.6 billion programme, equivalent to USD9.7 billion, with maturities ranging from 5 years to 27 years.

The depth and breadth of Asian capital markets have drawn investors to expand their investment activities to this region. Even central banks, as traditionally conservative investors, are also venturing into investing part of their reserves, in each other's markets. Bank Negara Malaysia, has since 2003, gradually embarked on investments in regional markets. This includes investments in the Indian rupee market. As an approved Foreign Institutional Investor, we have also been able to actively participate in the Indian rupee market.

### **Progression in the Malaysian financial markets**

Progressive efforts have been made to transform Malaysia's financial sector with a major dimension of the transformation involving achieving greater regional integration. Following a decade, institutional and financial infrastructure development that focused on enhancing domestic capacity of the financial sector while evolving a more competitive environment. We have the foundations to take our financial sector to a new level of development that will focus on new areas that will further strengthen the competitiveness and efficiency of the financial sector and its potential role in facilitating Malaysia's ongoing economic transformation and in strengthening our linkages in the region.

As Malaysia evolves and the new financial landscape emerges, one prominent area of focus is the development of deep, liquid and efficient financial markets in particular, the development of our domestic bond market. Malaysia's bond market has already grown to MYR867 billion or 105 percent of GDP in 2011, and has become one of the largest debt securities market in South East Asia which has now been liberalized to allow issuance by foreign corporation and in multiple currency. Our Islamic capital markets have also thrived, with a growing presence of international issuers and investors operating in both the ringgit and foreign currency sukuk markets in Malaysia. We have seen new innovative structures for sukuk issuances including a world's first issuance in Renminbi from Malaysia's own sovereign wealth fund, Khazanah Holdings. The money and foreign exchange markets also continue to grow in depth and liquidity. The volumes transacted in the domestic money market and the foreign exchange market have now reached RM23.5 trillion and RM9.21 trillion trades respectively. Participation in these markets have also broadened significantly with the growing presence of new issuers, banks, institutions and investors in general, including a growing presence of regional players.

In moving forward, measures will continue to be introduced to broaden further the participation of regional players in the domestic market through progressive liberalization of the foreign exchange administration rules and also the development of cross-border

settlement infrastructures to enable more efficient and cost effective foreign currency trading and settlements.

### **Arrangements supporting the regional integration process**

The region has more recently worked collectively towards establishing arrangements to support the economic and financial integration process. In particular, the ASEAN region has already benefited from the implementation of the ASEAN Free Trade Area (FTA), which was established to increase ASEAN's competitive edge as a production base in the world market through the elimination of trade barriers within ASEAN. This is now further strengthened with the implementation of the ASEAN Investment Area which was adopted to promote greater flows of capital, skilled labour and technology within the region. In the area of financial markets, the ASEAN Capital Markets Forum Blueprint is also working towards achieving significant progress in building a regionally integrated market. This vision encapsulates free movements of capital, freedom for issuers to raise capital anywhere and for investors to have access to investment avenues anywhere within the region. In such a market, investors would be able to trade in ASEAN capital market products freely in any ASEAN market at a competitive fee from a single access point, with capital market intermediaries being able to provide services throughout ASEAN. The strong cross-border linkages of an integrated ASEAN capital market provide vast business opportunities for countries to capitalize on the diverse comparative advantages in this region.

As an access point, Malaysia is well positioned to be one of the gateways for non-ASEAN countries, institutions and investors to participate in these markets. Malaysia has a facilitative environment with a strong regulatory and supervision to support business activities while safeguarding financial stability. In addition, there has also been the strengthening of bilateral economic and financial ties, which has become a prevalent theme across Asia. Supplementary to these affiliations, is also a strong trend to increase participation in Asia's enormous growth potential through affiliations in regional bodies. Within the ASEAN grouping, among the areas of priority is the deepening of cooperation to accelerate the role of the financial sector in supporting the realization of the ASEAN Economic Community by 2015.

### **Risk mitigation as Asia strives for regional integration**

The events surrounding the recent European sovereign debt crisis provide us with many important lessons. While exposures to numerous financial markets bring about tremendous economical and financial benefits, it is not without risks. Financial integration between markets, if not well designed, can lead to costly financial implications. Hence, the path to integration can expect its associated challenges that will need to be addressed. In implementing institutional arrangements across the region, it can be expected that individual countries will have to balance national priorities while seeking to strengthen their place in the global market.

Asia has therefore adopted a different approach to regional integration. The effort towards integration is from the perspective of strengthening economic and business ties, complemented by strengthening the resilience and stability of the financial sector. Towards this, regional surveillance mechanisms are being put in place reinforced by financial support facilities and an integrated framework for crisis resolution. Various forums among regulators and central banks are already in place across most of Asia to collectively enhance crisis management. Such fora also serves as financial safety nets across the region to ensure that the financial institutions operating in this region will be able to withstand the destabilizing spill-over effects of a global financial crisis in an orderly manner. Malaysia is already implementing such arrangements, with swap agreements and cross border collateral arrangements that will serve as an alternative avenue for banks operating in Malaysia and the region to obtain liquidity for their efficient functioning including during challenging times.

Bilateral arrangements that are now being entered into will allow for the acceptance of each others' currency and securities as collateral.

### **Strengthening economic and financial ties with India**

The potential for collaboration between India and Malaysia is tremendous. Historic and cultural ties originate many years back and form a strong foundation for the relations to be strengthened going forward. Currently, Malaysia's exports to India has amounted close to USD9 billion in 2011, equivalent to 4.1 percent of Malaysia's total exports, while the outstanding direct investments from India is now close to half a billion USD. The financial sector has an important role to be a catalyst to facilitate growth in such trade and investment activities between India and Malaysia. The establishment of our relationship has already begun with the issuance of a full commercial banking license to an Indian bank to operate here in Malaysia in 2010. A licence has also been granted to an Indian fund manager.

### **Rise of islamic finance in the new global economy**

Another development in several emerging economies in Asia and the Middle East is the rapid growth of Islamic finance. An important development in this decade has been the growing significance of the international dimension of Islamic finance and its increased role in mobilising and channeling funds to productive investment activities across borders. Expanding steadily at a double digit pace of growth, total Islamic financial assets currently is estimated to be more than US\$1 trillion. With more than 600 Islamic financial institutions now operating in more than 75 countries, countries from Asia, Middle East and Africa are increasingly participating in cross-border financial markets. In financing trade and investment activities, Islamic finance has influenced a new global pattern of trade and financial flows.

Islamic finance serves as an important channel for more efficient allocation of funds across borders and diversification of risks. It has facilitated stronger financial and economic ties between Asia and Middle East. The sukuk market in particular, has become an important avenue for international fund raising and investment activities that generate significant cross-border flows. The sukuk market has experienced tremendous growth in the recent few years from an outstanding amount of USD33 billion in 2006 to USD180 billion as at end 2011. Malaysia is now evolving to become a major multi-currency bond and sukuk market.

Important in this development are the initiatives that have been taken to strengthen the institutional and international infrastructure of Islamic finance. Most important is the emphasis being given to the development of the international financial infrastructure relating to financial stability. The Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) was established in 1990 and in 2002, the Islamic Financial Services Board (IFSB) was established as the international prudential standard setting body for the Islamic finance industry in the areas of risk management, capital adequacy, governance, conduct of business and supervisory process. From ten members at its inception, the IFSB is now a 189 strong member institution comprising mainly regulatory and supervisory authorities.

A more recent initiative is the establishment of the Islamic Financial Stability Forum (IFSF) as a platform for greater engagement between the regulatory authorities in the Islamic financial system and promoting more effective cross-border cooperation.

Efforts now is focused on putting in place arrangements for enhancing liquidity management in the Islamic financial system. The International Islamic Liquidity Management Corporation (IILM) was therefore established in 2010 as a collaborative effort between 12 central banks and two multilateral organizations to facilitate effective liquidity management solutions through the periodic issuance of short-term Shariah-compliant financial instruments.

Let me now conclude my remarks. This decade has been a defining moment for Asia, characterized by rapid global expansion and increased internationalisation. Among the

important trends are the significant actions taken by many emerging economies in Asia towards increased liberalisation as well initiatives toward strengthening of cross-border linkages. Moving forward, it is essential for us to continue to establish strong collaboration given the dynamic nature of the economies and financial markets today. As the new decade beckons the prospects for new opportunities, our ability to capitalize on these opportunities and realize its potential will be increasingly determined by our capability and capacity in building such strong and lasting regional and global linkages.

Thank you.