Zeti Akhtar Aziz: Big shift – traversing the complexities of a new world

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The global economy has now entered into a period of slower economic growth despite the significant and wide ranging pro-growth policies that have been implemented across the world. Why then has the world not been able to achieve a sustained long-lasting recovery? What has been holding back this prospect? In addition, the rapid and significant changes in the global environment have also brought with them new demands and new challenges. Our understanding of the factors that are containing the global growth prospects and the consequence of the new environment will better position us to face the fundamentally new landscape and to manage its consequent challenges.

Let me first thank Khazanah for the invitation to speak at this Khazanah Megatrends Forum. The topic on the Big Shift that is being experienced in the world today is indeed highly relevant. While the international and national attention is currently focused on the immediate challenges of the global environment, equally important, however, is to recognise the long-term changes that will reshape our future. The first part of my remarks today will focus on the immediate challenges of the global economy, taking into account the fundamental factors that are likely to affect the growth outlook. The second part of my remarks will touch on the key imperatives to best prepare us for the new global landscape, so as to be better positioned to succeed and survive in this new environment.

Policy-makers in the world economy have continued to be confronted with policy challenges since the onset of the global financial crisis. While the policy responses have focused on addressing the origins of the crisis – on the extensive build-up of excesses, the over-leverage and over-indebtedness of the private and public sectors, the breakdown in the functioning of financial markets, the loss of competitiveness, and the loss in confidence in the financial system and the economy, the concern now is on achieving a sustained economic recovery that is accompanied by job creation. Half a decade into the crisis, and this has yet to be achieved. In the recent months, the global economy has again experienced a broad-based moderation in growth from an already modest pace. This has stemmed largely from the renewed weakness of the economic recovery in several of the major advanced economies.

In the United States, the significant monetary accommodation, reinforced by the large scale financial market interventions and the significant fiscal stimulus during the early stage of the crisis, has averted an economic depression, but it has not, however, brought about a sustained recovery. In Europe, an economic contraction is being experienced, resulting from the combination of fiscal austerity, tight credit conditions, and the continued uncertainty and volatility in the financial markets. While important progress has recently been made in Europe on the arrangements that will contribute to containing significant high-risk events, and in paving the way towards a more sustainable and integrated European region, its immediate-term effects on economic recovery is likely to be limited.

There are several factors that are containing the potential for sustained growth in these economies. This can be classified into seven categories. Firstly, is the gradual process of unwinding the excesses that had been built up over several years. These include the high degree of indebtedness by households, the financial sector and the public sector. Secondly, is the significant long-term structural adjustments that are needed to regain relative competitiveness. This will involve greater efficiency and innovation within existing industries, and the shifting of resources out of industries in which these economies no longer have comparative advantage, into new industries which have comparative advantage. While the former may result in economic gains, it may not necessarily be accompanied by increased employment, and the latter may result in temporary economic dislocation and increased unemployment. Thus, even if such policies were to yield results, they may not produce a robust recovery of economic activity and a reduction in unemployment in the short and medium term.

The third is the need for the introduction of new institutions and the transformation of existing institutions to render them relevant to the changed environment. While existing institutions may need to be transformed, merged or even dissolved, new institutions may need to be established to facilitate management of the new environment. The same will hold true for businesses if they are to remain competitive, and, in particular, if they should venture into new areas and across borders.

The fourth category of factors concerns economic and financial management. Macroeconomic policies in most of these economies have been pursued to the limit, rendering limited policy flexibility. Monetary policy accommodation has resulted in substantially low interest rates which have been brought down to near zero levels, while the cumulative fiscal expansion during the period 2007–2009 has amounted to an average of four per cent of GDP. In addition, are the potential intended or unintended consequences of the international regulatory reforms. The reforms have focused on building a stronger global regulatory framework and raising the resilience of the banking system. While still in their early stage of implementation, concerns have been raised on their implications on the cost both to the financial intermediation process and to the real economy.

An important change in our environment both at national and international level is the increased inter-connectedness within the financial system and the global economy. This greater inter-connectedness, and hence the greater inter-dependence, requires having in place the governance arrangements for greater coordination. Fifth is that these arrangements have not been put in place both at the national and international levels. In addition, corporations or organisations in this new environment can no longer function by departments or sections, but as an integrated organisation. This also requires new governance arrangements. For an economy or a financial system, we have seen how a crisis in one segment was thought to be confined, but it had pervasive consequences on the entire financial system and the economy.

Sixth, is that despite the increased connectivity of the world, as exemplified by the swift spread of the financial crisis and economic shocks throughout the global economy and international financial system in 2008, the institutional arrangements for the cross-border dimension of policy-making have yet to reach the levels commensurate with the degree of economic and financial integration in the world.

Finally, the response to the crisis needs to be comprehensive. While addressing the weaknesses and lapses is important, equally important is the enabling environment for the measures to yield results. Pro-growth policies are vital for this purpose. During the Asian financial crisis, Malaysia gave equal attention to financial sector resolution to restore the financial intermediation process and thus credit supply. Equally emphasis was placed on addressing the problems of borrowers. Debt restructuring and mechanisms for support were put in place for the corporate sector, small and medium-scale enterprises and the household sector. This supported growth of the economy and at a fraction of the cost of the financial sector resolution.

In this current environment, the emerging economies are challenged by both the weakening global growth and the spillovers arising from the policy actions in the major advanced economies. While continuing to register reasonable economic growth, the momentum of the growth has moderated in most emerging economies, affected by slowing external demand and uncertainty in the financial markets. Nevertheless, current ongoing shifts occurring in the emerging economies have contributed to sustaining our economies. It is the growing importance of domestic demand in most of the emerging economies in Asia that is creating a huge cumulative domestic market, and this is resulting in greater regional integration with an increase in intra-regional trade. Greater regional and inter-regional integration of the emerging economies through the proliferation of interlocking networks of trade, investment and finance, has contributed to provide mutually reinforcing support to economic activity in the emerging economies.

In Malaysia, the decline in external demand while affecting overall growth, has been partially offset by stronger domestic demand, following the robust resumption of private consumption and investment activities, and the diversification of exports to the regional economies. In addition, the wide-ranging reforms implemented since the Asian financial crisis have resulted in strengthened financial intermediaries and a more developed financial system. This has allowed for the economy to better intermediate the volatile cross-border flows without disruption to the financial system. In addition, Malaysia's economic flexibility has allowed us to shift resources from industries in which we no longer have comparative advantage to new areas of growth. It is these factors that will continue to underpin the positive growth outlook of the Malaysian economy into the near to medium term.

Key Imperatives to prepare for the new global landscape

The changing global landscape presents significant new challenges for both the developed and emerging economies. Important is to be well-positioned to manage the new risks and to build the necessary capability and capacity to have the agility and flexibility to adjust to the rapidly changing conditions. As the emerging economies aspire towards achieving higher levels of income and living standards, a different path from that which led the way for the advanced economies will now need to be considered. The current global financial crisis and the Asian financial crisis have provided us with many important lessons that should form the underpinnings for our business models and our policies for growth and development. A key priority of policy should be to balance the need of ensuring sustained stability while having in place the necessary foundations to secure long-term development.

Avoiding and preventing the build-up of excesses is a critical imperative. The recent crisis has forcefully shown that markets cannot be exclusively relied on to rein in excesses. Market discipline needs to be complemented by policy interventions to effectively manage the build-up of imbalances in the financial sector and in the economy. In the financial system, this involves putting in place more comprehensive regulatory frameworks, complemented by enhanced surveillance arrangements and relatively more intrusive supervisory oversight. It also involves having wide-ranging policy tools, including macro-prudential policies, to mitigate and manage the risks emanating from excesses in the financial system. As the experience in the advanced economies has shown, the source of imbalances can arise in a number in segments of the economy, including from the household, the financial and the public sectors. This underscores the importance of prudence; to ensure that growth is underpinned by sustainability and not excesses. A further lesson is to build buffers during the good times to better position us to withstand future shocks.

Equally important for policy in the emerging economies is to put in place the necessary foundations for long-term growth. This involves few areas of significance. The first is to create a competitive environment that allows for greater economic flexibility. This includes reforms for a sequenced and gradual removal of distortions prevailing in the economy, lowering the costs of doing business, and to streamline the involvement of the public sector in businesses. The second is to accord importance to investments in modern infrastructure, and to enhance technological readiness that will enable the economy to prepare for the changing economic and financial landscape.

Another area of significance is to ensure balanced and inclusive development. Indeed, in the emerging economies, this is becoming increasingly urgent as the benefits of rapid development have not been evenly distributed, and income inequality has risen further even in the developed economies. Going forward, economic empowerment will increasingly depend on access to technology, high quality education, healthcare and social security systems. Equally important is greater financial inclusion. Without policy intervention, the trend towards greater inequality could potentially intensify. In Malaysia, many of the necessary policy strategies for long-term growth in these areas of significance are already at various stages of implementation, with considerable progress being made in certain areas.

As the technological gap between the emerging and the advanced economies converges, it will become increasingly critical for an emerging economy such as Malaysia to transition from growth based on capital accumulation, to growth based on productivity improvements. In addition, the rising global inter-connectedness characterised by the emergence of highly intricate networks such as the increase of global manufacturing supply chains, increases the susceptibility of industries to both cascading failures, as well as to the rapid re-orientation of business competitiveness through disruptive innovations such as in the mobile computing industry or the possible rise of additive manufacturing. To advance forward in this direction, human capital development is pivotal. It leads to greater value creation, enhanced technological readiness and the capacity to innovate and adapt – all of which are key for firms to operate in the new landscape. Productivity is thus not only a function of physical technology, but of talent development, including leadership development, given the increasing dynamic and complex environment.

In the area of regional collaboration and cooperation, the Asian region is well ahead in the areas of surveillance arrangements, financial safety nets and crisis management. These frameworks and arrangements were established in the period of relative stability since the Asian financial crisis. The establishment of regional arrangements and platforms, including the building of regional financial infrastructures and markets, is not only aimed at facilitating the efficient intermediation of financial resources in the region, but also at safeguarding financial stability in the region. This trend paves the way for coordinated policy actions to manage and mitigate the risks and vulnerabilities to the region. Given our diversities, there is also tremendous opportunity for the private sector, in particular in ASEAN, to integrate further in the areas of trade, investment and finance, and to leverage on the respective comparative advantage that exists in the region.

Conclusion

While we could best prepare for the future using all the knowledge that we currently have, the transition towards the new landscape will continue to be paved with uncertainty and new challenges. Further, there will be increasing complexity in the functioning of the global economy and the international financial system. In this environment, perhaps the best compass for policy-makers and businesses is one that is centred on principles; in particular, on ethics and integrity. Recent experiences in the advanced economies have put this into question. This needs to be restored. The next generation of policy-makers and leaders in business will be defined not by the power they hold and the amount of wealth they amass, but by the stewardship they exercise in serving the people and the responsibility they demonstrate to their communities. Thank you.