Zeti Akhtar Aziz: Greater financial integration and financial stability

Opening remarks by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the SEACEN 30th Anniversary Conference "Greater financial integration and financial stability", Kuala Lumpur, 20 October 2013.

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Bank Negara Malaysia is honoured to welcome you to the SEACEN 30th Anniversary Conference on "Greater Financial Integration and Financial Stability". We are especially honoured by the presence of Governors and senior officials who are here today, despite the pressing demands on our institutions during this period of persistent uncertainties in the global financial and economic environment. We continue to face challenging and often testing times. Over the recent five years, we have been confronted with recurring episodes of turbulence, followed by phases of transitory recoveries. We have seen, and have been part of, extensive collaborative measures and reforms pursued at both the regional and global level. Yet, the calm after the storm continues to evade us.

The SEACEN and Asian economies have seen significant structural adjustments and wide ranging financial reforms in this decade. During this period intra-regional trade activity has rapidly increased, signifying the deepening of economic ties within the region. Intra-regional trade in East Asia has expanded from an average of 44% of total trade in 1995, to 50% in 2012. Intra-regional investment activity has also been on an uptrend. Asia's young and increasingly urban and increasingly more affluent population, supported with policy initiatives to strengthen social safety nets – including for healthcare and retirement – will further enhance domestic demand in the region. This will further unlock our trade and growth potential. Our diversity also continues to be an important source of strength for the region. The complementarities between the economies in the region provide significant opportunities for greater shared prosperity and mutually reinforcing regional growth. The progressive liberalization of the domestic financial sectors, the development of domestic capital markets and the integration of payments and settlement systems have opened up new channels for regional financial institutions and markets to intermediate funds across borders. These developments have facilitated the recycling of surplus funds from the region for economic development in the region, while also enabling greater diversification of risks.

The lessons drawn from the Asian financial crisis more than 15 years ago also continue to shape our financial sector reforms, liberalization and economic and financial integration in the region. The focus is on developing a financial sector that serves the needs of the real economy, and which is built on solid foundations of sound risk management and strong financial buffers. An important precondition for financial liberalization and integration in the region has been ensuring that we build the capacity and financial infrastructure that would enable us to respond to emerging risks while also minimising their contagion effects. The recent global financial crisis and its aftershocks remind us that these lessons remain relevant and that we need to stay firmly on course in strengthening our foundations and resilience. A gradual and phased approach to financial liberalization and integration has served the region well, allowing time for the building blocks to be put in place, and flexibility to set the pace at which our financial systems can continue to grow and expand in line with the capacity to manage the attendant risks of a more open and interconnected financial landscape.

To date, financial integration in Asia has mainly manifested itself in the form of the increased regional presence, with increase participation of indigenous Asian banks in the regional financial system and increased participation in regional financial markets. The prospects for such greater regional financial integration are significant given that large flows of capital currently continue to be directed to developed economies outside the region. This is in contrast to the trade patterns in the region where intraregional trade flows account for more than half of total trade in the region. Promoting greater financial integration in Asia will not only serve to reinforce economic integration, but also enhance the depth and breadth of Asia's financial markets, contribute to the development of more sustainable funding sources for economic development, and potentially improve terms of trade by reducing transaction and information costs.

The strategy and path towards greater financial integration in Asia seeks to preserve the strengths inherent in the diversity of the region, while raising the standards which promote financial stability in the region. Recognizing the various stages of development across our economic and financial systems, the Asian financial integration model for the ten ASEAN economies is focused on: (i) strengthening preconditions through collective capacity building to promote more open market access; (ii) progressively reducing barriers to facilitate cross-border trade; (iii) developing the market infrastructure and an enabling environment to promote the efficient and effective intermediation of cross-border financial flows; and (iv) establishing appropriate safeguards for financial system stability. Two distinct elements of this process are important. The first is that it allows for different speeds of integration depending on the state of readiness of respective member countries. The second is the commitment of members to support each other in developing the preconditions that would make financial integration viable for the group as a whole in the long run. These elements are important for achieving a process and outcomes that will be sustainable.

The modernization of Asian financial systems during this period has also been accompanied by significantly strengthened regulatory and supervisory frameworks, improved financial safety nets, more effective surveillance of financial stability risks and stronger legal underpinnings. These reforms supported the transition towards more market-oriented financial systems that are anchored in stronger institutions, risk management capacity and governance. Today, our financial markets are better able to intermediate volatile financial flows and our financial institutions are supported by stronger financial buffers to withstand adverse developments and shocks. Significant strides also continue to be made in strengthening consumer protection frameworks, promoting financial inclusion, and enhancing market discipline. These developments continue to support the region through the recent episodes of turbulence in the global financial markets.

The region has also made important strides in enhancing monetary and financial cooperation arrangements to address regional financial stability issues and global policy spillovers. Much has been accomplished in the areas of surveillance arrangements, financial safety nets and crisis prevention, management and resolution. We have already experienced the important benefits of having these arrangements in place as the region came together to respond where needed to events that were unfolding during the global financial crisis. The authorities in the region remain committed to build on these foundations to bring regional cooperation to higher levels not only to reap its benefits but to also preserve financial stability in the region. In this effort, the current priorities for cooperation include improving information flows on risk assessments; advancing regional financial infrastructure and capacity building; and providing a regional voice on key international developments that may affect the region.

As financial integration gains pace, the demand will increase for greater convergence in regulatory and supervisory approaches and standards, including their implementation across borders. An important objective of such regulatory convergence is to ensure that cross-border financial linkages act to foster regional growth, while mitigating the propagation of systemic risk across borders through such linkages. The convergence of standards has proceeded in different ways in different parts of the world. In Europe, regulatory convergence has been driven by EU-level bodies and agencies, including the European System of Financial Supervisors and the European Systemic Risk Board. The EU-wide prudential rules are formulated and implemented through directives and regulations legislated by the European Parliament and European Council, with limited room for member states to apply "national discretion". Recent proposals to establish a single supervisory mechanism for banks led by the European Central Bank, and a single resolution mechanism, will further reinforce the role of EU-level institutions in the management of financial stability in the Euro area.

With significantly more diverse economies and financial systems, promoting greater regulatory convergence in Asia is more likely to proceed on the basis of a set of shared principles for developing and maintaining sound financial systems, while providing for the unique and distinct legal, financial, social and economic structures of individual countries within the region. It will be important to have clarity around the key principles, an inclusive process in agreeing on these principles, and mechanisms that support their effective implementation in individual countries. Under such an approach, individual countries will have the necessary degree of flexibility to tailor national implementation approaches to reflect the specific characteristics of their respective economies, while committing to uphold the essential regulatory and supervisory principles that underpin financial stability.

With Asia's varied experience in weathering financial crises, in developing our financial systems and in implementing the various regulatory reforms, valuable lessons can be drawn from the region to advance the progress and development of our respective financial systems and of the region as a whole. SEACEN has had an instrumental role for more than 30 years in the efforts to share this knowledge and experience widely among its members through providing a platform for such information sharing and through its research, training and capacity building initiatives. Today, SEACEN takes yet another important step forward in advancing this agenda with the launch of the ***SEACEN Financial Stability Journal***. We live in a world in which the management of financial stability is a highly complex undertaking, and its dimensions have continued to evolve in an environment that is rapidly changing. It is hoped that the Journal will contribute ideas, perspectives and insights and thus generate the intellectual dialogue and discourse on financial stability issues. As a region, Asia has many unique perspectives and experiences to share with others facing similar challenges in managing financial stability. I congratulate the SEACEN Centre on this important initiative. I wish it every success and look forward to contributions from SEACEN members and from the other parts of the world. The Journal can have a significant influence in drawing attention to the financial stability issues that are most important and thus contribute towards the thinking and responses on these issues. It is a process that should have an inclusive participation in this important agenda of financial stability.