Opening remarks

Dato' Ooi Sang Kuang[1]

Ladies and Gentlemen,

It is my great pleasure to welcome you to this BNM-BIS Conference on Financial Market Developments and their Implications for Monetary Policy. We are pleased to jointly host this conference with the BIS and I would like to thank the BIS, particularly the Hong Kong office, for collaborating with us to organise this conference.

I would also like to take this opportunity to express my appreciation to our speakers and discussants, for your contributions and for taking time off from your busy schedules to share your expertise and valuable insights with us.

Ladies and Gentlemen,

The topic of today's conference reflects our own recognition of the need to improve our understanding of how the changes that are going on in Malaysia's financial markets, as well as in the regional and global financial markets, are influencing, and how they could potentially influence, both the way we conduct monetary policy and also the impact of our policy on the economy. The topic is timely and of great relevance. We have thus organised the conference to provide a broad overview of the issues that would be useful to policymakers. The presentations are arranged in a manner that we hope will provide ample room for discussions and also for candid exchanges of views among the participants.

Financial markets clearly have a critical role in the conduct and transmission of monetary policy. Broadly, the growth and development of the domestic financial markets are important to the conduct and transmission of monetary policy in a number of ways. Let me mention two. First, deeper markets and greater availability of instruments allow for more effective and efficient monetary operations. Second, changes in financial prices are able to affect a broader scope of economic activities. There are, however, other financial innovations and developments in the financial markets where the implications for the conduct of monetary policy and the effectiveness of its transmission are less clear. The most important of these are financial globalisation, the increasing integration between domestic and global financial systems, and the rapid growth of the derivatives market, structured and leveraged funds. Capital flows in response to interest rate differentials and expectations regarding the direction of exchange rates have clearly made it more challenging to conduct monetary policy aimed at achieving domestic objectives. At the same time, developments in other financial markets have the potential to trigger sharp changes in the prices of financial assets in the domestic markets – note the gyrations of prices across many regional financial markets that have occurred over the two weeks preceding this conference in response to the problems related to sub-prime lending in the U.S. financial system. Also of concern is the rapid growth of the derivatives markets and the spread of highly leveraged funds.

The nature of financial intermediation is also continuously evolving, with traditional players like banks assuming new roles, while new players such as venture capital firms, private equity funds and investment banks create additional avenues for financing and investment. There has been a blurring of lines in terms of which financial institution does what. For instance, insurance companies in Malaysia that had traditionally invested their funds in

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financial market instruments and government securities are now offering loans at fixed rates to customers. The increasing size of capital markets has provided alternative channels for financial intermediation that compete directly with the role traditionally played by banks. There is evidence to suggest that the development of capital markets leads to faster interest rate pass-through compared to traditional bank-based financial systems. This development has also made managing market expectations an important part of how we conduct monetary policy.

Financial innovation has given rise to new products and instruments. Securitisation has created new asset classes and opened up alternative sources of financing for banks and investment banks, as well as to distribute risks. Beyond plain vanilla derivative products like options, swaps, futures and forwards, there is now a plethora of other products that go by acronyms such as NDFs, CDOs, CMOs and so on. As you are all aware, recent events have led to questions being raised about whether the financial market experts themselves, such as the rating agencies and investment banks, fully appreciate the risks associated with structured financial products; whether those that hold these products fully understand the risks they are taking, or whether they have the capacity to manage these risks.

The spread of derivative instruments, structured products and highly leveraged funds have multiplied the risks of contagion in financial markets across the world. Where the risks lie is not something that is easily determined. But we do know that with the globalisation of financial markets, risks originating in one market can easily surface in another market. The accumulation of leverage by groups that operate across international borders, and the growth of large financial institutions that have operations in many different markets, can create a chain of linkages similar to an electric circuit whereby a surge in one market can short-circuit financial activity in other markets. The events in the global financial markets over the week leading up to this conference underline this point.

These are issues not just for those who are concerned about financial stability but also for those of us that are concerned about monetary stability, as the consequent sustained market volatility and uncertainty can have a disruptive effect on the monetary transmission mechanism and the financing of real activity.

Ladies and Gentlemen,

Not all of these developments may be occurring in all of our financial markets, but as monetary authorities and regulators, we nevertheless need to understand their implications. They influence the domestic and global environments in which we operate. Some of these developments will enhance monetary effectiveness, while others could do the reverse. I hope that today's conference will help us improve our understanding of the implications and impact of global financial developments with regard to the conduct of monetary policy. I also hope this meeting will help us as policymakers sharpen our thinking about some of the challenges facing monetary authorities today.

Ladies and Gentlemen,

On that note, I wish you all an interesting and stimulating day of discussions and a pleasant stay in Kuala Lumpur.

Thank you.