# Opening remarks

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Bismillahhirrahmanirrahim

Assalamualaikum and good morning to our distinguished speakers and participants. I am pleased to welcome all of you to Malaysia for today's research conference on "Financial systems and the real economy". I wish to take this opportunity to thank our co-host, the Bank for International Settlement (BIS), for agreeing to hold this conference in Kuala Lumpur. The theme for this conference is very appropriate given the ever-changing financial landscape. Indeed, interactions between the financial system and real economy are taking on new and broader dimensions every day. A quick online search showed a few recurring research topics by the BIS – topics including leverage, emerging market economies (EMEs) and macroprudential policy. These topics are, in fact, the main coverage of six research papers that will be discussed over these two days. I believe the selection of such topics is not purely coincidental.

I have three key messages that I wish to deliver this morning. The first is to deliberate on the ***purpose of taking on debt***, as I believe this really matters. Globally, total credit to the non-financial private sector increased by 16 percentage points from end-2008 to reach 144% of GDP in the first quarter of 2016. This trend was more apparent for EMEs, where total credit to the non-financial private sector increased by 48 percentage points to reach 128% of GDP.

On this note, I wish to pose a question: Is increasing leverage necessarily bad? Debt, no matter what, remains the lifeblood of the modern economy, and is paramount in supporting economic growth. With debt, households and businesses are able to smoothen consumption and make long-term investment decisions. In EMEs, the increase in debt also reflects continuous financial deepening. Evidently, who takes on debt and how they use it is what really matters. This reminds me of a lesson from the subprime crisis – debt should be extended to those who have the capacity to repay, and if it serves real economic purposes.

In Malaysia, household debt remains elevated at 89% of GDP as at end-June 2016. About 58% of this is for the purchase of residential properties, which is the preferred form of long-term investment, to help finance children's education and prepare for retirement and medical costs. Another 15% of this is for the purchase of motor vehicles, which is deemed essential for work and income-generating activities, especially now, when public transportation system enhancements are underway. The bulk of the debt is granted by banks, and mainly borne by borrowers with income levels above the national average. In addition, credit underwriting and risk management practices of banks were assessed as remaining sound in an environment of a highly competitive retail financing market.

Nonetheless, excessive leverage has, in the past, placed undue stress on the global financial system and acted as a drag on world economic growth. While much debate still revolves around what constitutes excessive leverage, considerable efforts

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have been undertaken to build resilience in the financial system. Macroprudential policy is increasingly becoming an important component in the toolkit of central banks, regulators and supervisors to reduce excessive leverage and manage financial imbalances.

In Malaysia, our macroprudential policy framework is designed based on three key principles. First is the deployment of macroprudential policies, which is aimed to be pre-emptive and discretionary-based, rather than rule-based. This means that we do not set fixed threshold levels or triggers for the implementation of such policies. After deployment, we monitor the effects of such policies closely and calibrate from time to time as conditions change. This is important to ensure continued relevance and prevent "overshooting" the policy objectives. Second, we adopt a targeted approach in order to reduce unintended consequences or spillovers onto other segments. This is vital as macroprudential policies can affect financial behaviours and the wider economy. At the same time, we try to avoid designing overly complex policies that could give rise to regulatory arbitrage or circumvention, and of course, avoid confusion. Third, we typically use macroprudential tools to complement our supervisory, monetary, fiscal and structural measures to achieve greater policy effectiveness. Based on our past experiences, the greatest challenge for effective implementation is gaining policy acceptance and managing policy backlash. In addition, regulatory arbitrage needs to be actively managed to avoid shifting of risks to less regulated or unregulated sectors. In this regard, we have enhanced the governance arrangements for decision-making and mechanisms to promote effective inter-agency coordination during "business as usual" periods.

My second key message is about ***over-regulation – which to a certain extent, if not properly balanced and sequenced, can stifle economic growth***. Let's assume our financial system is an "hourglass"; the risks within it are the sand in the hourglass; and the act of turning the hourglass symbolises actions to mitigate such risks. If not careful, turning the hourglass too soon – in the context of financial regulations – could affect the ultimate objective of promoting sustainable long-term economic growth. This is what we saw in the aftermath of the global financial crisis, where a wave of regulations were established and implemented to strengthen the safety and soundness of the financial system to withstand potential shocks. While these efforts are certainly important and are welcomed globally, some question the suitability of such regulations if applied uniformly across advanced economies (AEs) and EMEs. On this note, I wish to pose a second question: When would regulations become too expensive?

One of the unintended consequences of the global reforms is the decline in correspondent banking relationships. In recent years, we have seen de-risking actions taken by banks in AEs. This has resulted in the withdrawal of correspondent banks in smaller EMEs across the regions of Africa, the Caribbean, Central Asia, Europe and the Pacific. For regions that are dependent on correspondent banking, this has disrupted financial services and impeded trade-related transactions and remittances. Some have even opined that this is a result of more rigorous prudential and tax transparency requirements, as well as heightened compliance costs from regulations on combating money laundering and the financing of terrorism.

While the financial system may be safer with the floodgates closed, concerns are now being raised about whether the trend could drive financing activities towards the shadow banking system. In this regard, EMEs and AEs have been supporting the concept of proportionality in regulations. This essentially means that regulations

should be commensurate with risks, and the cost of regulations should also be proportionate to the benefits. In achieving proportionality and the intended outcomes of the regulations, it is important that we do not abandon the wider objectives of growth, stability and inclusion.

Let me now move on to my third key message, which is about ***the need to embrace innovations for sustainable growth***. Historically, the banking industry has been resilient to disruption by technology. Arguably, this could be attributed to protective regulations that seem to favour formal banking, and sticky consumer behaviour. This may now be changing. Given the expanding needs of the economy and increasing regulatory requirements, the traditional banking industry may not always be able to cater to the needs of all segments. The rise of the "not-so-new kid on the block", financial technology or fintech, is pushing new frontiers in banking. Fintech advancements play an important role in reshaping behaviours of businesses and consumers. Innovations, in areas such as microfinance, remittances and crowdfunding, are providing consumers with greater and cheaper funding alternatives. For banks, fintech could boost profits by allowing speedier settlement and better capital allocation. Fintech could also play a significant role in addressing the aforementioned correspondent banking issue. While fintech holds boundless potential, it is not without associated risks. It could potentially lead to excessive debt accumulation, particularly in segments where underwriting and risk management standards are relatively untested. Similarly, fintech is also subject to consumer market conduct and protection issues, fraud and cyber risks and money laundering concerns.

On this note, I wish to pose a third and final question: Should we fight or embrace such innovations? This time, I will attempt an answer. Efforts to push back this wave of change may likely be futile, given that global and domestic financial systems and economies are now highly integrated. Policymakers can play a strategic role in embracing such innovations and steering them towards sustainable growth. In Malaysia, the central bank has issued a discussion paper to introduce a sandbox approach that allows companies to experiment with fintech solutions in a controlled and live environment, with appropriate safeguards in place. The framework is expected to provide regulatory clarity to fintech companies while emphasising the need for innovations that contribute positively to the public interest and real value creation.

Allow me to conclude, ladies and gentlemen, that while we focus on trying to achieve an optimal policy balance, new waves of change are now lapping on our shores. I hope that this conference will serve as a useful platform to discuss these changes and the appropriate policy responses. I also hope that you will have the opportunity to enjoy the diverse Malaysian culture, food and sights during your stay in Kuala Lumpur.

On that note, thank you!