Zeti Akhtar Aziz: Remaking Malaysia - investing in the New Malaysia

Opening address by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the Euromoney Conference - “Remaking Malaysia: Investing in the New Malaysia”, Kuala Lumpur, 3 August 2004.

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Yang Amat Berhormat Dato' Seri Abdullah Ahmad Badawi,
Prime Minister and Minister of Finance

Distinguished Guests,
Ladies and Gentlemen,

Bismillahirrahmanirrahim and good morning,

It gives me great pleasure to welcome you to this conference on 'Remaking Malaysia and Investing in the New Malaysia'. We are most honoured today by the presence of Yang Amat Berhormat Dato' Seri Abdullah Ahmad Badawi, Prime Minister and Finance Minister of Malaysia who has graciously accepted our invitation to deliver the Keynote Address of the Conference.

This conference takes place at a time of strengthening economic conditions in the global and domestic economy. At the forefront of investors' minds is the sustainability of these trends. There is also much interest on the policy strategies being adopted and how Malaysia will reposition itself in this more competitive environment. This Conference has brought together key policy makers, investors, fund managers as well as leading corporate and government officials to discuss these issues.

Building on the economic success that has been achieved for more than three decades, Malaysia is now taking the opportunity to reposition its strategies to ensure the sustainability of this strong growth performance. In Remaking Malaysia, the strategy is essentially to focus on our distinct capabilities and to leverage on the areas of our strengths to secure our competitive advantage.

Let me touch briefly on the current economic developments:

- Malaysia has seen a steady and strengthening economic recovery since 2001, with the growth performance strengthening substantially in the first half of this year increasing the potential for growth for the year as a whole to surpass our earlier estimates.
- This favourable performance has been accompanied by a rebalancing of focus between external and domestic sources of growth. In the external sector, there has been a greater balance between the traditional and new markets and between the goods and services sectors.
- In the domestic sector, there has been a greater balance between the economic sectors. The strategy to have a more diversified economic structure and more extensive markets has aimed to reduce vulnerability of the economy to global shifts in demand in any specific sector or to any particular region.
- The positive fundamentals of low inflation, strong external balance, low debt and stable employment conditions have accorded policy flexibility to support the growth during this period.

Going forward, the process of rebalancing the economy to enhance the competitiveness of the economy can be expected to intensify and widen.

- There will be a greater rebalancing between the role of the public and private sectors in the economy, with the public sector activity focussed on providing the enabling environment to strengthen the role of the private sector in the economy.
- While large domestic corporations and multinational corporations will continue to be important in the economy, the role of the small and medium-scale enterprises will gain significance.
- Greater focus will be given to secure competitiveness on a more comprehensive basis in terms of other dimensions such as productivity and efficiency, labour quality, logistics, research and development, the delivery system and the supply chain.

Malaysia will also continue to leverage on our low country risks in terms of the political stability, industrial maturity and the supply of a skilled workforce.

To promote endogenous sources of growth, greater focus has been directed at promoting greater private investment, including by the small and medium enterprises (SMEs). The financial infrastructure and incentive structure will continue to be enhanced to promote investment in new sub-sectors in particular, the services, agriculture and manufacturing sectors.

On the external front, while there has been a synchronisation of growth among the major economies, there has also been some rebalancing of the relative strength of the growth among the economies. The increase in the expansion of world trade and the strengthening of labour market conditions in most of these economies suggest continued and self-sustaining growth. Meanwhile, the Asian region has shown strong growth performance amidst robust intra-regional trade. This will be mutually reinforcing for the region in expanding the cumulative domestic market of the region and thus contributing to the overall growth prospects of the region.

While growth remains strong, there are risks on the horizon. The recent moves to raise interest rates have however aimed to adjust the economic expansion to converge to more sustainable levels. Policies in a number of the major economies have now shifted from addressing a deflationary environment to a more neutral position that is aimed at removing the inflationary bias. This is in contrast to an anti-inflationary stance which would require aggressive tightening.

On the domestic front, Malaysia continues to be highly integrated with the world economy in which economic and financial developments in our major trading partners will have implications on our economy. The strengthening of our economic structure, our financial system and our macroeconomic fundamentals, particularly since the Asian crisis in 1997-1998, has raised our tolerance level for absorbing volatility, enhanced our resilience to shocks, improved the agility to adjust to change and increased our policy flexibility to mitigate any adverse external developments on our domestic economy.

Going forward, the strong growth in manufacturing and services sectors will continue to sustain growth. The prospects for higher consumption spending is also positive. With the savings rate still high at about 35% of GNP and the rising incomes, Malaysia has the potential to promote a higher level of consumption without undermining the potential for financing of private investment from domestic sources. The higher consumption has also not created risks of increased household indebtedness which has remained within prudential levels at less than 60% of GDP.

Ladies and gentlemen,

Capital spending continues to gain momentum both in domestic and export oriented activities. Domestic companies are also forging strategic alliances as part of the strategy to expand to new export markets and leverage on new technologies. The on-going capacity expansion and more competitive business environment will keep inflation low thereby allowing domestic interest rates to continue to remain low for sometime to come. Malaysia's trade and investment links with Asia, particularly with the large economies in the region, is also expected to strengthen further.

There also continues to be steady inflows of foreign direct investment. In addition to sustained inflows into the manufacturing and oil and gas sectors, these flows have become more broad based with higher shares of new flows shifting towards higher value-added activity in the services sector. This structural change in FDI flows reflect the changing opportunities Malaysia accords with the services sector now gaining significance as an engine of growth. The new inflows have also tended to be low import content and higher value added. The FDI in services sector has also been increasingly broad based. A number of regional and global business processing centres and other regional facilities have been set up including the OHQs, regional offices, international procurement centres and regional distribution centres.

Ladies and Gentlemen,

As part of the Government policy commitment to improve the delivery system and reduce the cost of doing business, the Central Bank has undertaken a progressive liberalisation of domestic rules and regulations to reduce the cost of doing business. An area of focus has been the rules governing the foreign exchange transactions. Reducing cost of managing risks associated with such transactions include the recent liberalisation of rules on foreign currency accounts, interest rates swaps and hedging. To broaden and deepen our capital markets, the multilateral agencies and multinational corporations are now allowed to issue bonds in Malaysia. Going forward, Malaysia will continue to undertake further liberalisation while balancing the need to accord flexibility and choices to businesses with the macroeconomic objectives of ensuring stability in financial markets. Ensuring such long-term stability that facilitates planning and investment decisions has been an important part of maintaining our competitive position.

In the development of our financial sector, the banking sector continues to be the pillar of the financial system and is now at its strongest position with high level of capitalisation, improving asset quality and stronger profitability. Policy initiatives to strengthen the banking system, including in the areas of regulatory and supervisory frameworks, risk management, corporate governance and best practices in transparency and disclosure have contributed to strengthen the system further. These have been complemented with initiatives to deepen the bond and equity markets, resulting in a more diversified financial infrastructure.

Another priority area has been the development of the Islamic financial system as a viable component of the financial system. With more than two decades experience in developing Islamic finance, Malaysia today has a comprehensive Islamic financial system with all the core components of banking, takaful and the money and capital markets, and supported by a strong legal and supervisory framework. The assets mobilised by the Islamic banking sector have increased significantly to account for about 10% of the total assets of the banking system. In the Islamic capital market, outstanding Islamic bonds amounted to about 45% of the total outstanding bonds.

As our domestic financial system develops and strengthens, Malaysia has gradually moved towards a more deregulated and liberalised environment. In the regulation of the banking institutions, a balance will be made between promoting competition and innovation, and maintaining prudence and stability. Regulations will continuously be reviewed to provide greater operational flexibility for banking institutions without compromising prudential objectives. The introduction of the new interest rate framework reflects the move to promote more efficient pricing in the banking system. As progress is achieved in enhancing the capacity and capability of domestic institutions, the financial sector will continue to be gradually liberalised. Moving forward, further deregulation will be undertaken to simplify and liberalise regulations and administrative rules for businesses. To ensure stability as regulations are lifted, leveraging on technology to improve data monitoring systems have enhanced the ability to monitor developments to assess any emerging risks to the system.

During this period of strong fundamentals and rising potential for economic expansion, Malaysia has the flexibility to introduce measures not only to support growth but also to improve the quality of the growth and its long term sustainability. This includes significant investment in education and according priority towards achieving socio-economic stability. Overall, a balanced and holistic approach to economic management is aimed to ensure the foundation for a strong economy and its competitive position in the global economy.

Thank you.