

Zeti Akhtar Aziz: Benchmark market indices - milestones in financial market progress

Speech by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the launch of Citigroup Malaysian Government Bond Index & Dow Jones-RHB Islamic Malaysia Index, "Benchmark Market Indices - Milestones in Financial Market Progress", Kuala Lumpur, 23 June 2005.

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Yang Berbahagia Dato' Sri Sulaiman Abdul Rahman Taib, Executive Chairman, RHB Capital,
Dr. Zaha Rina Zahari, Chief Executive Officer, RHB Securities,
Mr. Piyush Gupta, Country Officer and Chief Executive of Citibank Berhad,
Distinguished Guests, Members of the media and Ladies and Gentlemen,

"The use of benchmark market indices emerged on the financial scene as early as in the 1880's. In 1884, Charles Dow, journalist and founder of Dow Jones & Company produced the first Dow Jones Index, published in the company's 'Customer Afternoon Letter' which was later to become the Wall Street Journal. Of what we know, Charles Dow had always been a keen market observer. The haphazard idiosyncratic price movements of shares of individual or group of companies indeed did not lend itself to a coherent assessment of the performance of the market nor enable any meaningful analysis of market direction and investors' inclinations. This gave rise to the need for an index that reflects the broad market performance and investors' interest.

This first market index was simple. Prices of 11 stocks, the most actively traded on the New York Stock Exchange, were averaged. Charles Dow himself chose these stocks, nine of them being railroad companies, the key growth industry at the time. Over time, he would revise the index as he saw appropriate to be reflective of ongoing market and industry developments.

Ladies and Gentlemen,

The construction and use of benchmark market indices today has undergone much advancement since then. Indeed, financial markets have undergone dramatic transformation. Economic, industry, and corporate expansion; the sophistication, proliferation and diversity of instruments; the expanding investment communities are all factors that have led to an increase in the number of benchmark indices and their greater use. Benchmark committees deliberate over the construction of the index and determine the rules of the benchmark. Investors need the benchmark indices to be used as performance indicators of the broad market and for an indication of the market direction and investors' sentiment on the corporate sector and economy. The representative stocks within a benchmark index need to be highly liquid and reflective of the key corporate sectors that drive growth in the economy. At the same time the index should also reflect the underlying changes in the economy incorporating the emergence of new industries. Thus, for an index to be a useful benchmark and to be used as a reference by investors and market players, the index needs to be regularly reviewed and adjusted accordingly in line with market developments and the transformations taking place in the economy. Indeed, benchmark market indices would reflect the broader investor participation and growing maturity of a markets.

Ladies and Gentlemen,

Today's launching of the Citigroup Malaysian Government Securities Index and the Dow Jones-RHB Islamic Malaysia Index, marks another step forward in the development of Malaysia's capital markets. The importance of these two indices should not be underestimated. This initiative by the Citigroup and RHB and Dow Jones is an important contribution to the development of our domestic markets.

With globalization, increased connectivity and rapid financial market integration, investors are no longer restricted to investing within their own domestic borders. Indeed the 'home bias' or tendency of investors to invest almost all their assets domestically, has been rapidly dissipating. Investors look abroad for enhanced returns and diversification opportunities. For more than a decade now, the pace of diversification across borders by pension and insurance funds, asset management companies, hedge funds and high net worth individuals has increased dramatically.

A region that has emerged strongly in the international investors radar screen is the East Asian region. Strong, sustainable economic growth, rapid expansion in intra-regional trade and investment have led to a correspondingly accelerated pace of development of the capital markets and to an increase in the

pace of financial liberalization and integration. In this environment, it becomes important to promote well-developed, deep and liquid capital markets.

Today's launch of the Malaysian Government Securities index will assist investors who have increasingly been attracted to Malaysian fixed income securities as an important asset class.

As I understand, the Citigroup MGS Index will potentially be part of their global bond index, an inclusion that would indeed contribute to increasing the significance of the MGS market in the global bond markets. The Citigroup's global bond index, previously known as the Salomon World Bond Index, has been one of the most referenced benchmark market index by the international investment community. It would promote Malaysia in the investors' investment horizon, whether as a long-term benchmark holding in their portfolio or as a tactical investment in seeking market out-performance. When this becomes a reality, the Citigroup Global Bond Index will be the first benchmark that has Malaysia as a component.

The index could also serve to facilitate enhanced trading or liquidity in the market, with the commitment to make market or provide prices for the bonds comprised within the index. Besides enhancing the trading volume and related business prospects, it would also spur competition among dealers and the growth of derivative products. Increased market activity and continuous availability of prices in a benchmark government debt market would, in turn, enable other markets; namely private debt securities and asset backed securities to be appropriately priced relative to the degree of risks, and for such securities to be further developed.

The Dow Jones-RHB Islamic Equity Index heralds another milestone in the growing Islamic financial markets. The merger of the Dow Jones Islamic Index for Malaysia and the existing RHB Islamic Index, besides achieving some form of economies of scale with reduced duplication of efforts, will have the significant added advantage of both international and domestic recognition. Moreover, as one of the leading countries that support the growth and development of Islamic financial markets, it is most appropriate for the development of the index to be part of the Dow Jones Islamic World Index.

Within a global index such as the Dow Jones Islamic World Index, the inclusion of the Dow Jones-RHB Islamic index will increase the potential for further investments into Malaysian Islamic equities. Malaysia is well positioned to benefit greatly from this as the infrastructure and marketplace for Islamic financial instruments and investment has long been developed. Indeed, in our equity market, more than 80% of the counters in Bursa Malaysia or previously known as the Kuala Lumpur Stock Exchange, are Syariah compliant.

Ladies and Gentlemen,

Certainly, the development of benchmark market indices is an important part and parcel of the continued progress, contributing to the further deepening of capital markets. Two particular areas of heightened focus are in the regional bond market and international Sukuk market.

In the region, the Asian Bond Fund 2, launched by the EMEAP central banks in December 2004, is aimed at promoting the further integration of the regional countries' bond markets and the creation of a new asset class for Asia and global investors. One of the important pillars of this development has been the construction of benchmark indices. Indeed the launch of Asian Bond Fund 2 is accompanied by the development of benchmark indices that are fully replicated by the fund manager of each individual country sub fund, as well as in the umbrella Pan Asian Index Fund.

Meanwhile, the Islamic Sukuk international market's expansion is gaining momentum. Wider acceptance by investors and greater awareness of issuers of this alternative structure has seen increased issuances over the past few years. In the sovereign markets; Malaysia, Qatar and Bahrain have come to the market with Sukuks. Supranational institutions such as the Islamic Development Bank, World Bank and the International Finance Corporation (IFC) have also ventured into issuing Sukuks, with the latter two institutions issuing the ringgit-denominated instruments in our domestic bond market. The first USD1 billion-issue size was launched in 2004 by the Government of Dubai. In 2005, it is estimated that a total of more than USD5 billion of Sukuk is in the pipeline globally in a range of currencies. The market is indeed growing.

Ladies and Gentlemen,

The introduction of a benchmark index can act as a catalyst for a more rapid pace of development of the financial market and the recognition of a new asset class. The conditions are timely for the crafting of a benchmark index to further spur the growth of the Islamic financial and capital market to meet the needs of a larger pool of Muslim savers and investors.

On the domestic front, the ringgit denominated Islamic debt market continues to grow encouragingly. In the private debt securities market, a total of 42% of securities outstanding as at end 2004 were Islamic securities. For the debt markets as a whole, Islamic securities comprised 25.7% of total outstanding bond issues at the conclusion of 2004. Coupled with increased turnover volume, the size and liquidity of the Islamic debt markets are improving, possibly paving the way for even greater demand for Islamic financial products. The formulation of a benchmark index to reflect the ringgit Islamic debt market could well be a strategic opportunity for market players to take up as the next step forward.

Ladies and Gentlemen,

The future growth and development of the Malaysian capital market, including a dynamic Islamic financial market with breadth and depth, has never been brighter. As we witness in the current environment, cross-border flows, joint ventures and partnerships with global players have become the norm. New growth markets, enhanced integration and liberalization of economies and financial markets are the themes that will increasingly dominate our business activities. Positioning ourselves for these developments is imperative in these highly competitive markets. Part of that positioning is certainly transpiring before us today, right here.

With that, it is with great pleasure that I officially launch the Citigroup Malaysian Government Securities Index and the Dow Jones-RHB Islamic Index. Thank you.