

Zeti Akhtar Aziz: Monetary and financial policies in the Asian network economy

Introductory remarks by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the Tun Ismail Ali Chair Public Lecture by Datuk Seri Panglima Andrew Sheng on "Monetary and Financial Policies in the Asian Network Economy", Kuala Lumpur, 18 April 2006.

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Introduction

Let me first of all welcome you to the Tun Ismail Ali Public Lecture for 2006. This Public Lecture is part of a series of events organised in conjunction with the Tun Ismail Ali Chair in Monetary and Financial Economics at the University of Malaya. The Chair was established by Bank Negara Malaysia in August 2000 to commemorate the contributions of the late Tun Ismail Mohamed Ali, the first Malaysian Governor of Bank Negara Malaysia. It is our hope that this Chair would contribute to the advancement of new ideas and knowledge in the area of monetary and financial economics.

Today, we are indeed honoured to have Datuk Seri Panglima Andrew Sheng, holder of the Tun Ismail Ali Chair for 2006, to speak to us on "Monetary and Financial Policies in the Asian Network Economy". This occasion is particularly meaningful because Andrew was with Bank Negara Malaysia for many years, from 1976 to 1989, and during that period, he had worked closely with the late Tun Ismail Ali.

Ladies and Gentlemen,

The theme for today's Public Lecture: "Monetary and Financial Policies in the Asian Network Economy" is indeed timely and highly relevant, in the current regional and global environment. The Asian economies have always been highly integrated into the global economic and financial network. Indeed, the success of the Asian economies lies essentially in its ability to be highly networked. The nature of these networks however, has evolved over time, heightening the complex nature of the inter-linkages.

In this recent decade, this trend is being reinforced by the intensification of regional integration. It is being facilitated by increased liberalisation and the increased potential for complementarities in the region. It is also driven by the conscious efforts by the authorities to facilitate the integration process. This is premised on the potential for increasingly mutually reinforcing positive outcomes.

There is a growing recognition of the need for enhancements to the institutional arrangements and regulatory and legal framework to better manage the risks and vulnerabilities associated with the network economy. In this regard, an enhanced understanding of the changes in the way financial markets and payment systems operate in a more connected environment becomes important. As part of this process is the support provided by an enhanced surveillance mechanism. A further implication of a more networked economy is in the area of payments, clearing and settlement systems, in which the benefits are derived from the economies of scale and the positive network externalities of increased participation. Inevitably, payment networks could become more interconnected and a single and large payment network could emerge. It then becomes essential to be in a position to manage the risks that may emanate from places beyond national boundaries. There has to be then a high level of preparedness against any disruption in the flow of information, funds and securities becomes vital.

Ladies and Gentlemen,

The policy response

How have these developments changed the way Bank Negara Malaysia operates?

In Malaysia, efforts are currently being taken on several fronts to meet the challenges arising from these trends. These range from structural enhancements to the macro surveillance systems, to strengthening of the robustness and capacity of financial players, in addition to promoting greater understanding of the intricacies of the interconnectivity, and the nature and speed of contagion risks within the overall system.

On the regulatory front, closer regulatory oversight is particularly important in ensuring the strength of the risk management framework of large and complex financial institutions that are active in cross-border transactions. Towards this end, Bank Negara Malaysia is enhancing its prudential framework for the management of operational risks among such financial institutions, with the introduction of

sound practices. The Bank's prudential framework has also been refined and enhanced to ensure that financial institutions address the risk management implications of new financial products, including credit derivatives, credit default swaps, credit linked notes and collateralised debt obligations. In addition, the introduction of the Payment System Act in 2003 provided Bank Negara Malaysia with a broader scope on the oversight function over payment systems and instruments that are operated or issued by banks or non-banks, given that advances in ICT have increased the participation of non-banking institutions in the payments system. The Bank has therefore put in place a specific legislative authority to institute more comprehensive and effective mechanisms for achieving effective oversight of the payments system in a networked environment.

Bank Negara Malaysia also maintains very close contacts with its counterparts in other jurisdictions to keep abreast of developments in the financial markets. Strengthened surveillance and information sharing on a real-time basis has become key. Cooperation among the Asian central banks is very strong, and there are various avenues for increased interface for collaboration at all levels in the regional central banks.

To maintain effective surveillance, importance is also placed on regular engagement with the financial market participants, the industry and the public. An emerging dimension in the changing environment is to strengthen Central Bank communications. The aim is to enhance market understanding and awareness of the benefits as well as the potential risks and the policy initiatives in a network economy. The regular publication of the Bank's Monetary Policy Statement is to appraise markets of the direction of monetary policy. Other measures include outreach programmes on investor and consumer education to enhance financial literacy.

Finally, Bank Negara Malaysia has also put in place business continuity plans as part of its contingency programme to deal with all eventualities and threats to financial stability, in particular, those emanating from a more networked financial system. Similar contingency plans have also been introduced in the domestic financial industry, where regular test-runs are conducted to ensure the integrity of all the back-up systems.

Going forward, Central Bank cooperation continues to be enhanced to strengthen risk management capabilities in the Asian network economy. Measures to enhance national surveillance is complemented by cooperation on regional surveillance mechanisms to provide comprehensive oversight over the entire regional network. Closer cooperation with the respective regulators is also important to promote greater understanding of the nature of the risks involved and to facilitate the development of appropriate circuit breakers and mechanisms to contain the risks in the network.

In addition to the establishment of Business Continuity Plans to help to mitigate risks arising from outside the financial network, the harmonisation of regulatory and financial standards would facilitate the containment process. These cooperative efforts to harmonise standards are to support financial infrastructure development in facilitating the flow of funds and settlement requirements across borders.

Conclusion

Datuk Seri Panglima Andrew Sheng's lecture today will explore the behaviour of markets as networks, and the implications of such network behavior on monetary and financial stability in the Asian network economy. Going forward, it can be expected that the Asian networked economy will become increasingly more entrenched. While this will open up new opportunities for enhanced efficiency and productivity gains in Asia, a better understanding of the risks inherent in networks will better prepare the regional economies to address these risks. This will be a shared responsibility within and among the regional economies. Closer regional cooperation, strategic alliances and smart partnerships will be important key responses for enhancing the prospects for higher growth and development in Asia.

Thank you.