

## **Zeti Akhtar Aziz: Strengthening of regional integration in Asia**

Speech by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the Korea-Malaysia Business Forum, Kuala Lumpur, 8 April 2010.

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It is my great pleasure to be here this afternoon to speak at the “Korea-Malaysia Business Forum”, in conjunction with the 50th anniversary of diplomatic relations between Korea and Malaysia.

The global economy is now on the path of recovery after the worst financial crisis in decades. This recovery is however uneven. Several of the advanced economies are still being confronted with unresolved crisis-related issues, in addition to structural factors that will constrain their growth performance in the years to come. Emerging economies, in particular Asia, is leading the global recovery. The region is fast becoming the anchor of growth and stability in the world economy.

New growth dynamics are already at work to reinforce the strength of Asia over the next decade. Increased intra-regional economic and financial integration and other structural factors are supporting this trend. While this trend will intensify, the future global environment is going to be fundamentally different. Asia will be confronted with new challenges in this changed environment. Asia, therefore, needs to be well positioned to effectively manage these fundamental new global trends to ensure sustainability of our economic advancement. The business community and policymakers need to rise to the new challenges and build on our existing relationships. We can work together to forge a more integrated Asia in the areas of trade, investment and finance and thus, strengthen the potential of Asia.

My remarks this afternoon will focus on three areas; the increasing regional economic and financial integration in Asia, the implications on the evolving bilateral relationship between Korea and Malaysia and on Malaysia’s strategies for reforms to better position our economy to rise to the new challenges of the global economy.

### **The emergence of the new Asia**

In these 50 years, Asia has undergone several phases of economic transformation. While individual countries have embarked on their own strategies and achieved tremendous individual success, today, however, as the world becomes more interdependent, the development of Asia has reached a new phase in which greater economic and financial integration will contribute to unlocking our potential in the global economy.

Over the years, trade and investment barriers within the Asian region have been progressively removed and capital mobility has been on the increase. Ties within Asia have strengthened on several fronts, from trade to investment and financial linkages, as policymakers recognise the importance of the region as a mutually reinforcing economic entity. As a group, Asia has now emerged as a global economic powerhouse with the share of GDP to world GDP amounting to 13.4% in 2009, about twice that in 1980. Going forward, the IMF projects that developing Asia will grow by 8.2% in the next five years, higher than the rate recorded in the period of 2000–2009.

The strengths within Asia has been most evident in the recent global financial and economic crisis. Asia has demonstrated remarkable resilience in the face of the unprecedented international financial crisis. Most regional economies have seen positive growth since the second half of 2009, with prospects for a sustained recovery. The region has benefited from strong fundamentals and the financial reforms undertaken in this recent decade which has enabled the region to recover faster with a stronger performance.

Several other factors have contributed to this early recovery. First, the region had policy flexibility to respond to the consequences of the international financial crisis. Strong fiscal positions, including relatively low public debt levels, have allowed many Asian governments to implement larger fiscal stimulus. Second, the financial sector in the region is in good health. Disruption to credit flows to the private sector have been avoided. Third, households and the corporate sectors in Asia are not over leveraged, and thus are in a better position to resume consumption and business activity once confidence had returned. Fourth, Asia is also not plagued with wide scale unemployment. Fifth, increased intra-regional trade has contributed significantly to the resumption of international trade in most of the regional economies. The strong surge in exports in the regional economies in the recent months is due primarily to the significant rise in intra-regional trade.

### **Strengthening of regional integration**

Regional integration will become an increasingly important factor in sustaining the future growth in the region. Despite Asia's diversity in people, culture and traditions, the region has been able to come together as a group to achieve greater integration in the areas of trade and investment.

While trade remains an important contributor to growth in the region, of importance is that the pattern of trade of the Asian economies has changed significantly. This decade has seen the rise in intra-regional trade. Intra-regional trade in Asia has risen from 32% of total exports in 1995 to an average of 50% in 2008. Increasingly, as incomes rise in Asia, intra-regional trade will increase to meet the rising domestic demand of regional economies. More than half of the world's population resides in Asia that has a favourable demographic structure that comprises of a significant young and dynamic segment. The growing middle class has altered the consumption and savings patterns in the region, providing the region cumulatively with a huge growing consumer market. Asia also has high savings which allows for higher consumption while still having surplus funds to finance regional investment activity. The rapid trade liberalisation across Asia has improved market access, creating a vast market for goods and services. In addition, bilateral and region-wide free trade agreements are set to expand further even as multilateral agreements continue to be pursued.

The growing pace of intra-regional investment flows has also gained momentum to complement the region's trade integration. Businesses in the region are leveraging on regional complementarities as well as taking the opportunity of the growing markets in the region. In Malaysia, almost half of foreign direct investment into our country originate from the regional economies. In addition, Malaysian corporations have also in recent years increased substantially their presence in the region. The success of intra-regional investment reflects the competitiveness and dynamism of Asia.

A more recent phenomenon is the increased financial integration. As this occurs, it will result in a more efficient recycling of Asian savings into investments within Asia. Given that Asia will need about USD8 trillion in infrastructure development over the next ten years, the effective channelling of Asia's large pool of savings into productive uses within the region will be important to support growth and development in Asia. Deeper financial integration within Asia is already occurring as financial markets in Asia become more developed and mature. Regional efforts are being intensified to accelerate this process, including in developing the regional bond markets.

Policymakers in Asia have also come together in ASEAN+3 and the Executive Meeting of East Asia Pacific (EMEAP) groupings to promote greater cooperation in maintaining regional macroeconomic and financial stability. The more volatile and unstable international financial and economic conditions have called for the need for greater regional surveillance for the early detection of risks to the region. These have now been put in place including mechanisms to enable the region to cope with rising uncertainties. Through EMEAP, regional collaboration on surveillance has been enhanced to strengthen the region's vigilance and

resilience against potential crises. The ASEAN+3 member countries have already taken steps to multilateralise the Chiang Mai Initiative towards a more advanced and robust framework for the effective pooling and utilisation of liquidity support in the region.

### **The bilateral relationship between Malaysia and Korea**

Malaysia's economic relationship with Korea is very much part of this integration process in Asia. The bilateral trade and investment relationships between Korea and Malaysia over the recent years has continued to increase with trade now averaging RM45 billion per annum. Both countries have already benefited from the growing production networks within the region as well as from the numerous trade and investment opportunities from an increasingly open and liberal business environment.

Investment linkages, though still relatively modest, have been on an upward trend since 2006. Korean investment in Malaysia is predominantly in the manufacturing sector, particularly the electrical and electronics sub-sector. The opportunity for further co-operation in this area is vast. Korea, as a nation known for its knowledge-based and innovative capabilities, can leverage on the liberal investment climate offered by Malaysia to diversify into new growth areas such as green technology and biotechnology.

In the area of finance, Malaysia now has a well-developed financial system, with deep capital markets including a comprehensive system of Islamic finance. The Malaysian bond market is the fourth largest in Asia in terms of volume after Japan, China and Korea. More than 55% of the outstanding bonds are Shariah-compliant and the sukuk market is the largest in the world. In 2008, the Export-Import Bank of Korea and Industrial Bank of Korea successfully raised a total of RM2 billion via bond issuance in the Malaysian bond market. Moving forward, the sukuk market represents an important channel to reinforce regional financial integration. It presents an opportunity for Korean corporations to raise financing and issue sukuks out of Malaysia. In addition, Korean investors can also participate in the wide range of Islamic financial instruments in the Malaysian financial markets, including from more than 150 Islamic unit trusts, Islamic REITs, wholesale mutual fund products and other Islamic structured products.

In addition to robust economic ties and potential financial links, Korea and Malaysia enjoy a growing mobility of talents. With the rise in Korean investment in Malaysia, this has led to an increase in Korean expatriates. Koreans are also coming to Malaysia as students and to participate in our Malaysia My Second Home programme. In addition, the Korean Wave, which spread to Malaysia in early 2000s, has contributed to make our country more aware of the Korean culture and traditions, thus promoting a better understanding between these two countries.

### **Prospects for the Malaysian economy**

Malaysia is an economy that is transitioning into a new phase of development. In the current environment, our economy is now firmly on the recovery path. This year, the Malaysian economy is projected to grow in the region of 5% with further upside potential. Domestic demand is expected to become a major driver of growth as the private sector benefits from the strong macroeconomic fundamentals, healthy balance sheet position and a resilient financial system. Both fiscal and monetary policies are aimed at providing an enabling environment for sustainable growth. Monetary policy will remain supportive of growth, while attention will continue to be focused on ensuring that the private sector, in particular SMEs, have access to financing. In addition, the Central Bank is now in the process of formulating a new financial sector blueprint to chart the development of the Malaysian financial sector over the next decade so that the financial sector will reinforce transition of the Malaysian economy into a high value-added and high income economy.

As the Malaysian economy is gathering strength, the focus of policy has also shifted towards laying the foundations for the economy into a high value-added, high income economy. In this regard, the Government has recently announced the New Economic Model, which is intended to accelerate Malaysia's development into a high income economy by 2020. The broad thrust of the strategies is to re-energise the private sector to drive growth. This involves providing an enabling environment in which high productivity, competitiveness and innovation can take place. As part of these initiatives, further liberalisation of the economy and the privatisation of selected Government-owned corporations are undertaken. This is also accompanied by the Government Transformation Program to enhance the public sector's efficiency. Throughout Malaysia's more than 50 years of development, the country has demonstrated economic flexibility to successfully shift to the new areas of comparative advantage to the new areas of growth. I believe, with the foundations in place, Malaysia has every potential to transition into a high value-added, high income economy.

### **Concluding remarks**

Asia's new role in the globalisation process has only just begun. The continuous dynamic evolution of Asia as greater regional economic and financial integration take place will contribute towards raising the standards of living in this region. In this context, the important partnership between the Government and the private sector remains a key element in ensuring stability and sustainable economic development in the future.