

Zeti Akhtar Aziz: Towards realising the Asian century

Keynote address by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the Asian Banker Summit 2014 “Towards Realising the Asian Century”, Kuala Lumpur, 21 May 2014.

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It is my honour and great pleasure to be here today to speak at this Asian Banking Summit. The Summit, now in its 14th year, has been an important constructive platform to surface important issues that are shaping the future of the financial services industry. For the Asian region, this has meaningful relevance as we reflect on our journey towards realising the Asian Century in this highly dynamic environment that is being significantly transformed.

The Asian region has remained remarkably resilient during this recent global financial crisis of 2008/09 and its aftermath. The region is also emerging as an important source of global growth. While Asia certainly still has some distance to go in our journey towards the Asian Century, by many accounts, Asia’s performance for a number of decades now has been its best so far. While the journey ahead for Asia has tremendous promise, it also presents significant challenges arising from the changes that are reshaping the regional and global environment. Strategies that have brought our previous successes will now need to be reexamined. The issue before us is whether Asia can rise to these new challenges to realise what is being envisioned.

Asia from a global perspective

Asia’s role in the global economy has for several decades experienced significant transformation. The changes have been multi-faceted, not only in terms of its increasing size, but also in terms of its influence in the global economic and financial developments. Asia now constitutes about one-third of the global economy, accounting for 35% of world GDP in 2013, increasing from 26% since 2000. Excluding Japan, Asia accounts for 30% of world GDP in 2013, an increase from 18% since 2000. Significantly, Asia contributed 62% of global GDP growth in 2013, compared to 30% in 2000.

Asia also accounts for 32% of world trade, increasing from 25% in the year 2000. In addition, today, Asia has become a global hub of information technology services and continues to be at the forefront of the manufacturing sector, with the top five ranking countries being in the Asian region¹. In addition to trade flows, net inflows of private capital into the region averaged USD83 billion a year between 2000 and 2010. Regional capital markets in several of the East Asian economies have expanded significantly, in particular, the bond market, which has expanded by more than thirteen-fold since 2001, with significant foreign participation. At the same time, Asia also hosts a large and diverse group of foreign financial institutions, many of which have a long history and entrenched presence in the region. Finally, the population of 3.7 billion that resides in Asia accounts for 55% of global population. With the intensification of urbanisation, of the 26 mega cities in the world in 2012, 16 are in Asia. In addition, about 45% of Asia’s population is in urban areas compared to 37% in 2000.

Economic and financial progress has also been accompanied by remarkable social progress. These include rising life expectancy, lower mortality rates, increasing literacy rates and higher education levels. According to estimates, Asia collectively lifted over 430 million people out of extreme poverty in a period of five years spanning 2005 to 2010, representing 93% of the global poverty reduction during this period.

¹ Source: Cushman & Wakefield, Where in the World: Manufacturing Index 2014.

The Asian story: building resilience

The rising prominence of the region in the global economy is however, not by chance. An important focus for Asia has been to strengthen the region's potential to progress and its capacity to manage the attendant risks associated with a more challenging global environment. In the period that followed the Asian financial crisis, during a period of relative stability, the region has taken the opportunity to press forward with economic adjustments and restructuring, and wide-ranging financial reforms. The economic rebalancing and financial reforms have resulted in stronger fundamentals, and a solid and sound financial system, both of which have proved to be vital in enabling Asia to weather the recent global financial turbulence. With more diversified economic structures, in particular with the increased role of domestic demand as an important source of growth, with the shifting role from the public to the private sector, and with more developed and resilient financial systems, Asia was able to swiftly recover from the global financial crisis and has become better positioned to cope with highly volatile capital flows arising from the shifts in global liquidity. Over this challenging period, credit flows in most financial systems were sustained, supporting overall economic growth in the region. While these developments brought risks of too rapid credit growth and excesses, vigilance was heightened to guard against the risk of the build-up of financial imbalances.

To further develop more resilient financial systems, regulatory regimes and supervisory approaches were significantly strengthened, and governance and risk management practices in financial institutions were enhanced. The development of institutional frameworks that supported financial stability was also aggressively advanced. At the same time, efforts to deepen domestic and regional capital markets have reduced reliance on the banking sector and further diversified funding sources. In several parts of Asia, this was complemented by reforms towards greater market orientation and progressive liberalisation, including adopting more flexible exchange rate regimes. This served to promote a more competitive environment, while affording greater flexibility to adjust to changing external conditions. Enhanced surveillance and the development of a wider range of policy tools, including macroprudential tools, have increased the ability of policymakers to pre-emptively mitigate risks in the financial sector.

Policymakers and business leaders in Asia had also recognised early the benefits of being integrated into the supply chain of an increasingly globalised market, and pursued strategies to reinforce this trend. While Asia is one of the most diverse regions in the world in terms of size, stages of development, resource endowments, economic structure, degree of openness and market orientation, it has been able to harness the strengths and comparative advantage that exists in the region. This is evidenced by Asia's large network of comprehensive supply chains, which has generated significant expansion in intra-regional trade, investment and financial flows. This has allowed the region to not only foster the development of smaller-scale domestic firms, but also home-grown multinational companies. More than 150 Asian multinational companies were listed in the global Fortune 500 companies in 2013, reinforcing the region's stature in the global economy.

Challenges and imperatives in the drive towards the Asian century

While the regional reforms of the recent decade have brought us to where we are today, Asia needs to press ahead, building on the foundations and momentum of its current progress to achieve greater inroads in the coming decades. To be positioned to strategically capitalise on the opportunities in the new and evolving global economic and financial environment, Asia needs to address the challenges of the 21st Century. It is against this background that I wish to highlight several key challenges and imperatives that will need to be addressed for Asia to sustain its previous success and to firmly anchor Asia's future growth and stability.

First, is the priority that needs to be given to achieving balanced and inclusive growth. Over the recent two decades, developing Asia achieved remarkable progress in lifting millions out

of poverty. Yet, Asia today still accounts for almost two-thirds of the world's poor. As Asia charts its future, it is critical to ensure that the pursuit of growth is accompanied by an equally determined pursuit of greater equality and inclusion. While the development of supply chain networks have contributed towards lifting the economic potential of low- and middle-income countries, there is, however, much more that Asia needs to do to reinforce economic empowerment and further entrench inclusion. Of importance, is the need for greater leverage on technology and new institutional arrangements to extend the outreach to a wider spectrum of society.

Another development affecting economic well-being is the rapid urbanisation in Asia. This trend is expected to continue, with the region's urban population projected to increase from 1.9 billion currently to 3.3 billion by 2050. The bulk of this urban population will consist of the middle income, where the current middle class of more than 500 million people is projected to exceed 3 billion by 2030. These developments are presenting immense challenges to the region. The inability for supply to meet the rapid growth in demand has resulted in rising cost of living as well as strains on public infrastructure and housing. Collectively, if these issues are not addressed, it could result in the displacement of some segments of the society and rising urban poor, with its consequent socio-economic problems. The challenge is therefore multi-dimensional. Further efforts will be needed to expand employment opportunities for the growing urban population, especially the youth, as well as access to essential and high quality services in particular healthcare and education, as well as for retirement. In addition, the provision of social housing and adequate public transportation facilities will serve to raise the standard of living of the urban community.

While public policies to address these issues are important, it also needs to be reinforced by private industry if we are to succeed in achieving truly inclusive growth that brings benefits to the many. In the immediate aftermath of the global financial crisis, global financial institutions came under criticism for opportunistic practices that focused on short-term growth and reverse generation with little consideration for responsible and ethical conduct. In the regional and other cross-border expansion strategies by many international corporations, it is important for such organisations to also contribute to the economic environment of the host countries where they have operations. The alignment to the long-term interest of the country will be mutually reinforcing as it will provide for achieving socio-economic stability, thereby creating a stable environment for the conduct of business activity.

Second, Asia needs to be better-positioned to harness the opportunities from productivity enhancement. As Asia becomes more developed, its future growth will increasingly depend on the transition from growth based on labour and capital accumulation, to one that is more deeply rooted in productivity gains. This will need to involve the wider adoption of high technology in production, transport and marketing, the effective protection of intellectual property rights, and the development of a more vibrant financing ecosystem to catalyse innovation. In tandem with this is the need for a stronger emphasis on human capital development and talent mobility to ensure the workforce has the requisite skills which would result in higher value creation, and the capacity for increased innovation. As a greater proportion of the population is educated to higher levels and become proficient, it will result in well-being. Productivity is thus not only a function of physical technology, but also of talent development. Collectively, these elements will be key components of Asia's productivity gains in the new Asian Century.

Third, is the further deepening of economic and financial integration within Asia. Despite Asia recording the highest savings in the world, with several countries having sizeable current account surpluses, Asia faces immense funding requirements for its development and investment projects. Currently, a large part of Asian funds are still intermediated through global financial markets and then recycled back into Asia. Within the ASEAN region, more than 90% of cross-border portfolio investment flows are with advanced economies outside Asia. Greater regional financial integration will facilitate more effective and efficient

intermediation of funds to enable at least some part of Asia's surplus savings to be channelled towards productive investment opportunities in the region.

Economic and financial integration in Asia is important in paving the way towards a more dynamic and competitive Asia. It will allow us to leverage on our respective strong comparative advantages and complementarities. Further benefits to Asia were evident in the more recent period, when banks within Asia stepped in to bridge the gap left by the retrenchments of lending activities by some of the European banks, thereby mitigating the impact of the financial crisis on the region. Deeper economic and financial integration also enables Asia to pool its resources to address common regional objectives that are beyond any one nation, at a lower cost and with improved risk diversification. This includes the financing of cross-border infrastructure projects and developing solutions for disaster risk management – an area of increasing importance to Asia given the environmental and climate changes that the region is exposed to.

Fourth, is the continued efforts to strengthen the foundations for financial stability. As the region becomes more interconnected, strengthening Asia's resilience needs to consider potential contagion effects and the potential for a financial crisis on a regional scale. At the national level, this will entail continued commitment for the development of strong regulatory and supervisory systems and the strengthening of institutional arrangements that safeguard financial stability. Regionally, important progress has already been achieved in the areas of regional surveillance and supervisory arrangements, and in crisis prevention, management and resolution. The capacity of the region to respond to stressed conditions has also been enhanced through cross-border liquidity support arrangements and the multi-lateralisation of currency swap agreements which would extend support to participating economies in the region during such times. Going forward, collective and coordinated actions will enhance the ability to manage and respond to risks to the region, thus contributing to regional financial stability.

Fifth, is the need to further strengthen overall practices for greater transparency, accountability, governance and integrity. These enhanced practices will empower both the public and private sectors to successfully implement reforms and ensure resource allocation that will contribute to sustainable growth. Of importance, is to ensure that, in tandem with rising growth, there continues to be economic and financial accountability. For Asia, this involves the development of more transparent business models, responsible leadership expectations, and strengthened incentive systems and governance arrangements. Additionally, consumer and shareholder activism are also powerful complements in exerting discipline and serving as a check and balance, against imprudent and irresponsible behavior.

For Asia to truly reach its potential, a further area of focus is to give attention to closing the governance deficit in businesses and governments, and to raise the standards of management in all spheres of economic activities. Examples of these include the production of goods and services by businesses and in the delivery of public services, such as safety and security, healthcare services and transportation that have strict adherence to the appropriate standards. To achieve this, it requires not just the adoption of best governance and management practices, but also ensuring the effective implementation and monitoring. There are several examples in advanced economies, including in Asia, in which these high standards have contributed significantly to the economic well-being.

Sixth is for Asia to remain fully engaged in the international process. Asia has much to contribute to global discourse and dialogue, particularly in standard-setting bodies where Asia can bring to the table the emerging market and Asian perspectives, ensuring that international standards take account of its potential unintended consequences, particularly in emerging economies. This is important in the building of a safer and more stable global financial architecture, that emerging economies need to be a part of. Asia has made significant inroads with the broader representation today of Asian economies in international bodies such as the Group of 20 (G20) and the Financial Stability Board. Asian groupings

have also increased their participation in shaping developments in other important areas such as international accounting standards. Going forward, efforts should be made to strengthen these links to also include the smaller Asian economies.

Conclusion

Let me conclude my remarks. Following the first chapter of Asia's remarkable growth story, the second chapter – the dawn of the Asian Century, needs the same spirit of cooperation and collaboration to succeed. A strong commitment to cooperation and a clear focus on enhancing Asia's long-term potential is key to bridge between Asia today and Asia in the new Asian Century. Will Asia be able to replicate its successes? Clearly, there is tremendous potential, but it will require strong political fortitude, the alignment of economic and financial interests with sustainable goals and the continued agility to respond to the rapidly changing environment.

Just as Asian economies built bridges that connected isolated societies in our countries – freeing resources and transforming lives, we must now build bridges connecting our economies – harnessing the potential and transforming Asia. May this conference inspire discussions, and solidify solutions as Asia advances towards the Asian Century. On that note, I wish you an engaging and productive conference.