Muhammad bin Ibrahim: ASEAN's rapid economic growth and future potential

Opening address by Mr Muhammad bin Ibrahim, Deputy Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the ASEAN Fixed Income Summit (AFIS), Kuala Lumpur, 29 September 2014.

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I am pleased to be here at the inaugural ASEAN Fixed Income Summit, which is hosted by Bank Negara Malaysia, together with Cagamas, the ACI – Financial Markets Association of Malaysia and Malaysian Association of Corporate Treasurers. We have here today, an impressive gathering of senior policy makers across ASEAN and senior representatives from major financial institutions and corporations operating in the region. I would like to welcome all of you to Sasana Kijang, Kuala Lumpur and to Malaysia.

Today, we are in one of the most dynamic and fastest-growing regions in the world. Based on IMF's forecast, world growth in 2014 and 2015 would be 3.4% and 4% respectively. The ASEAN region is expected to grow by 6.4% in 2014 and 2015. ASEAN's GDP is expected to reach USD3 trillion by 2017, tripling in size relative to a decade ago. With a diverse range of economies in terms of size, stages of development and economic structure, including home to many dynamic and emerging economies such as Myanmar and Vietnam, economic expansion in this region are expected to be sustained, and significantly outpace global growth. As ASEAN continues to open up to global investors, foreign direct investment flows (FDI) is expected to accelerate. Going forward, ASEAN with a sizeable population of 618 million offers vast investment prospects as the economy is expected to grow strongly for the next few years.

ASEAN leaders have also embarked on an ambitious vision to create a single "common market". Realisation of this vision will lead to a freer flow of goods and services, capital investment and skilled labour across the region. Many initiatives and measures have been implemented under the ASEAN Economic Community Blueprint since its launch in 2007 and many more areas of importance are being discussed and negotiated. Like most regional economic community, ASEAN aims to promote greater regional connectivity in which lessons of history in economic development had shown, would expand economic growth potential.

Data has also shown that intra-regional trade flows have already grown substantially among ASEAN-10 members countries reflecting the increasing phenomenon of freer trade with its neighbouring countries in recent years. Consequently, the share of intra-regional trade has also increased, from 22.5% in 1999 to 25% in 2011.

Against this backdrop, ASEAN financial markets had also grown significantly in tandem. In particular, the ASEAN fixed income markets, are instrumental to support the growth of intra-regional trade, financing and investment in infrastructure.

ASEAN fixed income markets have expanded by more than six folds since 2000, and now stand impressively at USD1.1 trillion. The size of ASEAN local currency bond markets is now five times larger than the total USD-denominated bonds issued by ASEAN entities, indicates the growing maturity, resilience and the important role of domestic bond markets in each economy. The compounded annual growth rate in ASEAN local currency bond issuance has been 12.9% since 2003. The regional individual markets have experienced growth rates ranging from 5.3% to 42.2%.

These figures are very encouraging. The potential is enormous. A relatively new area of growth for ASEAN bond market is infrastructure financing. Infrastructure investments in Asia, by some estimates, will amount to a staggering USD8 trillion, over the next decade. ASEAN bond markets can play a big role in bridging this long term financing needs given that most economies within the region are bank-dependence for long term financing. Not only the economy would be better served by a new source of funds, but the risks of depending on the banking sector for long term financing would be greatly reduced.

However, formidable challenges still exist. The financial linkages between ASEAN fixed income markets are insignificant and intra-regional investments by ASEAN investors are still small. Malaysia, the largest fixed income market in ASEAN, has seen a fair share of non-residents participation and investment. Despite the growth of our fixed income market and the substantial non-residents investment, the participation from other ASEAN countries is limited.

It would be a fair guesstimate that this is similar in other ASEAN fixed income markets. Within the ASEAN region, more than 90% of cross-border portfolio investment flows are still with advanced economies outside Asia.

For reserve management, Bank Negara Malaysia has for a number of years invested in both USD and local currency denominated Asian bonds. It has been an enriching experience investing in these markets. The many years of experience in our neighbours' financial markets has enabled us to have a hands-on understanding on the regulatory environments and nuances of the Asia local currency debt markets. For example, liquidity is a challenge in most markets, including the Malaysian, for some issuances. But it can be overcome if we look at the issue from a fresh perspective.

Another area is the underdeveloped repo markets and hold-to-maturity behaviours of Asian investors that reduce liquidity, an important investment criteria for many investors. In addition, the non-uniform regulatory environment across regional markets pose significant resource and capacity challenges that prevent ASEAN fixed income market to function as a single large market. These shortcomings add to the complexities and cost in investing in the region, thus making it less attractive to potential investors.

Collectively, there is much more that can be done. The capacity and capability of the domestic players need to be elevated and to enable them to efficiently facilitate regional investment by providing to would be investors up-to-date and comprehensive information and advice on credit, regulatory requirements and tax implication. Equally important, they should be able to effectively offer ancillary services such as FX and interest rate hedging and securities custody services. More should also be done to promote the participation of domestic long-term investors such as insurance companies and pension fund into the region. Through these measures the intention to recycle Asian savings and surplus funds for the productive use of the region would be realised.

Malaysia has taken several steps to develop its market to facilitate cross border investment activities. Over the years, we have liberalized foreign exchange administration rules to make it easier for domestic investors to invest abroad and for foreign investors to invest in Ringgit assets.

With this progressive liberalization, ASEAN investors can now buy Ringgit assets from the region or any part of the world. Together with the Malaysian Securities Commission, we have introduced a transparent and facilitative framework for the issuance and subscription of ringgit and foreign-currency denominated Sukuk and bonds in Malaysia. Our efforts have resulted in a growing trend of regional issuers participating in our domestic market.

A leading Indonesian oil palm plantation company was the most recent issuer in Malaysian domestic bond market, issuing MYR500 million Islamic securities, its second securities issuances. Other Asian issuers that have tapped the Malaysian domestic bond market include two other Indonesia's palm oil plantation companies, a Hong Kong based global supply chain company, Korean banks and corporations. As at September 2014, the total issuances by non-residents, including ASEAN issuers, amounted to 58 issuances. This accounts to a total of MYR20.5 billion (USD6.5 billion equivalent).

We are a firm believer in cooperation between financial markets. In enhancing market infrastructure connectivity and linkages, we have also collaborated with Euroclear and Hong

Kong Monetary Authority to facilitate custody services of Ringgit securities by launching a platform for cross-border investment and settlement of debt securities. This would promote greater efficiency in cross-border debt securities settlement and would strengthen the capacity for debt securities issuances in the region. Accompanying this development, the domestic Real Time Gross Settlement System, known as RENTAS, has been upgraded. Its capability has been extended to act as a central depository and settlement for foreign securities. RENTAS now includes US Dollar and Renminbi securities. Earlier this month, Cagamas' inaugural Renminbi 1.5 billion bond issuance, the largest to date by an ASEAN corporate entity, was deposited and settled via domestic payment system, RENTAS. This success affirms the readiness of our infrastructure to serve as a platform for foreign currency issuances.

The growth prospect and potential in ASEAN is tremendous. Our previous cooperation, initiatives and efforts have been very fruitful and beneficial for the region as a whole.

Looking forward, in further enhancing regional financial integration and strategizing towards a more dynamic ASEAN financial market, there are many proposals and ideas that can be pursued.

Among these proposals, which would provide significant benefits to our fixed income markets is the need to implement a regional framework to mutually recognize approvals in domestic jurisdiction which will be deemed approved in other ASEAN member country jurisdictions. This effort should be expedited to provide issuance flexibilities and accelerate intra-regional cross border issuance. Much has been discussed and deliberated on this subject matter. It is timely to put idea into action. The benefits are significant, as ASEAN issuers will be able to raise long-term domestic currency funding not only from their onshore investors but across the region. Issuers would have access to a wider base of investors. A wider source of funding would also potentially enable them to better match funding and investment needs. Such a framework would also expedite the issuers' compliance with regulatory process, leading to a shorter time to market, which would result in more reasonable cost issuance.

Another bold step is to recognize the credit rating given by the domestic credit rating agency for domestic currency bond or sukuk issuance. Such recognition ought to be given should the rating agency had long enough credit cycle to prove its rating reliance. Domestic rating agencies have better local knowledge and insights. The rating methodologies are similar, technical model-driven and back tested. In addition, most domestic rating agencies have international partners for technical assistance, standard and quality assurance.

Before I conclude, there are some ideas that could contribute to the further integration of our fixed income markets. Firstly, a crucial driver for greater financial integration is the availability of efficient and effective financial intermediaries. We should look to enhance and better connect the network of intermediaries in the region as it would support the development of a strong and integrated market.

With the agreement of the region's regulatory authorities, this can be achieved through the formation of a regional dealers' network for the primary and secondary market. Such regional dealers will help to distribute securities around the region and more importantly create the market to facilitate cross-border transactions. In doing so, it creates liquidity in the fixed income market, attracting greater foreign investors' participation and lowers the cost of funding. ASEAN corporates are thus able to tap into new markets and investors and widen their sources of financing. This contributes to greater depth and breadth of the regional fixed income market.

Secondly, as intra-regional trade within ASEAN is becoming more significant with further potential in intra-regional investments, another untapped area is the cross currency foreign exchange market, that could support regional settlement for trade and investment. ASEAN is well positioned to advocate the greater use of regional currencies that will further enhance and deepen regional financial integration via use of regional currencies for trade settlement. The cost of hedging the exchange rate risk will be lower thus it promotes efficiency in trade and enhances export competitiveness of our businesses. We should therefore, work together and double our effort to promote and enhance the use of regional currencies for trade and investment settlement. Sovereign funds managers could also give a timely boost to this effort by investing a fraction of their funds into domestic currencies of regional bond markets.

Finally, this Summit itself is a platform to promote regional integration, as it can be an important avenue to discuss and showcase developments of the ASEAN fixed income market and bring together policy makers and industry participants. Given the benefits and outcome that can be derived from this Summit, our ASEAN financial market community would be better served if this Summit is organized on an annual basis and hosted by rotation among the ASEAN countries. This would provide an excellent opportunity to each ASEAN member country to showcase their domestic fixed income market to regional policy makers and investors and further deepen our own understanding of the region.

On that note, I wish all of you a productive Summit, one that generates ideas for us to expand and prosper from the rapid economic growth of ASEAN.