Muhammad bin Ibrahim: Building on the past, investing in the future

Remarks by Mr Muhammad bin Ibrahim, Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at Invest Malaysia Kuala Lumpur 2017 "Building on the Past, Investing in the Future", Kuala Lumpur, 25 July 2017.

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Thank you for the opportunity to speak here today at Invest Malaysia Kuala Lumpur. It gives me a chance to share a few words on the Malaysian economy and financial markets.

Malaysia as a nation has forged strong ties with investors over a century. In fact, Malaysia’s relationship with foreign investors is older than the inception of the country. For example, HSBC, Shell and Nestlé have been in Malaysia for more than a hundred years.

This year marks the tenth year since the Global Financial Crisis, which should more appropriately be called the Trans-Atlantic Financial Crisis since it did not directly impact Asia at the time. Closer to home, around 10 years ago, we created the Northern Corridor Economic Region. Today, the Northern Corridor is a success story, with the highest number of approvals for manufacturing investments.

Let me share 10 facts on Malaysia to showcase our ever-thriving symbiotic relationship with investors. Three key things on the Malaysian economy:

i. Malaysia’s openness to foreign investment and trade,
ii. The country’s bright growth prospects; and
iii. Our drive and agility for change to always remain relevant and competitive

Malaysia has always been open, friendly and fair to foreign investors.

Malaysia has always been open, friendly and fair to foreign investors. Foreign investment in Malaysia dates back to more than a hundred years ago. In fact, foreign investors have been major partners of our economic growth. Foreign investment had contributed significantly towards the expansion of the country’s manufacturing sector, the creation of employment and the birth of economic hubs.

Today, foreign investors remain key allies in our quest to become a high income nation. Periodic reviews and dismantling of burdensome regulations have been our ethos. In 2009, we reduced barriers for partnership with local companies and liberalised 27 service subsectors. Since then, at least 15 more subsectors have been liberalised. These measures have boosted investments in many corridors around Malaysia.

Malaysia is a profit centre with no restriction in repatriation of profits even during difficult times.

Foreign investments have indeed yielded significant returns for investors. Returns on FDI have grown by an average of 13% per annum, higher than Malaysia’s nominal GDP growth of 7.7% and one of the highest in Asia. Clearly, Malaysia is a regional profit centre where foreign investments are protected and is allowed to operate in a conducive environment.

More importantly, profits by investors are freely movable. Malaysia does not impose any restriction on the repatriation of profits, even during difficult times. A fact sometimes missed by analysts. Even during the 1997 crisis, we did not restrict the movement of profits from Malaysia.

Our compass in attracting investment has always been guided by seeking *quality,* rather than *quantity,* of investments. Our rules and treatment are fair to all genuine investors. Any incentives granted to both foreign and domestic investors are subject to stringent performance requirements. This ensures adequate safeguards for the goals of the incentives and underscores our fair treatment to all.

This would also create a relationship built on the principle of mutual reinforcement, beneficial to both Malaysia and its partners.

A growing economy which parallel global development and growth.

The Malaysian economy has always been very well run. It has bright growth prospects, in the immediate future and in the longer term. We have been one of the fastest growing economy in the last decade. Our economic growth has consistently outpaced global growth since the Trans-Atlantic Financial Crisis. Comparing average growth rates since then, Malaysia's growth rate has been 170 basis points higher than the global economy, growing faster by 38% to be exact. In the region, we are among the fastest-growing middle-income economy. I am quite confident that this trend is set to continue as we move forward.

In the first quarter of the year, Malaysia grew by 5.6%, surpassing market expectations. Growth has been lifted by the stronger domestic demand with additional impetus from exports. Our export performance is generating greater positive spillovers to the domestic economy. Judging by these, the economy is poised to register stronger growth in 2017.

Many factors account for the sustained economic performance. A key reason is our economic diversification. While we were once an export-driven economy, our resilient domestic demand has served as a strong anchor of growth when external demand became challenging in the aftermath of the Trans-Atlantic Financial Crisis.

We have a long track record of sound macroeconomic planning and management. Today, let me focus on international reserves. Malaysia's management of its international reserves has always been undertaken with integrity and prudence. Under meticulous management, the size of our foreign exchange reserves has grown substantially in the last two decades.

The development of Malaysia's international reserves has been under the media spotlight lately. It is important to note that speculation on the country's international reserves, if not managed properly, can affect trust and confidence in the economy, financial system as well as its currency.

The main purpose of international reserves is to serve as a buffer against external shocks. This reduces the likelihood of a balance of payments crisis, thereby preserving monetary and financial stability and orderly market conditions. The sheer magnitude of funds flowing between financial markets is now staggering.

This is further complicated by the rapid pace at which these transactions may occur because of technological advancements. In such periods, changes in international reserves should respond accordingly.

But one area we should be mindful of is that reserves should increase and fall in an open financial market, serving as a buffer against potentially disruptive volatile financial flows. A decline in reserves during periods of capital reversal is not a new phenomenon. In contrast, during periods of capital inflows, it is natural for reserves to be accumulated. Reserves play a role in both circumstances to manage adjustments in the financial markets. This includes ensuring the stability of the exchange rate is preserved. This is how we maintain orderly market conditions.

Malaysia's level of foreign exchange reserves is adequate for our stage of economic development, domestic market structure and external position. Malaysia's reserves is well-within the adequacy range, placing us in a comfortable position relative to regional peers and fulfilling recognised global standards.

Malaysia's long-term growth prospects also remain favourable. These are reinforced by both naturally occurring domestic economic trends and policy consideration, deliberation and action. Malaysia will also continue to reap its demographic dividends and benefit from a young and productive population for the foreseeable future. As education and income levels continue to rise, an increasingly affluent and informed consumer group would emerge – providing additional impetus for economic growth.

Time and again, Malaysian policymakers have continuously supported growth by removing structural impediments and promoting an enabling environment for new growth areas to flourish.

Strong banking sector and financial market that intermediate business needs.

Malaysia's diversified and well-developed financial sector can intermediate the business and economic needs of the country, enabling businesses to flourish.

Malaysia's banking sector is one of the strongest and most developed in Asia. Banks are well-capitalised, with capital in excess of the minimum regulatory requirement of Basel III.

Malaysian banks, with their vast network of presence across the region could also serve as investors' gateway to East Asia.

Malaysia has been innovative in developing its financial system. This is very much evident in the rise of Islamic finance that offers investors a wider range of financial and insurance products. Prior to 2000, we had only two Islamic banks and two takaful operators.

Today, Islamic banking assets account for more than a quarter of the total banking system. There are more than 100 financial products beyond the basic financial services offered. These include wealth management products, corporate financial solutions and investment banking services. Indeed, Islamic finance has arrived. From being a novelty to mainstream – it is able to meet the needs of the economy.

At the same time, our capital market also stands at par with Asia's best. We currently have one of the largest bond market in East Asia. We do not restrict any form of foreign participation in our bond and equity markets. This allows for natural deepening and widening of the financial system in Malaysia. Importantly, it allows investors like yourselves a diversified source of funds to manage your financial needs.

Sovereign implied rating is at times, better than assigned ratings by the Credit Rating Agencies.

Currently, all three of the major rating agencies, namely Moody's, S&P and Fitch rate Malaysia at 'A-' and on a stable outlook. The last time Malaysia's long-term foreign currency ratings were upgraded by these agencies was more than 10 years ago. Our per capita income was then at RM17,600 (2004) per annum compared to RM37,800 in 2016. And yet, our rating remains the same at ‘A-‘.

Rating agencies assess sovereign credit risks based on a long term outlook and at most times are reactionary to certain events. This may result in the credit ratings falling behind the curve and not incorporating the latest market developments. For example, Indonesia was only recently upgraded to investment grade by S&P, more than 5 years after Moody’s and Fitch’s gave a similar rating.

Market-implied ratings may be a better gauge of a country’s latest credit profile and is already widely used by the market. In the past 3 years, based on bond market yields, Malaysia’s market-implied rating has at times reached levels that indicate a better rating than that assigned by the rating agencies.

Throughout the first half of this year alone, yields for the 10-year Malaysian government securities have swiftly recovered to 3.9% from a peak of 4.5% last November, post-US elections, reflecting higher confidence in the Malaysian bond market.

We are currently the largest bond market in ASEAN in terms of percentage over GDP. The Malaysian bond market continues to be resilient and well-functioning. Non-resident holdings of Malaysian bonds have settled at a lower level of 26% compared to its peak of 34.7%. However, we have observed a more diversified and well-balanced non-resident investor base in recent months and our surveillance indicates that composition of medium to long-term investors is now much higher. The participation of a diverse spectrum of non-residents, including central banks and sovereign funds, is pivotal in providing a more stable and balanced two-way flows.

Malaysia is constantly in top 20 global competitiveness index.

Malaysia is the world’s 34th largest economy. We are also consistently ranked among the world’s most competitive economies. These are externally driven indexes and are independently researched.

In the World Bank Doing Business report, Malaysia scored better than the average OECD high income nations in terms of legal rights and credit information. Our protection of businesses are also stronger with faster and higher recovery rate in cases of insolvency.

In terms of talent development, attraction and retention, Malaysia has consistently ranked in the top 20 of the IMD World Talent report. Within the region, Malaysian talents stand out due to our diversity. A key attraction for investors in Malaysia remains the English proficiency of our workforce. We have maintained a top 15 ranking in the EF English proficiency index for the last 6 years.

Many multinational companies based in Malaysia have taken note of this cultural diversity. The familiarity of our people with the numerous languages spoken within Asia, including Mandarin, Arabic, Tamil, Urdu and Malay allows for Malaysia to be a natural choice for regional business operations. The flourishing of our Global Business Services industry illustrates this point. Google has established its Center of Excellence in Cyberjaya. This centre would showcase a range of Google for Work products such as Google Apps for Work and Google Cloud Platform.

Malaysia always subscribes to global best practice and standards.

From national statistics to macroeconomic management, international organisations like the IMF and World Bank have long acknowledged Malaysia’s adherence to international best standards.

A quick word on the impact of global standards on the real economy. Our adherence to international standards has extended to the quality of our products. From precision semiconductors to commodities, a wide array of Malaysia’s exports have gained international recognition.

A recent case in point is the palm oil industry, which also marks its 100th year of industrialisation this year. Since the introduction of the Roundtable Sustainable Palm Oil (RSPO) standards, our major palm oil players have redesigned their plantation strategies to comply with the strict RSPO standards. We have also gone a step further by introducing the Malaysian Sustainable Palm Oil (MSPO) certification to elevate the standards of smallholders.

Malaysia's economic and business policies are agile and pragmatic.

Our world is increasingly fast-paced, with ever changing challenges. To remain competitive and relevant, policies must be agile and efficient. Malaysia's policies have been flexible and pragmatic. Time and again, we have demonstrated the courage to take bold and unconventional measures to protect the economy and the interests of genuine investors. Time and again, our policies have become even more liberalised than before, as we move forward to make the market more competitive, more transparent and more dynamic.

Seven months ago, we took swift and pragmatic actions to implement foreign exchange market development measures to stabilise the foreign exchange market. I am pleased to report that these measures are successful, where the 1-month implied volatility has halved. Onshore foreign exchange have recovered to a stable daily average volume of USD10 billion, an increase of 1.25 times before the measures. Daily foreign exchange turnover remains 5 times higher than equity trades.

Another policy that merits attention is the global phenomenon of rising inequality. Markets are not always the best arbitrator for the distribution of jobs, wealth and income.

In the era of rapid globalisation, advancement in technology and consequently, the creation of a new economy, there are many winners and losers. As responsible policymakers, we need to reconcile the benefactors of the new economy with those who have been excluded or dislocated during this era of transformation.

Cognisant of the urgent need to improve our social safety net, the minimum wage was implemented in 2013. Many have benefitted from this, including migrant workers. The B40 group was also given cash assistance to cope with the rising cost of living. In the near future, the protection and wellbeing of workers will be enhanced through the introduction of unemployment insurance. I urge businesses to take a broader view of these policies and not purely from a cost perspective. These measures are necessary to secure long term sustainable prosperity and modernisation of the country as we move forward. Lest we forget, a well-compensated labour force also makes for good consumers as well.

Devising policy to be part of the future.

We are constantly crafting policies to secure a stronger foothold in the future. Businesses and policymakers need to be proactive and agile. To embrace and facilitate, not to deter or hinder. This is the Bank's modus operandi in embracing financial technology, or FinTech for short.

We were one of the pioneers to implement a Regulatory Sandbox, which allows for the safe experimentation of FinTech innovations. We shall facilitate and make the hard decisions necessary if the innovations benefit the economy, even if it means changing the status quo.

In meeting demands of the future economy, Malaysia welcomes innovators to develop the 'next big thing'. This year, the Government launched the world's first Digital Free Trade Zone in collaboration with e-commerce giant, Alibaba Group. The hub will be Alibaba's first e-hub foray out of China.

The sharing economy is another new source of growth that promises to increase efficiency in an inclusive manner. Unlike the conventional work structure, it is accessible to anyone who has idle or under-utilised assets, skills or time to spare. Recognising its vast potential, the Government has partnered with the industry to promote sharing economy, while safeguarding against its risks. The measures include ensuring adequate worker and consumer protection, and creating a level playing field.

Population that is used to change, reform and transformation.

Malaysia is no stranger to change and reform. Our people are very adaptable. We used to be a primary commodity producing economy in the 1960s and 1970s, before embarking on import substitution and then manufacturing. In merely two decades, we have transformed from an agricultural economy to a manufacturing powerhouse. Since the Asian Financial Crisis, we have metamorphosed the economy from an export dependent to a domestic driven economy. And now, Malaysia embarks on a journey into high-value growth activities. We are confident in achieving our quest to be a high income nation with equity.

Today, Amazon has steadily nudged out physical retailers, rendering them almost-obsolete at retail outlets. Soon, checkout counters would seem as foreign as cassette tapes to our millennials.

While driverless cars seems to be the “in” thing now, it is quite possibly, just the start to many more changes that we cannot even fathom now. Against these changes, the ability to learn, un-learn and re-learn would be an indispensable requirement.

There are many lessons to be learnt. One of these lessons is that we need to prepare society for jobs that do not yet exist. Students of today can expect to hold more than 11 jobs between the ages of 18 and 42. That is more jobs than most of us have ever. With automation and artificial intelligence on the verge unleashing many possibilities, our value proposition is not knowledge, but cognitive skills. Essentially, we need to teach our young on how to learn and adapt, not how to work. I am confident that Malaysians as a whole are able to adapt to these changes, as we have proven on numerous times over the course of our short history.

Conclusion

Let me conclude. Malaysia has evolved significantly in the last 60 years. Our history has shown how Malaysia has been an economy that is able to adapt to an evolving environment. We welcome business, we provide an opportunity to profit, and we are pragmatic and agile in our policies to protect the interest of all. With more than a hundred years of history between us, Malaysia looks forward to a mutually beneficial relationship with both foreign and domestic investors alike.

Thank you.