BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

GOVERNOR'S STATEMENT

The global economy entered 2013 with improved economic and financial conditions. The overall global situation, however, continues to remain challenging. The pace of recovery prevailing in several of the advanced economies remains constrained by the unresolved fiscal, financial and structural concerns. While affected by global developments, emerging economies have continued to perform well. Emerging economies in Asia, in particular, have continued to be resilient, sustained by domestic demand and robust domestic fundamentals.

The Malaysian economy is expected to continue to remain on a solid and steady growth trajectory in 2013. The favourable economic performance has benefitted from the restructuring of the economy during the recent decade, the resilience of the financial sector and the potential flexibility of policy. Following the economic restructuring, domestic demand has increasingly been the driver of growth. The growth has essentially been sustained by the strong private consumption and, more recently, the resurgence of private investment. The sources of economic growth have also become more diversified and balanced across economic sectors and across trade partners. Of greater significance is the increasing role of the private sector in the economy.

Malaysia's economic performance has importantly been well-supported by a resilient financial sector. Despite the increased volatility experienced in the domestic financial markets following developments in the global economy and financial system, domestic financial intermediation has continued uninterrupted. A strong banking system and a well-developed domestic bond market have not only provided continued access for financing of the economy, but it has served to disperse the concentration of risk in the financial system. Additionally, the progressive liberalisation and the greater foreign presence has not only increased competition in the financial system but has contributed to increased two-way capital flows and thus orderly market conditions. Moving forward, the continued financial reforms and development will aim at enhancing financial sector resilience and ensuring that the financial sector will continue to best serve the economy.

Equally important in supporting the economy is the potential flexibility of the domestic macroeconomic policies, particularly in an increasingly complex and challenging environment. The Bank has always been pragmatic in the design and use of its policies, relying on a comprehensive set of measures to achieve the desired objectives. While monetary policy remains the main policy lever, other complementary measures such as macroprudential policies have been relied upon to address risks in specific segments of the financial system and the economy, thus broadening the policy space and avoiding an over-reliance on monetary policy. Coordination with fiscal policy has also enhanced the impact and effectiveness of the policies in influencing the economy.

While inflation has trended downwards to the lows of 1.3% at the start of 2013, the focus of monetary policy during the year will be on managing the risk of rising prices while supporting sustained domestic economic growth. Given the assessment on the domestic and global economic prospective conditions, the expectation is for inflation to remain modest. The Bank will continue to be forward-looking and take a medium-term perspective given that monetary policy is most effective when used pre-emptively. Consideration will also be given towards avoiding the build-up of financial imbalances that could adversely affect macroeconomic and financial stability over the medium term. Lessons can be drawn from the crisis-ridden economies on the consequences of excessive build-ups of household indebtedness which would eventually have adverse and prolonged effects on consumption, the broader economy and financial stability. While the assessment is that household indebtedness in Malaysia and the risk to financial stability remains contained, a number of measures have already been implemented as a pre-emptive step to prevent it from becoming a problem.

Recent data shows that the growth of credit to households has begun to moderate. In addition, the growth of credit to households has been supported by a comprehensive and well-developed infrastructure to manage the risks. These include a well-functioning credit information registry that allows banks to make an informed assessment on the aggregate borrowings and creditworthiness of a borrower, a targeted financial education programme for new and young borrowers and a well-structured debt resolution and counselling mechanism to facilitate orderly management of potential financial problems among households. Through the supervisory assessment, the underwriting and risk management practices of banks has also been upgraded and become more robust.

As a highly open economy and with an increasingly more liberalised financial system, Malaysia is vulnerable to international shocks. Increased regional and global integration has in particular strengthened our economic and financial links with other economies in Asia. This has resulted in a greater diversification of the sources and destinations of trade and investment flows. Recent progress towards greater regional financial integration has also allowed for a more efficient and effective intermediation of funds within the region, improved risk diversification and provided the needed financing to support the investment activities in the region. The greater international and regional integration has brought with it increased challenges, including the risk of contagion from other parts of the world. This has prompted policymakers in the region to work together to pre-empt any incipient risks to the regional financial systems and economies. This is particularly important in the present circumstances where the region is being affected by volatile capital flows.

Among the regional central banks, there is a shared appreciation and strong commitment for combined efforts to secure regional macroeconomic and financial stability. Under the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP), there is greater collective action in forming surveillance frameworks for early detection of risks and vulnerabilities to the region. Also being put in place is the pre-emptive preparations for an integrated framework for crisis management for the region. Reinforcing this is the ASEAN+3 financial initiatives which have strengthened and expanded the liquidity support mechanisms through the Chiang Mai Initiative Multilateralisation (CMIM). It enables a prompt response to any impending stress to the balance of payments or to a short-term liquidity position in the region. The South East Asia Central Banks Research and Training Centre (SEACEN) also has a key role in facilitating greater and more inclusive regional collaboration among the regional central banks. The extensive membership of SEACEN, including the major central banks in the region, has significantly deepened the collective pool of talent and resources in its core activities. SEACEN's unique regional position has facilitated a number of high-impact capacity building activities and collaborative research, as well as providing an inclusive platform for rigorous high-level policy discussions on issues of common strategic interest.

From the medium-term perspective, the main challenge for Malaysia is to successfully manage the transition towards a higher value-added economy, in which growth is private sector-driven and characterised by greater productivity and innovation, while at the same time being sustainable and inclusive. Key structural reform initiatives are currently being undertaken towards achieving this transformation, while taking into consideration the domestic realities and a more dynamic global environment. In this regard, the role of macroeconomic policy will be to ensure stability, and to provide the right incentives for the private sector to participate in this economic transformation process. As part of this transformation, the financial sector is envisaged to assume an important role in the efficient intermediation of funds, not only within Malaysia but increasingly also in the region and in other emerging economies. This will require new financial products and services to meet the requirements of a more knowledge- and innovation-intensive domestic economy and the financial infrastructure that will support the regional intermediation of funds for productive purposes.

During the year, the Bank has continued to modernise and strengthen its organisational capacity. The Bank is now well into the third phase of its organisational transformation, to ensure our continued effectiveness and to bring the Bank to the next level of performance. Key to the transformation is the Bank's three-year Business Plan, which provides focus and organisation-wide clarity on the strategic directions of the Bank, as well as a greater appreciation of the interdependencies of the desired outcomes. This has also strengthened horizontal collaboration within the Bank.

The Bank achieved several key milestones during the year. This included the enactment of the new Financial Services Act 2013 and Islamic Financial Services Act 2013, which merged several existing acts to provide a more uniform framework for the regulation of the financial sector and to provide the Bank with the necessary powers to act effectively in a much more complex financial landscape. Another milestone was the establishment of a centralised shared services division in the Bank to enhance the productivity and the level of professionalism in the delivery of support services to the Bank. There has also been more targeted talent development, with an increased focus on leadership development throughout the Bank, to ensure the readiness of the Bank's succession plan. Finally, the Bank introduced in 2012 the new currency series for all denominations of its notes and coins, with designs that distinctly reflect Malaysia and incorporating the latest security features and banknote technology.

The Bank has undergone many changes that have ensured that we remain effective and are in a state of readiness to meet the greater demands and challenges before us. Central to these efforts is the unwavering dedication and professionalism of the Bank's staff. On behalf of the Board and the management, I wish to express our appreciation to the staff of the Bank for their commitment to achieving our strategic goals and the economic and financial well-being of our nation. I also thank the Board of Directors for their continued support and guidance. With more challenges ahead of us, the Bank will continue to strive towards achieving the highest standards of excellence in fulfilling our responsibilities and upholding the trust that is placed upon us, guided by our vision, resolve, and shared values.

Zeti Akhtar Aziz
Governor
20 March 2013