Governor's Statement

BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

The global economic and financial environment in 2008 became increasingly difficult as the conditions of increased inflationary pressures arising from the sharp escalation of global fuel and commodity prices in the first half-year shifted to a rapidly deteriorating slowdown of the global economy in the second half of the year. Despite recording declines in exports and industrial production in the latter part of the year, Malaysia registered an economic growth of 4.6% in 2008 following strong growth in the first half of the year.

The global economy is expected to continue to weaken significantly in 2009, with all advanced economies experiencing sharp economic contraction. There is, at this stage, no visible sign that the global financial crisis has abated. Delays in addressing the financial sector problems in several of the advanced economies have increased the prospect of a more protracted and deeper economic downturn. The experience from the Asian financial crisis more than a decade ago suggests that the financial sector resolution measures would need to be comprehensive to restore financial system stability. The restoration of the financial intermediation process and a resumption in lending activity are vital elements for economic recovery. While a number of stimulus measures are being undertaken across the globe to counter the effects of the economic downturn, the full impact of these measures will require time to take effect.

The significant deterioration in the advanced economies, particularly the collapse in private sector activity, has contributed to a substantial weakening of global trade and investment flows. Asia, with its strong international trade and investment linkages, has been adversely affected. A number of economies in Asia are already in recession, while others are experiencing a sharp moderation in growth. The relatively strong financial systems and the extensive monetary and fiscal policy responses instituted by the regional economies are, however, expected to contribute towards partially mitigating the impact of the global economic slowdown on this part of the world.

The year 2009 will be a highly challenging year for the Malaysian economy. While the domestic economy has been affected by the adverse global developments since the second half of 2008, it is expected that the Malaysian economy will experience the full impact of the global recession in 2009. Taking into account the full implementation of the measures to support domestic demand, the GDP performance in 2009 in real terms is projected to be between -1% to 1%. This outlook is dependent on stability being restored in the crisis-affected economies in the second half of the year. It will essentially depend on the effective implementation of the announced resolution and stimulus measures. Should the financial sector problems globally remain unresolved, conditions can be expected to continue to deteriorate.

For the domestic economy, the increased capacity for domestic demand, which has been built up over several years, has the potential to remain positive going forward. In addition, the high degree of economic diversification, in terms of exports and markets, and in the increased range of domestic-oriented activities, is another key element that will contribute towards growth. These trends need to be developed and further reinforced, including our trade with the other emerging economies especially in Asia. Under these circumstances, the strategy is to provide support to domestic demand in order to mitigate the severity of the economic downturn. Two factors are important in supporting domestic demand. Firstly, to ensure that the monetary and financing conditions are supportive of domestic demand. Secondly, is the role of fiscal policy to support domestic demand and to place Malaysia in the position to resume growth once conditions in the global economy stabilise.

The monetary policy response has been forward-looking in this environment of shifting challenges. An accommodative monetary environment was already maintained in the first part of 2008 despite the rise in supply-driven inflationary pressures. The balance of risks to both growth and inflation had become more acute and elevated when inflation surged due to the significant adjustment to fuel prices in June 2008, resulting in a deflationary shock to the economy. It was assessed, however, that in the latter part of 2008 the balance of risks would shift from higher inflation to slower growth. Indeed, headline inflation has continued to moderate, from the peak of 8.5% in July 2008 to less than 4% by the beginning of 2009. This downward trend is expected to continue, with inflation now projected to slow significantly to an average of less than 2% in 2009. With the risk that growth would decelerate more significantly with the deteriorating global environment, monetary policy action was frontloaded. Since November 2008, the Overnight Policy Rate (OPR) has been lowered by 150 basis points to 2% and the Statutory Reserve Requirement was lowered by 3 percentage points to reduce further the cost of intermediation.

Moving forward, the focus of attention will be to ensure the continued access to financing. The strong domestic banking system, with its ample liquidity, has been important in ensuring that the access to financing remains uninterrupted. Several measures have been introduced to further enhance access to financing for all economic sectors. These include the establishment of special funds, financing guarantee facilities for businesses, adequate liquidity including the availability of US dollars for trade financing, and the establishment of the Financial Guarantee Institution to provide credit enhancement to companies for fund-raising in the domestic bond market.

In a highly uncertain global economic environment and volatile international financial markets, the flexible exchange rate regime has enabled Malaysia to adjust to and absorb these international developments, while according broad stability against our main trading partners. The exchange rate represents an important price in a highly open economy such as Malaysia. An excessively volatile exchange rate would have significant disruptive impact on international trade and investment. The policy of the Bank would be to continue to maintain orderly conditions in the ringgit foreign exchange market to facilitate international trade and investment. While the exchange rate in the current environment has been largely influenced by capital flows, it is well supported by a strong external position.

The current crisis has highlighted the benefits and importance of raising the level of regional cooperation, particularly in undertaking joint-surveillance of the developments in the region and putting in place mechanisms for crisis management among central banks in the region. Such collaborative efforts have been extensive. The establishment of an integrated regional monitoring mechanism, undertaking vigilant risk management functions, and the setting up of an integrated crisis management and crisis resolution mechanism under the aegis of the Executives' Meeting of East Asia Pacific Central Banks (EMEAP) Monetary and Financial Stability

Committee, are important developments that have taken place. Steps are also being taken to enhance the liquidity support mechanism in the Chiang Mai Initiative by moving towards multilateralisation that would enable an effective pooling and utilisation of liquidity support among member countries. In addition, bilateral arrangements have taken place within the region. Bank Negara Malaysia and the People's Bank of China entered into a bilateral currency swap arrangement to promote bilateral trade and investment early this year.

Bank Negara Malaysia marks 50 years of central banking this year. We can look back with pride at our contribution to maintaining monetary and financial stability and to the development of a comprehensive financial system in the nation. This has also involved the modernisation of the Bank to ensure that we remain effective in a rapidly changing environment. In 2008, continuous efforts were directed towards transforming the Bank into a more strategy-focussed and performance-based organisation. This year saw the development of a 3-year Business Plan encapsulating the Bank's key priorities, strategic results to be achieved and the effective alignment of our resources for this purpose. In the area of talent management, focus continues to be given to the development of the talent pipeline for leadership succession and to the management of performance.

As part of the modernisation of the Bank, a new Central Bank of Malaysia Act will be tabled to the Parliament this year. The proposed Act involves a comprehensive review of the Bank's mandate, governance, accountability and the legislative framework to ensure that the Bank remains effective in performing its functions. The proposed Act aims to provide greater clarity to the existing roles and functions of the Bank and will entrust the Bank with the necessary powers and instruments to perform the Bank's roles and functions effectively. The proposed Act will further institutionalise many of the practices that have been introduced in this recent decade. In addition, the governance framework of the Bank would be strengthened through the proposed Act to enhance accountability, professionalism and transparency.

The experience over 50 years in preserving monetary and financial stability and in supporting the sustainability of economic development has seen many challenges, with many lessons learnt. The year 2009 presents another highly challenging year that would place greater demands on the readiness, capacity and capabilities of the Bank to sustain the welfare of the nation through these difficult times. In the tradition of the strength of our resolve, the Bank will remain focussed in the pursuit of these goals.

Zeti Akhtar Aziz
Governor

25 March 2009