BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Governor's Statement

2017 was a year of resurgence. The improvements in the global and domestic economy far exceeded earlier expectations, with growth being broad-based, entrenched, and synchronised. This was despite ongoing political and policy uncertainties in the major economies, threats from geopolitical and financial market developments, and commodity price volatility. The global economy recorded its highest growth since 2011, underpinned by stronger investment activity in most economies, and strong export performance, particularly in Asia. The environment today is an immense improvement from the outlook envisioned at the end of 2016.

As the recovery in the major advanced economies gains traction, the prolonged period of easy monetary conditions will continue to be normalised. While the impact of the normalisation process has thus far been contained within the financial markets, risks of destabilising capital flows and growth disruptions arising from premature tightening of monetary accommodation remain. In tandem with the upswing, emerging market economies have continued to record respectable growth and will continue to benefit from the ongoing global recovery.

For Malaysia, the economy performed strongly in 2017. The diversified structure of the Malaysian economy has not only enhanced its resilience, but has placed Malaysia in a position to benefit from the global growth upturn. The external sectors benefited significantly from the global upswing, with gross exports growing at its fastest pace since 2004, reflecting the greater demand from Malaysia's key trading partners and the improvement in commodity prices. Domestic demand remained the key contributor to the overall solid performance of the economy during the year, grounded on healthy fundamentals and backed by improving business and household sentiments.

This renewed growth impetus offers a good cause for optimism, but it must not cause complacency. We must learn from past crises and guard against excesses that could induce economic and financial stresses. While notable progress and reforms have been made over the decades to strengthen our resilience, improve our economic fundamentals, and deepen our financial markets, challenges remain. Continued vigilance, together with the ability and will to act pre-emptively to address the build-up of vulnerabilities, risks and imbalances, are critical to secure our growth prospects. It is during the good times that reforms should be accelerated. The present strength of the economy should not lull us into policy inactions. We should capitalise on this upswing to build policy space, fortify the financial system, bolster domestic reforms, tackle long-term growth obstacles, and nurture our people.

Given the positive performance and robust macroeconomic outlook, the Monetary Policy Committee (MPC) decided to normalise the degree of monetary accommodation at the January 2018 MPC meeting. The decision ensures that the monetary policy stance continues to be accommodative and is appropriate for sustainable growth prospects while mitigating risks that could arise from a prolonged period of low interest rates.

The Bank also initiated a series of pre-emptive measures to future-proof the economy. The Financial Markets Committee (FMC) measures were introduced to develop, strengthen and further liberalise the domestic financial markets. Specifically, the measures were focused on improving liquidity in the domestic bond market and providing additional hedging flexibilities. The FMC also announced initiatives to promote a financial market that is trusted, competitive, and resilient through the adoption of guiding principles for a fair and effective financial market, and a new code of conduct for the wholesale financial markets. This will continue to be supported by firm action on the part of the Bank to preserve financial market stability. Irrational speculation and behaviour require firm and rational regulation. There are clear signs that the measures implemented have achieved their intended outcomes. By the end of the year, volatility in the ringgit exchange rate had declined significantly, and speculative position-taking on the ringgit, particularly in the offshore market, had subsided. With non-resident holdings of Government bonds improving to a more sustainable level and trade flows more aligned with Malaysia's trade surplus, the demand and supply of the ringgit and foreign exchange in the market became more reflective of Malaysia's underlying economic activity.

Beyond monetary and financial stability, sufficient resources will be allocated to address various impediments in the economy. Quality investments continue to be advocated to ensure that Malaysia reaps maximum economic and financial benefits from these investments. The reassessment of investment incentive frameworks serves as one of the initiatives to promote higher quality domestic and foreign investments. More broadly, investment policies need to take into account ongoing shifts in the global value chain and advances in technology, and encourage the economy's progress towards greater levels of complexity. In the labour market, there has been a concerted effort to upskill the workforce, notably in the financial sector, to meet the growing demands of an evolving economy. More importantly, this needs to be matched with the creation of quality jobs. The Bank's active participation and collaboration with the various key stakeholders to establish the Malaysian Bureau of Labour Statistics underscore our commitment to address the gaps in labour market statistics, including on job creation, wages and hours worked, labour turnover and hiring. The development of these high-frequency and reliable indicators would facilitate more informed data-driven policymaking on labour-related issues. Collectively, these efforts envision a more advanced economic architecture that will support the nation's aspirations to reach a high-income and developed nation status.

Beyond aiming for robust, sustainable growth, the Bank is conscious of the gravity in delivering growth that is equitable and inclusive. The Bank continues to direct significant efforts to promote financial inclusion that enables greater participation in financial services by the underserved segment of society. In addition, measures continue to be pursued in collaboration with other agencies to broaden financing solutions for SMEs, in particular, to support innovation and automation to enhance their competitiveness.

The Bank is mindful of the divergence between the strong headline numbers and anecdotal on-the-ground sentiments. The attainment of one without the other may reduce the effectiveness of policies. Greater focus therefore has been given to improve communication and engagements with the public to better inform and complement policy. Equally important is the need for a continued evaluation of policies.

These have been crucial to ensure that policies achieve the intended outcomes. For one, policies involving cost of living issues should not only focus on cost-related solutions, but also encompass more income-enhancing measures. The provision of a living wage that is commensurate with productivity can be a step towards attaining a higher and quality living standard. A coordinated response to issues of affordable housing and escalating costs of healthcare would contribute to enhanced welfare. As with any deep-rooted changes, there is no quick fix. The Bank will continue to actively contribute to and support multifaceted solutions to these issues to serve the overarching aim of growth that benefits all segments of society.

Policy flexibility and pragmatism are pivotal. As the economy and financial markets evolve, too rigid a policy framework can be constraining and inflexible. In this competitive and rapidly changing environment, the Bank will continuously re-assess, re-calibrate and refine policies to ensure that policies remain relevant. We will continue to be receptive to ideas that may not conform to conventional thinking; be willing to innovate; and be ready to act decisively to remedy policy weaknesses for the benefit of the economy.

While the right policies are paramount to provide the enabling environment for the economy to prosper, it is the private sector that should drive change and lead the economy towards greater sophistication with higher value-added activities and higher overall productivity. In this respect, buffers, capacity, and capabilities need to be strengthened to ride the next wave of economic development. Strategic investments, both in skilled human capital and cutting-edge infrastructure, should be prioritised to increase competitiveness as the nation continues its pursuit towards innovation-led growth.

The Bank as an institution requires constant renewal to remain relevant and effective. Strong emphasis is placed on continuous professional development and investment in our staff. In navigating the uncertainties ahead, the Bank is embarking on a new three-year business plan. The business plan articulates a comprehensive series of high-impact strategies to deliver measurable results and elevate the Bank's capability to support sustainable economic growth, financial services digitalisation, and socioeconomic development. Whilst improving the Bank's accountability to deliver, there will also be an increased emphasis on inculcating a culture of innovation, creativity and agility. These behavioural attributes encourage diversity and elevate productivity in the work environment by allowing teams to ideate and innovate, leveraging on new platforms such as innovation labs.

On the international front, the Bank remains committed to strengthen regional and international collaboration. The Bank continues to engage in key platforms such as ASEAN, ASEAN+3, the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) and the South East Asia Central Banks (SEACEN) Research and Training Centre. The Bank has undertaken the necessary steps to further deepen the economic interlinkages and financial integration within the region. The enhancement to the ringgit-baht and the operationalisation of the ringgit-rupiah settlement frameworks, for example, serve as testaments to our regional cooperation. The frameworks are critical as they enable the settlement of trade and investment in the respective local currencies, providing greater options for businesses in settling their transactions. Capitalising on the intellectual cluster of Sasana Kijang, its status as the international and regional centre of excellence for financial services was enhanced with the hosting of several high-impact and high profile discourses, including the Bank Negara Malaysia (BNM) - International Monetary Fund (IMF) - IMF Economic Review Summer Conference — the first in Southeast Asia, the BNM Monetary Policy Conference, the Global Symposium on Development Financial Institutions, and the 3rd Counter-Terrorism Financing Summit. These events, held in collaboration with the international financial institutions and global standard-setting bodies such as the IMF and the World Bank Group, are consistent with our policy to collaborate at the international level. Malaysia's leadership in Islamic finance was further cemented with the issuance of the world's first green sukuk in partnership with the World Bank Group and the Securities Commission.

As we move forward, there are three key risks that could disrupt our robust economic growth. First is the risk of a premature or over-tightening of global monetary accommodation. While much has been accomplished since the Global Financial Crisis to put the global economy back on track, finding the balance between premature tightening and prolonged easing will continue to be a challenge for policymakers. The second major risk is a sharp correction in global financial markets that may reignite extreme market volatility and derail the global growth momentum. Amidst the extremely low volatility environment in 2017, global financial markets performed strongly and reached historical highs in some key markets. However, low volatility does not equate to low risks. A third risk is the escalating trade tension, whereby an economic fallout from protectionist policies may undermine the sustainability of global growth.

While these risks may seem daunting, the future holds many promises. Technology will continue to be a key catalyst for growth. Embracing digitalisation is no longer an option but an imperative. The present policy debates have rightly been focusing on maximising the economic benefits while confronting the threats that may arise from this trend. This must include avoiding a digital divide and ensuring that the benefits of the digital economy reach all segments of society. Our nation has proven its agility to flourish in an environment of rapid change. I am confident in our collective strength to thrive in the ever competitive environment to the ultimate benefit of our country and people.

As challenging as the year has been, I remain encouraged by what we have achieved. These achievements would not have been possible without the outstanding dedication and professionalism of the Bank's staff. For this, I am truly grateful. I would also like to extend my appreciation to the Board of Directors for their unwavering support and guidance. As an institution, the Bank is entrusted with responsibilities that are challenging but enormously rewarding in our efforts for the betterment of society. We shall continue to deliver with the highest standards of excellence, transparency and integrity.

Governor Muhammad bin Ibrahim, *FCB*

28 March 2018