BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Governor's Statement

The year 2018 has been eventful. Developments that unfolded underscored the importance of financial stability to the sustainable growth of the Malaysian economy. In the face of heightened uncertainties driven by both domestic and external forces, Malaysia's financial system has remained resilient. On the external front, unresolved trade tensions, policy uncertainties and fluctuations in commodity prices weighed on financial market conditions and business performance. On the domestic front, Malaysia experienced an unprecedented transition of government at the federal level. Throughout these developments, strong financial institutions and orderly market conditions have continued to support financial intermediation. In particular, credit flows to the economy have been sustained, with institutional arrangements in place to pre-emptively address problem assets arising in segments of the household and business sectors that are facing more challenging conditions. Public confidence in the safety and soundness of financial institutions also remains high.

In 2018, the Bank remained vigilant to risks arising from the elevated level of household debt. While direct risks to financial stability are largely contained given the strong capital buffers of banks, risks to the broader economy and indirectly to the financial system, could be substantial if households become more vulnerable to financial shocks and this in turn impacts consumption. These risks have continued to recede. Continuing adjustments in the housing market are also helping to reduce housing debt burdens and encourage a more sustainable housing market. The measures implemented to promote responsible lending therefore remain relevant and necessary. In the commercial property sector, the Bank remains concerned over the potential for existing, and possibly further oversupply of office and retail space, to cause property prices to adjust sharply lower. In an environment of slower global growth and more uncertain financial market conditions, the Bank also continued to pay close supervisory attention to ensuring that banks remain prudent in managing their external exposures, including those arising from the increasing significance of their overseas operations.

Going into 2019, against a backdrop of sustained growth in the Malaysian economy and signs of less tighter global financial conditions from earlier market expectations, risks to domestic financial stability are not expected to change significantly. That said, we cannot afford to be complacent. Completing the domestic implementation of the relevant Basel III prudential reforms which were finalised at the international level last year, remains a focal point of regulation and supervision to reinforce a safe and sound banking system. Malaysian banks are also implementing these standards from a position of strength, thus minimising short-term costs while securing longer-term resilience to support the economy through difficult times. In the insurance sector, enhancements to valuation standards that drive capital requirements are planned in the coming year. This will lay the ground for a further examination of areas in which capital standards may need to be further strengthened. In parallel with capital and liquidity reforms, further progress in recovery and resolution planning will serve to mitigate the impact of adverse developments affecting financial institutions on the broader financial system and economy. In 2019, the Bank also plans to clarify and test crisis management arrangements as part of efforts to strengthen the collective capacity of the financial system to respond to crises.

In recent years, issues of culture and conduct have shifted into focus amid revelations of large-scale misconduct involving financial institutions in a number of jurisdictions. This has continued in the past year, underscoring both the financial and reputational ramifications that can undermine trust in the financial system. An important lesson from these episodes has been the need to actively influence a positive culture through an unambiguous tone from the top that is matched by consistent incentives, policies and practices. In Malaysia, an increased emphasis on culture was one of several key changes made to corporate governance standards applicable to financial institutions in 2016. This has been accompanied by a closer examination of cultural drivers of behaviour in financial institutions as part of the Bank's supervision, in line with the more active role expected of boards and senior management in raising standards of responsible and ethical conduct. The ongoing consultations with the industry on measures to strengthen accountabilities at an individual level are a further move in this direction.

The transformation of financial services through digitisation has also introduced new dimensions to the Bank's management of risks to financial stability. The Bank continues to actively reduce barriers to innovation, drawing on insights and evidence gathered from the Regulatory Sandbox. This recognises the potential for developments in financial technology to increase efficiency, support better risk management and provide greater and more inclusive benefits to society. At the same time, the Bank expects similar risks to be treated consistently under the prudential and market conduct frameworks to ensure a level-playing field between new entrants and incumbents. It has been equally important for the Bank and financial institutions to understand new risks associated with advances in financial technology - including liquidity, concentration, operational and conduct risks. Certainly, increasing operational and cyber resilience, both at the institutional and system levels, will be a key area of focus with the more pervasive use of technology in the provision of financial services. The Bank will continue to closely monitor developments in this area - and adapt regulations as appropriate to maintain confidence in the financial system.

Looking ahead, shifts in Malaysia's economic priorities and structure will present new challenges for the financial system. In this Report, we examine the demand conditions in SME financing more closely and consider policy measures to further improve access to financing for innovative firms, both from traditional bank and alternative sources. Regulatory and structural reforms are also being pursued to increase the impact of development financial institutions in addressing the nation's contemporary development priorities more effectively and sustainably. In Islamic finance, further progress in the implementation of value-based intermediation strategies will reinforce a stronger alignment between finance and the real economy. In addition, measures to catalyse the development of insurance and takaful solutions for segments of society that are underserved to strengthen their resilience to financial shocks - are expected to gain greater traction in the coming years. Collectively, these developments will serve to promote effective financial intermediation supportive of the changing needs of the economy, while maintaining strong foundations for financial stability.

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Governor
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