



## Governor's Statement

2016 was a year of aberrations – a year of departures from the conventional wisdom of global development, characterised by major policy and socio-political shifts. The larger and longer-term impact of these shifts are still unfolding. These developments have become a source of great uncertainty and volatility for the global economy and financial markets. As these developments continue to unfold and shape events, we need to be agile and pragmatic in reviewing and rethinking our strengths and weaknesses in our effort to strengthen the economy's resilience.

Fundamental shifts in political and social dynamics have made the environment increasingly challenging. These add to existing risk factors that remain present, such as uncertainties surrounding the monetary policy path of the US, sharp movements in global commodity prices and the uncertain trajectory of global growth. In 2016, these factors were compounded by unexpected developments such as the UK's EU referendum (Brexit) and the outcome of the US presidential election, which set a new tone for the global economy and its development. In the advanced economies, prospects for policy shifts have added a layer of complexity and uncertainty to the long-shared aims of globalisation, trade integration, and capital and labour mobility. These developments have also brought renewed optimism that fiscal policies would take centre stage in supporting growth in the global economy. But a qualifier is appropriate here. As the fiscal positions of governments get increasingly stretched, we might see a similar fate befalling monetary policy – overburdened and diminished in its effectiveness.

Faced with such a dynamic and challenging environment, it is critical for us to contemplate and renew our resolve. First, there is a need to reflect on and examine the current state of play and the policy choices at hand. Monetary and fiscal policies have their limitations. With greater challenges, new strategies and approaches are therefore needed to support existing policies. Most likely, the use of technology will give us alternative sources of growth. Second, continuous renewals should always be pursued and implemented proactively before events dictate our course of actions. Bold, but pragmatic renewals may be warranted to reduce short-term vulnerabilities, build future resilience and raise productivity. Finally, once these strategic renewals on policies have been agreed upon, there should be strong resolve and perseverance by all stakeholders to carry these policies to their finality.

Reflecting on Malaysia's performance, the domestic economy continued to record commendable growth despite these challenging times, driven by domestic demand. Household spending was supported by continued wage and employment growth, with additional lift from targeted measures for low- and middle-income households. Investment activities continued to be anchored by the ongoing implementation of infrastructure projects and capital spending. On our part, the Bank was pre-emptive in its policy calibration to support the sustainable growth of the Malaysian economy.

The Bank's policy adjustment in 2016 was a pragmatic decision. Timing was key. The Bank took advantage of the window of opportunity to restore the degree of monetary accommodativeness and leveraged on the benign domestic inflationary environment. The policy move was further made possible given the subdued risks of destabilising financial imbalances. Macro- and microprudential, and fiscal policies implemented over the years to contain financial imbalances have been successful and played a central role in complementing monetary policy. Employing a broad toolkit of policies has allowed policy measures to remain well-balanced without the overburdening of any single policy tool.

Likewise, continued efforts have been directed towards optimising the trade-offs between liberalisation strategies and their associated risks. In May 2016, the Bank established the Financial Markets Committee (FMC), drawing from the vast experience of various market participants from different industries. The FMC was entrusted with the mandate of formulating strategies to further develop the domestic financial market and provide an effective engagement platform to discuss potential issues and risks related to financial market development. Since its inception, proactive measures have been introduced to develop the onshore foreign exchange market, mitigate speculative activities and correct imbalances that existed within the onshore foreign exchange market.

Malaysia's continued economic and financial resilience is an outcome of previous and ongoing fundamental reforms and institutional improvements. These reforms have accorded us the capacity and dexterity to navigate through uncertain times. Over the past few decades, Malaysia's successful economic diversification strategies have made the economy more resilient to external shocks while strategic investments in infrastructure have increased the country's growth potential. At the same time, ongoing investments to improve labour mobility and quality will equip the workforce with the relevant skills and readiness to tap new opportunities in a fast-changing environment. The Government has also maintained and committed to the course of fiscal reforms and should achieve its eighth consecutive year of fiscal consolidation in 2017. The resilience of Malaysia's economy is further supported by continued efforts to strengthen our domestic financial and banking system.

It is imperative that we remain disciplined in pursuing the required reforms to preserve our resilience while searching for new sources of growth. Malaysia's economy should be further diversified and deepened to encourage private investments, allowing the public sector to shift resources to other priorities, especially infrastructure. New and diversified sources of revenue are also required to fund new infrastructure that can advance Malaysia's transition towards becoming a high value-added, high-income nation. Malaysia must create a competitive niche in the rapidly evolving new economy. In this respect, the Bank is playing its role by providing a conducive regulatory environment that harnesses the potential of financial technology (FinTech) to modernise, deepen and inject competition to the domestic financial and funding markets.

In embracing technological advancements in the pursuit of new growth opportunities, all segments of society should enjoy the benefits and not be dislocated in the process. It is thus important to strike the right balance between innovation, stability and equality. To this end, the Bank continues to accord priority to financial inclusion. The Bank will also strive to adapt our approach to maintain relevance in the conduct of macroeconomic policies and understanding of issues faced by households and businesses. Various platforms have been established to actively engage households and businesses, such as the establishment of the Financial Ombudsman Scheme to assist the public in their dealings with financial institutions. Granular data analyses are also carried out extensively to deepen our understanding of the impact of shocks and policies. This will enable better and effective policy prescriptions. Moving forward, exploration into big data could become an effective tool in supporting macroeconomic and financial stability analyses.

Beyond the domestic front, the Bank continues to engage in key initiatives that reinforce regional cooperation and integration. Bank Negara Malaysia is committed to deepen regional financial integration through the establishment of the ASEAN Banking Integration Framework (ABIF). The bilateral agreement with Otoritas Jasa Keuangan of Indonesia, for example, allows greater presence of ABIF Qualified ASEAN Banks. Significant achievements have also been made to settle trade and investment in domestic currency. With the operationalisation of bilateral agreements with the Bank of Thailand and Bank Indonesia, businesses will have more options in settling their trade transactions. The Bank continued to take concrete steps to provide the enabling environment that enhances regional macroeconomic and financial stability via collaborative arrangements under 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. Adding to the intellectual cluster in Sasana Kijang, the opening of the World Bank Group Global Knowledge and Research Hub further raises Malaysia's profile as a regional centre of excellence that promotes learning opportunities and enhances thought leadership.

Going forward, plans to further develop Malaysia into a progressive high-income nation have a high probability of success if we remain resolute in our reforms and public policies. This cannot be done single-handedly. It requires collective effort from all policymakers to advance agreed public policies that are well-designed and inclusive. Once these policies have been announced and implemented, we must remain steadfast to ensure policy objectives are met. As an open and liberalised economy, we had enjoyed benefits from open trade and we should continue with this strategy despite rising protectionist sentiments.

The strength of our institutional arrangements has always been tested and proven in times of change and uncertainty. The year 2016 was no exception. Despite these testing times, the foundations laid have accorded us stability and continuity in our policies. For this, the Bank owes Governor Dr. Zeti Akhtar Aziz a deep debt of gratitude for her vast and invaluable contributions. Her visionary leadership has brought the organisation to new heights, setting the Bank on a sure and strong footing to deliver our mandates. The Bank has always adopted an agile and innovative approach and will continue to embrace the necessary changes to ensure we stay relevant and effective. During the year, the Bank allocated additional resources for financial intelligence and enforcement activities as well as implemented measures to enhance our information security and technology. We shall continue to emphasise on the highest standard of excellence in our work, corporate culture and ethical conduct.

Central to the Bank's ability to meet increasing demands is the highest level of dedication and professionalism of the Bank's staff. The Bank values its talent base and is committed to continuously improve talent management and development. On behalf of the Board and the management, I wish to express our appreciation for the commitment and hard work by all the Bank's staff. I am also thankful to the Board of Directors for their continuous support and guidance. The Bank will continue to deliver the mandates entrusted upon us, and in these challenging times, with greater vigour and perseverance.



**Muhammad bin Ibrahim**

Governor

23 March 2017