



GOVERNOR'S STATEMENT

2015 was a year of significant developments with far-reaching implications. The recovery of the global economy has remained modest, amid slowing world trade, moderating growth in the emerging economies and the ongoing concerns on the durability of the economic recovery in the advanced economies. This was against a landscape of changing global policies, with monetary policy normalisation in the US and the continued policy easing in other major economies, and the collapse of energy prices arising from both short-term and structural changes in global supply and demand conditions. The confluence of these developments has generated large shifts in capital flows and heightened volatility in the international financial markets.

In the near term, these developments will continue to unfold and the expectation is for the global environment to remain highly uncertain. As we move further into the future, it is important to recognise that the global landscape has changed in fundamental ways and that these conditions will not revert to those experienced in the decades before. The challenge to secure more sustainable global growth will increasingly be dependent on the efforts across advanced and emerging economies to being better able to adapt to this changed landscape.

Given the high degree of openness of the Malaysian economy and the increased integration with the international financial system, our domestic economy is significantly affected by both the global and regional developments. Despite the challenges, however, the Malaysian economy has been able to weather the developments in 2015 and sustain a respectable growth. Importantly, the growth prospects for the economy remain. The resilience that underpins the Malaysian economy in facing the current difficult environment is derived from the continued strength of our economic fundamentals and a reflection of the structural adjustments and reforms that have been undertaken in the recent decades. A key aspect of this is the diversification of the structure of our economy from an over-dependence on exports to develop new domestic sources of growth. This has reduced the reliance of the overall economy on any single source of growth and thus the vulnerability to shocks in any particular industry.

Additionally, growth has become more balanced, anchored by sustained private sector-led domestic demand and reinforced in part by the series of measures implemented in the recent years to rein in excesses and imbalances. The financial system is also a key pillar of Malaysia's economic strength. While the domestic financial markets and the ringgit exchange rate were affected by the large shifts in capital flows, the more resilient and developed financial system, together with the continued high level of international reserves and the manageable level of external indebtedness, have strengthened the capacity of our economy to cope with the external shocks. It has ensured that financial intermediation has remained uninterrupted.

On the domestic front, the Malaysian economy continued to be in a period of adjustment, with the ongoing implementation of fiscal reforms. These reforms are crucial and have a vital role in supporting the sustainable growth of our economy. In the interim, however, these domestic adjustments, alongside the impact of the weaker ringgit exchange rate, have affected the cost of living for households, particularly for the lower-income segment. But as they are being introduced in an environment of lower global commodity prices and generally subdued global inflation, the expectation is for the overall inflation to remain manageable. In addition, to mitigate some of the adverse impact of these adjustments, various measures have been put in place to support the vulnerable segments of the economy. The progress made in advancing financial inclusion, and the mechanisms that have been put in place by the Bank to provide assistance to households and businesses that are experiencing financial difficulties have contributed to reducing the vulnerability of this broader segment of society during difficult economic times.

Confronted with this more challenging environment, the Bank remained focused on preserving monetary and financial system stability. The economic and financial resilience that was built over the recent decades has served as an anchor of stability in these testing times. It has removed the need to over rely on any single policy option, thus leaving room for pre-emptive and forward-looking economic management. At present, the Bank's policy priority has been on two fronts – to address immediate-term vulnerabilities, and to continue to provide an environment that supports sustainable growth. In ensuring ample liquidity conditions in the financial system amid the period of net external outflows, the Bank has continued to provide liquidity to the banking system through the use of a comprehensive set of measures. The monetary operations were strengthened and enhanced through the introduction of new instruments. This has been complemented more recently by the reduction in the Statutory Reserve Requirement. As external and domestic developments have continued to affect the ringgit exchange rate, efforts have also been directed at ensuring orderly conditions in the foreign exchange market. Consistent with price stability and the sustainability of the overall growth prospects, monetary policy has been kept steady and has remained accommodative and supportive of economic activity.

Over the medium term, the challenges that Malaysia will face are expected to remain significant. Beyond managing the risks to macroeconomic and financial stability arising from external uncertainties, focus must continue towards building future resilience. At the same time, there is increased urgency for the economy to accelerate its transition to a higher value-added, high-income economy and avoid a slide into a middle-income trap. To achieve this outcome, three vital shifts are necessary. The first is the intensification of a private sector-driven shift towards higher productivity and innovation, and to reduce reliance on factor accumulation and low-value production to drive economic growth. The second shift necessary is for the Malaysian economy to strengthen its integration with the global economy given the new and changing international landscape, by drawing on new areas of comparative advantage and harnessing new sources of opportunity. The third shift is the further strengthening of our existing institutional and physical infrastructures to create an enabling environment for a modern economy in this fast-changing environment. Despite the challenges, Malaysia has every potential to transition into a higher value-added, high-income economy going forward.

There were several important milestones during the year towards strengthening regional economic integration. The most notable of these was the establishment of the ASEAN Economic Community (AEC). For regional financial integration, the launch of the ASEAN Banking Integration Framework (ABIF) has provided the foundation for a more integrated banking system in the region. Within the ASEAN countries, financial integration is intended to be inclusive and benefit all segments of society. Consequently, financial inclusion has been elevated to be a policy priority in the region. As we move forward, the ASEAN integration process is expected to continue to gather momentum through the AEC Blueprint 2025. This has created the platform to further advance financial integration over the next decade while enhancing financial inclusion and safeguarding financial stability. In addition, regional central banks have also remained committed to ensuring regional macroeconomic and financial stability through various other collaborative platforms such as the ASEAN+3, the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) and the South East Asia Central Banks (SEACEN) Research and Training Centre.

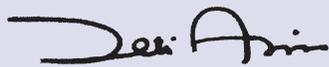
Beyond the progress made under ASEAN, Malaysia's participation in international free trade agreements such as the Trans-Pacific Partnership and the Regional Comprehensive Economic Partnership will drive increases in productivity and the needs for structural changes in our economy, including supporting Malaysia's longer-term development. It will foster competition, create market access, incentivise transparency and good governance practices, while strengthening the trade and financial inter-linkages between Malaysia and the rest of the world.

The Bank has during the year continued with our own organisational transformation and modernisation to remain relevant and effective in our management of the new challenges confronting us. Following more than a decade of several series of organisational transformation, the Bank now stands on solid foundations. In particular, over the recent 15 years, more than ten major legislations governing the central bank and the financial industry have been introduced, including the Central Bank of Malaysia Act 2009. Commensurate with the new powers accorded to the Bank, the accountability frameworks and governance structures have been considerably enhanced and institutionalised. As part of this, the oversight role of the Board of Directors has been strengthened in the areas of risk management, internal controls and governance. The Central Bank of Malaysia Act 2009 also institutionalised the monetary policy independence that has prevailed since the establishment of the Bank in 1959. In 2015, new external members were appointed to our Monetary Policy Committee, adding to the collective diversity of experience, expertise and knowledge. The robust governance framework also ensures that the Bank's policy decisions are undertaken with the highest levels of professionalism and integrity, and are always in the interest of our nation.

Going forward, I believe that the Bank is in a position of prime strength. Of importance is that the Bank's institutional foundation is built on the strength of our talent. The Bank has placed a high priority on investing in the continuous development of our talent to ensure that we are always equipped with the best central banking skill-sets and calibre. These talent and leadership development efforts are underpinned by the Bank's robust talent strategies, succession planning and differentiated performance rewards. The Bank adopts a high-performance culture with a strong sense of accountability. Within our corporate culture,

there is a shared purpose to strive in the service of the nation, to be committed to duty, and to uphold our enduring tradition of integrity. The Bank has also transformed over the years from being vertically integrated towards horizontal collaboration so as to benefit from the diverse expertise that resides in the Bank. These have allowed for our resources and energies to be optimised and aligned towards the strategic outcomes, to ensure that the best results are achieved. Our work ethos also requires good risk management, considering the many implications and effects of our policies.

The Bank's dedication to maintaining high standards of excellence has provided a conducive environment for performance. It is the professionalism and expertise of the Bank's staff, together with the clarity of outcomes and roles, that have enabled the Bank to stay the course to deliver the mandates entrusted upon us, despite being confronted with domestic and external challenges. On behalf of the Board and the management, I wish to express great appreciation to all the staff of the Bank for their dedication and commitment in delivering the mandates of the Bank. I am also grateful to the Board of Directors for their ongoing support and guidance. As we continue to strive to excel as an organisation that serves in the best interests of the nation, I am highly confident that the institutional resilience and capacity built over the years have equipped the Bank to advance forward with every potential to deliver the best in the years to come.



Zeti Akhtar Aziz
Governor
23 March 2016