



GOVERNOR'S STATEMENT

The economic restructuring and financial sector reforms undertaken during this recent decade have well positioned Malaysia to manage the external challenges experienced during the year. These efforts have improved Malaysia's macroeconomic foundations and have resulted in a well-diversified economic structure. While the export sector remains an integral component of the economy, domestic demand has now become the key driver of growth, anchored by strong private sector activity. Underpinning the robust domestic demand is the revival of investment activity, particularly by the private sector. Private investment has grown at an annual rate of 15% on average since 2010 and it is now more broad-based both across industries and geographically. The re-orientation of the economic structure has also reduced the reliance of the domestic economy on any particular economic sector. Of significance, is that the economic restructuring has been supported by a more well-developed, resilient and inclusive financial system that has been able to effectively meet the changing requirements of the economy.

The more moderate recovery of the global economy projected for 2015 is generating a challenging environment across both the advanced and emerging economies. Although the growth momentum is strengthening in some economies, weaknesses in several major economies suggest that the global economy remains vulnerable to downside risks. In addition, the significant decline in global oil prices is also having a differentiated impact on the world economy. This uneven growth momentum prevailing in the global economy has raised the prospect of a divergence in the direction of monetary policy in the advanced economies, resulting in shifts in global liquidity and increased volatility in the international financial markets. For small and highly open economies, such volatile capital flows have resulted in challenges in pursuing an independent monetary policy.

Given the degree of openness of the Malaysian economy and financial system, we are not insulated from these global developments. The diversified structure of the Malaysian economy and our strengthened fundamentals have however enhanced the resilience of the economy and have placed us on a steady growth path. Economic growth in 2015 will continue to be primarily driven by private sector-led domestic demand with some support from the expansion in exports. While the mining and commodity sectors have an important role in the economy, growth is expected to be sustained by the broad-based expansion in the services, manufacturing and construction sectors that now account for more than two thirds of the economy. Investment is also increasingly being driven by capital spending by the non-energy-related private sector and public enterprises. The lower inflation outlook and the positive labour market conditions will also continue to support household spending during the year.

In this environment, economic management has focused on the areas of vulnerabilities and building the resilience of the economy. This aims to ensure that Malaysia will continue to have the flexibility to respond and manage the challenges when shocks occur. As part of the strategy, targeted measures have been implemented to rein in excesses in the property market and to reduce the level of household indebtedness. These series of measures, implemented since 2010, have now begun to yield results. Additionally, the fiscal reforms, including the subsidy rationalisation, the introduction of the Goods and Services Tax, and the commitment to consolidation have also improved the fiscal position while ensuring that economic growth is not undermined. In the external sector, while the current account of the balance of payments is affected by the lower commodity prices, it has been to a significantly lesser extent. This is largely due to the more diversified export structure and markets including the exports of services. Consequently, despite the considerable decline in commodity prices, the current account balance is expected to remain in surplus.

Over the longer term, the resilience of the Malaysian economy continues to be strengthened following the on-going structural reforms and institutional improvements. These efforts have contributed towards the creation of a more competitive economic environment that is also driven by the diversification into higher value-added activities. A key pillar of the resilience of the economy is the financial system that is supported by a resilient banking system and the more developed financial markets. Ample domestic liquidity conditions in this environment have facilitated the financing of domestic economic activity. As a result, there has not been excessive reliance on external funding. With financial stability preserved, there have not been any disruptions to the intermediation process. The financial inclusion agenda has also advanced during the year, providing all segments of society, particularly small businesses and low income households, access to financial services and thus, enhancing their participation in the economy.

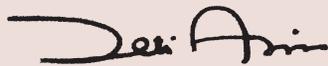
Taking into consideration the downside risks to growth and the more subdued price pressures, the thrust of monetary policy has been to remain accommodative and supportive of economic activity while giving continued attention to risks of destabilising financial imbalances. In managing these challenges, the Bank has relied on a broader policy toolkit that includes targeted micro- and macro-prudential measures which are also complemented by pro-growth measures. Other such growth supporting measures by other parts of the public sector have included assistance to vulnerable segments of the economy, in particular, to the small and medium enterprises and to the low income households. Additionally, the more developed financial markets have better intermediated the large and volatile capital flows. In particular, orderly conditions in the foreign exchange market are important to facilitate international trade and foreign investment flows.

During the year, significant strides were made in the area of regional financial integration and cooperation. Most notably were the efforts to enhance the effectiveness of financial intermediation in the region with the finalisation of the ASEAN Banking Integration Framework (ABIF). The year ahead will be important for ASEAN as it moves closer to becoming an economic community as the economies and financial systems in the region become more integrated. In this regard, as the Chair of ASEAN in 2015, Malaysia will focus on the effective operationalisation of ABIF, advancing retail payment systems integration across ASEAN and elevating financial inclusion as a policy priority for the region. Central bank cooperation in the region has also continued to have a prominent role in managing the challenges presented by the global economy. Collaborative regional forums including the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP), the ASEAN Central Bank Meetings, and the platform provided by the South East Asia Central Banks Research and Training Centre (SEACEN) have allowed for increased information sharing, resource pooling, collective capacity building, and the potential for policy coordination and joint actions. In addition, a regional financial architecture for financial stability and regional financial safety nets are well in place, including the arrangements such as the ASEAN Swap Arrangement, the Chiang Mai Initiative Multilateralisation and the EMEAP Monetary and Financial Stability Committee.

During the year, the Bank made further progress in expanding opportunities for higher value activities within the financial system, notably in developing the enabling environment in the Islamic Finance Marketplace and in the strengthening of the eco-system for multi-currency trading, including the appointment of a renminbi clearing bank. The Bank was also successful in our bid to host the headquarters of the Alliance for Financial Inclusion (AFI) and the World Bank's regional office in Sasana Kijang, enhancing Malaysia's role in supporting the regional and global development agenda.

In 2014, the Bank continued to invest in our organisational capacity. This has aimed to ensure robust strategic, risk, talent and financial management to enhance our organisational performance. These have included better risk surveillance, programmes for the acquisition of technical competencies, in addition to leadership development to manage our succession pipeline. In a challenging external environment, having the organisation-wide clarity of purpose and focus has been important for the effective functioning and performance of the Bank. This year, the Bank will embark on its third three-year business plan.

The dedication and perseverance of the Bank's staff are central to the continued effectiveness of the Bank in delivering its mandates. On behalf of the Board and the management, I wish to express our appreciation to the staff for their steadfast commitment to fulfilling our responsibilities and safeguarding the economic and financial well-being of our nation. I am also grateful to the Board of Directors for their continued support and guidance. I would also like to record our greatest appreciation and gratitude to Datuk Oh Siew Nam and Tan Sri Datuk Amar Haji Bujang bin Mohd. Nor, our two long-serving members of the Board of Directors, who completed their term of service in February 2015, for their unwavering support and contributions to the Bank during these two decades of immense challenge. The Bank will continue to strive towards achieving the highest standards of professional excellence to fulfill the mandates that have been entrusted upon us, and to excel as an organisation in the service of our nation.

A handwritten signature in black ink, appearing to read 'Zeti Akhtar Aziz', with a stylized, cursive script.

Zeti Akhtar Aziz
Governor
11 March 2015