Invest Malaysia 2015 - "Facing Malaysia's Current Economic Challenges" Kuala Lumpur, 23 April 2015

Speech by

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It gives me great pleasure to be here at Invest Malaysia 2015. This event takes place at a time of major transformative change in the world, in the region and in our country. These changes include the world becoming more inter-connected, integrated and interdependent within and across countries. It also reflects the significant shifts in demographic structures occurring in major parts of the world and the marked transformation in the international financial landscape following the international regulatory reforms prompted by the recent Global Financial Crisis. Slower but nevertheless equally far-reaching are the changes in the institutional arrangements that are altering international and regional circumstances. A further fundamental change is the greater reliance on unprecedented and unconventional monetary policy responses that has brought us into uncharted territory. And finally, the world is also being transformed by the more significant cross-border financial, information and talent flows.

My remarks today will touch on three key areas: the current challenges confronting the global and domestic economy in this new environment; the intrinsic strengths of the Malaysian economy that will enable us to navigate through these more challenging times; and finally on the new changing profile of Malaysia's investment landscape and what it means for the prospects of our economy.

Key Challenges and Prospect for the World and Domestic Economy

We meet today at the time when the international economic and financial environment has become immensely more challenging. To a large extent, this has been due to the significantly higher degree of uncertainty that has prevailed on several fronts in the world today. Firstly, is the uncertainty about the prospects for global growth in the aftermath of the Global Financial Crisis. The persistence of this uncertainty is now having its implication on sentiment and confidence. Secondly, are the conditions in the commodity and financial markets that have become more volatile. The massive shifts in global liquidity are precipitating volatile capital flows with its immense implications on the asset and foreign exchange markets.

Thirdly, is the increased uncertainty prevailing in the policy environment in the global economy in terms of the extent and timing of policy changes. In particular, is the uncertainty with respect to the timing of the exit from the highly accommodative policies and the implications of the divergent monetary policy stance that are being pursued in the major economies. Fourthly, is the uncertainty related to the implementation of the structural reforms to address the structural rigidities and deficiencies that surfaced during the Global Financial Crisis. Fifth and finally, are also considerable geopolitical uncertainties prevailing in the world today. Cumulatively, these developments have compounded the uncertainties surrounding the global economy.

In this environment of great uncertainty, a more moderate recovery of the global economy has been projected for 2015. The most pressing challenge, therefore for the global economy, is to generate an economic recovery that is balanced and sustainable. Although the growth momentum has improved in a number of major economies, the growth has thus far been modest. In addition, weaknesses in several major economies continue to point to a global economy that remains vulnerable to downside risks.

While the growth performance in most emerging economies is projected to moderate, collectively emerging market economies remain an important driver of growth of the world economy. A less robust external sector, slower domestic demand and specific domestic factors are amongst the reasons for this growth performance. In Asia, the growth for 2015 is projected to be sustained at 6.4%, while growth in the ASEAN-5 is projected to be in the region of 5%.

A further phenomenon affecting the global economic performance is the significant decline in global oil prices. While this has partially offset the weaker-than-expected growth momentum in some of the advanced countries, it has, in different degrees, adversely affected the oil exporting economies resulting in divergent growth performance across and within regions. Overall, however, the global economy is expected to benefit from the lower oil prices. A further recent development is the consequences of the unprecedented and divergent monetary policies being pursued in the major economies which have now resulted in significant policy spillovers to other parts of the world. Against this backdrop, the financial markets are therefore expected to remain in a state of heightened volatility during this year.

Given the degree of openness of the Malaysian economy and the financial system, we are of course affected by these global developments. These effects, however, need to be seen from the perspective of our underlying conditions. Malaysia is affected by these external developments through trade and capital flows. The diversified structure of our economy and of our exports has reduced the impact of the effects of the plummeting oil prices on the economy. While the current account of the balance of payments is expected to narrow, it is projected to remain in surplus. The global shifts in liquidity have caused sizeable outflows from emerging economies, including Malaysia, resulting in volatility in our financial markets and depreciations in our currencies. Despite these developments, after a stellar performance in 2014, the economy is projected to remain on a steady growth trajectory with an economic growth being in the region of 4.5 – 5.5% in 2015 with the growth mainly being driven by domestic demand.

Solid Macro Economic Fundamentals

Building the foundations and resilience is the best line of defense to deal with the spillovers from external developments and on future shocks. Malaysia has, over several decades demonstrated time and time again, the ability to emerge from commodity price shocks, financial crisis and spill overs from disruptions generated from other parts of the world. While Malaysia will always be affected by such external developments, the strategy has been to have the flexibility to absorb and adjust and the strength to rapidly rebound. While each crisis or setback has been different, there are several common features that have allowed Malaysia to rapidly recover from such shocks.

For each respective major shock confronting our economy, Malaysia has registered V-shaped recoveries. This has essentially reflected the flexibility of the economy to adjust and the early and comprehensive policy response. The ensuing periods were often marked by structural reforms and institutional development that were designed to rebuild the fundamentals of the economy, address the weaknesses and vulnerabilities and to forge new areas of growth. This has, decade after decade, resulted in vital changes in our economic structure, from being export-led to now being predominantly domestic demand-driven, and from being over-reliant on specific sectors to having a more diversified economic structure with the manufacturing and services sectors having now transitioned to higher value added activities.

In essence, the structure of the economy has now become significantly more diversified in terms of sources of growth. While the export sector remains an integral component of our economy, domestic demand has now become the key driver of growth, anchored by strong private sector activity that now accounts for 70% of GDP. Underpinning the robust domestic demand is the sustained consumption spending and the revival of investment activity by the private sector. On the external balance, the more diversified exports and markets has allowed the balance of payments position to remain sound. Thus, despite the fall in commodity prices, the trade

and current account is expected to remain positive, sustained by manufactured exports while the financial account is expected to adjust in an orderly manner.

During this same period, the financial sector restructuring, rationalisation and reforms, the institutional development, the strengthening of the regulatory, supervisory and legal framework and the development of the domestic financial markets have also diversified the financial sector and has enhanced its ability to disperse external shocks throughout the system. In particular, the financial reforms also involved the transition to greater market orientation and more liberalised financial system which has allowed for greater flexibility to adjust to the effects of shifts in global liquidity. The now deep and robust financial system is also underpinned by high levels of capitalisation and sufficient levels of liquidity. This has ensured that financial intermediation continues to be effective in providing support to economic activity.

It is therefore not the recent policies nor the new measures that have placed Malaysia on a stronger position to manage the external challenges. Rather it is the economic restructuring and financial reforms and development undertaken during the recent two decades and the building of several layers of buffers that has allowed us to weather the current challenging operating environment.

Further solid fundamentals include the relatively low rate of inflation, the low levels of unemployment, the high rate of savings and the manageable levels of external debt with the majority of debt in medium- to long-term tenures and with more than 40% of the external debt being denominated in ringgit. This, together with the ample international reserves, accords the economy with the policy flexibility to manage external risks. The combination of these factors will cumulatively enable a more effective policy response to mitigate the impact of any external shocks on domestic demand. While monetary policy has remained accommodative and access to financing has been enhanced, wide-ranging measures including macro prudential and tax measures have been implemented to rein in excessive leverage and excessive risk-taking to ensure growth is achieved without compromising our future prospects.

Malaysia's New Investment Landscape

As Malaysia progresses, so has the nature and profile of our investments. Compared to the 1990s, the current investment landscape is driven by the private sector, is geographically and sectorally more diverse, and is focused on high value-added activities and new growth areas.

Since 2010, Malaysia has experienced an investment renaissance and continues to benefit from a long-standing track record of being a profit centre for large multinational companies. Malaysia continues to be a recipient of foreign direct investment (FDI). This is also reinforced by a high level of capital spending undertaken by Malaysian companies. Regional economic corridors established has also expanded and transformed the Malaysian investment landscape to be more geographically diverse and extending the development throughout Malaysia.

The emergence of new growth areas in Malaysia such as renewable energy (e.g. solar) and semiconductors in fast-growing segments such as automotive, medical devices and telecommunications, has enabled Malaysia to be plugged into the global supply chain. Investment in the manufacturing sector has moved towards higher value-added activities, shifting from basic production and assembly to producing goods which have advance applications such as in the automotive and healthcare sectors.

As a country which is strategically located within close radius of two of the most populous economies in the world, PR China and India, Malaysia is centrally located in Asia, more broadly, and in ASEAN, in particular. With the conception of the ASEAN Economic

Community (AEC), companies would benefit from the stronger economic inter linkages through greater cross border liberalisation and increased intra-ASEAN trade. Firms in this region will gain greater market access to 630 million people that are generating economic region that is worth USD2.4 trillion.

The increasing importance of Asia in the global economy has raised international interest to better understand Asia - the economies, businesses and the people that comprise the region. On that note, I would like to mention that Bank Negara Malaysia has entered into a collaboration agreement with the Massachusetts Institute of Technology Sloan School of Management (MIT Sloan) to establish the Asia School of Business (ASB) in Kuala Lumpur. ASB is envisioned to be a premier business school that develops transformative and principled leaders that will contribute to a better future and the advancement of the emerging world.

Conclusion

Let me conclude my remarks. We are now experiencing a phase of modest growth in the global economy, in an environment that is characterised by heightened uncertainty and volatile financial markets. The Malaysian economy has withstood these challenging times, supported by our strong initial conditions and early and comprehensive policy responses. The intrinsic strength of the economy, reinforced with policies to encourage greater investments that would serve to ensure greater economic sustainability for the future. Finally, active regionalisation is an important strategy for Asia to enhance regional economic prosperity. Malaysia actively participates in the efforts to strengthen linkages within the ASEAN community and to creating opportunities to foster greater economic integration. These efforts will place ASEAN on a path to realising its economic potential and enable the region to collectively prosper.

ASEAN SME Conference 2015 - "Connecting ASEAN SMEs through Financial Integration" Kuala Lumpur, 27 May 2015

Speech by

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It is my pleasure to be here this afternoon to speak at this inaugural ASEAN SME Conference. This conference takes place at a challenging and yet exciting time for the ASEAN region. While there continues to be uncertainty on the future prospects for the global economy, the ASEAN economies have demonstrated a high degree of resilience. The ASEAN economies have benefitted from the efforts for more than a decade to strengthen the foundations of our economies and financial systems. Our potential is now being further enhanced by steps to intensify regional economic and financial integration. In particular, ASEAN has taken the opportunity during our period of growth and stability within this decade to remain steadfast in advancing our efforts to forge greater economic and financial integration to unlock the immense opportunities in the region including for the SME business community.

My remarks today will touch on three areas; the significant intrinsic potential of the ASEAN economic bloc, how the SME sector would stand to benefit from these prospects, and how greater financial integration can serve as a catalyst for the growth and development of SMEs.

ASEAN: A Growth Centre in the Global Economy

ASEAN has emerged centre stage in the global economy and has been recognised as one of the most dynamic regions in the world. The region has sustained high economic growth with a long-term average GDP growth of 5.3%, higher than the global growth average of 3.6%. Currently, as a single entity, ASEAN is the 6th largest economy in the world with a GDP close to USD2.5 trillion. With a projected annual GDP growth of 5.4%[1] over the next six years, the region is poised to reach an economic size of USD3.7 trillion by 2020, four times the size it was a decade ago. The strong growth and dynamism of the region is supported by its favourable demographic structure. With a population of more than 630 million people and a burgeoning middle class, ASEAN is rapidly transforming into a thriving hub for consumer demand. By 2020, ASEAN is expected to account for more than USD2 trillion of additional consumption. This is being reinforced by rising incomes in the region, with per capita income almost trebling in this recent decade.

The rapid progress of economic integration in ASEAN has enabled the region to harness the benefits arising from the diversity and complementarities that exist across the ASEAN economies. Amid the strengthening of cross-border supply chains in the region, intra-ASEAN trade and investment activity have increased significantly over these recent 15 years. Intra-regional trade now accounts for almost a quarter of the region's total trade while intra-regional investment activity has quadrupled to 17% of total investment since 2000.

The vibrant SME sectors in the respective ASEAN economies have been an important part of this commendable economic progress. Indeed, going forward, the development and growth of ASEAN SMEs will have significant potential to contribute to the region's prospects and become a key source for the future growth of the region. It is estimated that SMEs would account for between 20 to 50% of GDP across the ASEAN economies, constituting more than 96% of enterprises in the region, and contributing 50 to 80% of total employment.

[1] International Monetary Fund World Economic Outlook (April 2015)

While SMEs continue to contribute significantly to domestic economic growth, intra-regional trade in ASEAN remains driven by large multi-national companies with the SME sector mainly having a supporting role in the regional production network. The next phase of the ASEAN economic integration process should therefore be focused on enhancing the role of SMEs in contributing towards greater cross-border economic activity. To realise this, policy initiatives are being geared to ensure that SMEs in our region will be plugged into the regional and global value chains.

Leveraging on ASEAN's Growth Prospects

The recent drive for the greater economic and financial integration of ASEAN has paved the way for SMEs to expand and thrive. Firstly, ASEAN has enabled SMEs in the region to **gain access to a larger and more extensive marketplace**. The realisation of ASEAN into an integrated economic community means that the potential benefits for SMEs in the region are no longer constrained by national borders. With easier cross-border flow of goods, services, capital and people, ASEAN offers significant market opportunities for SMEs. Given the large consumer base in ASEAN, SMEs can also utilise ASEAN as a platform to strengthen competitiveness before entering into the global market.

Secondly, the **lowering of regulatory barriers to trade** within ASEAN has further increased the potential for SMEs. The standardisation of trade procedures, the removal of tariff and non-tariff barriers and the improvement of regulatory frameworks across the region has been an additional enabling factor. This will not only provide SMEs with a level playing field in conducting businesses across the region, but will also maximise the competitive advantage of the individual ASEAN economies. This is evidenced by the emergence of regional supply chains, where reductions in tariffs on imported raw materials have resulted in lower production costs, while the removal of tariffs on a wide range of finished products for export within ASEAN will also benefit SMEs that trade within the region. Thus, the lowering of tariffs within the region and the large regional market will provide an environment for SMEs to grow and achieve the production scale and efficiency required to compete in the global marketplace. Additionally, an integrated ASEAN market will also serve to facilitate the meeting of global standards as SMEs upgrade to meet the more harmonised compliance requirements across the region.

Thirdly, SMEs will also benefit from the **drive to strengthen connectivity** in the ASEAN region. As highlighted in the Master Plan on ASEAN Connectivity, a comprehensive roadmap of strategies has been outlined to address connectivity challenges on three key areas, namely physical infrastructure, institutions and the people in ASEAN. Increased connectivity across all three dimensions will provide the physical and soft elements needed to create the enabling business environment for SMEs.

Fourthly, various **SME-specific policies by the ASEAN member countries** will also benefit SMEs in the region. This includes the establishment of a regional SME internship programme which has assisted SMEs in seven ASEAN countries to enhance the skills of their employees through structured staff exchanges and capacity building workshops. A further initiative is the recent launch of the online ASEAN Marketplace which aims to provide SMEs with information on the business environment in each respective ASEAN country and a business directory of SMEs to facilitate the access to the markets in the region as well as the potential for collaboration of SMEs across the region. To date, more than 1,000 SMEs across the region have registered with this online portal. It is expected to attract more than 20,000 businesses during the course of this year. Moving forward, the ASEAN Strategic Action Plan for SME Development 2016-2025 will also focus on promoting productivity, technology and innovation, access to financing, enhancing market access and internationalisation, while also enhancing the policy and regulatory environment, and promoting entrepreneurship and human capital development.

Fifth and finally, SMEs in the region will also benefit from **ASEAN's strategic economic linkages** with the greater Asia and with other parts of the world, including the advanced economies and other emerging regions. Several countries have entered into bilateral agreements, including trade agreements with ASEAN to enhance economic cooperation. These multilateral and bilateral engagements have the potential to create many new business opportunities for ASEAN SMEs.

Greater Financial Integration as a Catalyst of Growth for SMEs

Let me now turn to the prospects for greater regional financial integration and its potential to support growth for the ASEAN SMEs. Given the region's high savings rate of approximately 30% of GDP, there is immense scope to benefit from greater financial integration in the region. An intensification of financial integration in ASEAN will serve to enhance the more effective intermediation of funds and thus the efficient allocation of resources in the region. It will allow for excess savings in one country to be channelled into productive investments in another country within the region, thereby acting as a catalyst to achieve a growth that is mutually reinforcing for the economies in the region.

The bulk of ASEAN's surplus funds, however, are currently intermediated mainly through the international financial markets before being reinvested back into the region. In particular, more than 90% of cross-border portfolio investment flows are channelled to the advanced economies. Given the USD 1 trillion infrastructure funding required by ASEAN in the next decade[2], greater financial integration will facilitate the re-channelling of at least a part of the region's surplus funds towards productive investment opportunities in the region. Regional financial integration will also allow for more efficient risk diversification of assets to include foreign assets from within the region. This will not only reduce vulnerability to external developments but will contribute to achieving more stable conditions in the regional financial markets.

Following the development of the domestic financial systems in ASEAN, the next phase of development is to foster greater financial integration in the banking, insurance and capital markets and in the linking of the payment and settlement systems. The growing presence of regional financial institutions will be an important contributor to the development of SMEs in ASEAN. The availability of cross-border financing will enable SMEs to innovate, invest and further expand within the region. Beyond financing, SMEs can also leverage on the extensive networks and advisory services of regional banks to facilitate matching with regional clients and entry into new markets. This can be an important source of information on country-specific dynamics and requirements for the SMEs before venturing into new markets in the region.

The digital age also augurs well for SME businesses. The use of technology such as mobile and internet banking have enabled financial institutions to provide quality and affordable financial services to a regional SME client base. It is paramount for SMEs to embrace these technological enhancements. This includes the adoption of end-to-end supply chain management solutions that integrate the production and financial flows of SME activities, allowing for greater expansion into regional production networks.

Together with digitalisation, the financial integration process will catalyse the convergence of institutional frameworks across ASEAN countries to create a more effective regional financing ecosystem. Such institutional infrastructures and instruments include credit guarantee schemes and credit and collateral registries. Another example is the ASEAN SME Working Group's methodology for the ASEAN Benchmark for SME Credit Rating to facilitate the establishment of credit bureaus in ASEAN member states. Through these credit bureaus, financial institutions would have wider access to reliable credit records of SMEs, thereby

[2] As estimated by the Asian Development Bank.

increasing the access to financing for the SMEs.

The promotion of deeper financial inclusion can be regarded as the final mile in enhancing and enriching the regional financial integration process. The ASEAN Finance Ministers' and Central Bank Governors' Meeting in March this year elevated financial inclusion as a regional policy priority. Indeed, ASEAN will continue to coordinate and intensify efforts to advance financial inclusion, including addressing cross-border financing issues for SME trade financing and investments. This is critical to ensure the benefits of regional integration are experienced by all in the region.

Conclusion

While the future for ASEAN looks promising, ASEAN businesses, including SMEs, need to consider and explore an ASEAN strategy and to view ASEAN as an increasingly integrated market. Having such regional or international perspectives may prove to be a game changer for SMEs, paving a path towards sustained growth, increased job creation, and higher innovation capacity.

A crucial element in the ASEAN economic agenda is the development of the SME sector which will contribute to stronger and more equitable growth in the region. The next frontier for SMEs is to emerge as regional players that are not constrained by the domestic consumer base. SMEs possess the potential to participate in global production networks by riding on ASEAN's intrinsic strengths and prospects, multiple SME-focused policy initiatives as well as the continued wave of regional financial integration. This will allow for the transition for SMEs to benefit immensely from the ongoing regional economic and financial integration and thus contribute towards a balanced and sustainable growth of our region.