Malaysia International Islamic Financial Centre (MIFC) Regulators Dialogue with the Financial Industry 1 November 2006, Kuala Lumpur

Keynote Address by

Tan Sri Dato'Sri Dr. Zeti Akhtar Aziz
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The MIFC initiative was launched on 14 August 2006 amidst strong foundation and steady performance of the Islamic financial industry. It marks the beginning of a new era for the future landscape of the Islamic financial system in Malaysia. Several landmark measures were announced to initiate the MIFC agenda. It is to set the stage for Malaysia to position itself as a centre for the offering of Islamic financial products and services in international currencies to the global and domestic financial community. This presents new prospects and business considerations for financial institutions to realise the potential of evolving a vibrant Islamic financial hub.

Today's dialogue, the first of its kind among key stakeholders, is aimed at promoting greater awareness on the initiative, to discuss implementation issues and to foster greater collaborative effort for the MIFC's overall success. We have with us here today the members of the MIFC Executive Committee, the country's high level coordinating body that has been set up to advance forward this national agenda.

Objectives of MIFC

This national agenda aims to achieve several major objectives. As one of the key intermediation linkages in the global market place, the MIFC can have an important role in accelerating the process of bridging and strengthening the relationship between the international Islamic financial markets and thereby expand the investment and trade relations between the Middle Eastern, West Asia and North Africa regions with East Asia. Situated centrally in the Asian time zone, Malaysia is well positioned to effectively serve the East Asian region. Among the key intermediation role for MIFC is to act as a centre for origination, issuance and trading of Islamic capital market and treasury instruments such as sukuks, and to act as an investment gateway to the region specialising in Islamic fund and wealth management, and as a takaful and retakaful centre.

In promoting capital and cross-border trade flows between the financial communities of these regions, it will thereby strengthen the international integration of our domestic Islamic financial system. In addition, this initiative is expected to improve further the performance of the Islamic financial industry and strengthen its competitive edge in this increasingly more challenging global environment.

Currently, assets of the Islamic banking and takaful in Malaysia have been increasing at a double digit growth rate of 19 percent and 25 percent respectively in the recent five years. The Islamic banking and takaful markets which amounted to RM122 billion and RM6.6 billion in assets are among the largest in the world. The Islamic sukuk market has now exceeded RM120 billion and represents the largest Islamic bond market in the world.

Malaysia has developed the comparative advantage in the area of Islamic finance. The comprehensiveness of the Islamic financial system in Malaysia has been mutually reinforcing with the key components of the financial system comprising the Islamic banking, takaful, Islamic money and capital markets now being at an advanced stage of development. In addition, the established legal, regulatory and Shariah frameworks in the Islamic financial infrastructure is also

a key competitive advantage for Malaysia, placing it ahead of other financial centres offering Islamic financial services.

In terms of Shariah governance, it has enabled the development of Islamic finance to be orderly and compliant with the Islamic injunctions, thereby ensuring that customer confidence be maintained. The conducive Shariah environment has also ensured that Malaysia is sustained as a centre of product innovation, producing cutting-edge products for the increasingly sophisticated customers. In respect of Shariah interpretation and practices, the MIFC will adopt a stance of mutual recognition and accommodate the various juristic reasoning that has been approved by recognised Shariah advisers . Next week, Bank Negara Malaysia will again host the 2nd International Shariah Scholars Dialogue, gathering the Shariah scholars from different regions in our endeavour to continuously bridge and foster greater interaction and promote understanding on the issues and challenges faced by the Islamic community on the aspect of Shariah.

Malaysia also has a strong and advanced regulatory regime and legal structure in the Islamic financial system. This was deliberately undertaken since the inception of Islamic finance in this country to sustain the soundness and stability of the system and thus the confidence of the financial community. Reinforcing this is the Islamic Financial Services Board (IFSB) as the international standard-setting body of the prudential and supervisory framework that was established in 2002. The balanced regulatory approach being applied also aims to ensure that the trust and efficiency of doing business is maintained.

In undertaking a holistic approach to drive the MIFC initiative, the Government has streamlined the associated delivery system to facilitate advancing the MIFC agenda with the formation of the MIFC Executive Committee. The Committee comprises a high-level group of 28 top officials from the key relevant Ministries, Government departments and agencies, financial and market regulators and representatives from the banking and takaful sectors. Through the shared vision and commitment, this Committee is responsible for providing the direction as well as undertaking a review of all existing policies that are relevant for the comprehensive and coordinated promotion of the MIFC. Two meetings thus far have been convened and several issues have now been resolved with solutions provided to several key implementation issues which ranged from foreign ownership to immigration policies.

The Secretariat, formed by Bank Negara Malaysia will not only serve the Executive Committee but will also act as a single contact point for the implementation of the MIFC initiatives. Working level committees have also been formed to undertake the task of considering new proposals and monitoring the implementation of the MIFC recommendations. To take into consideration global trends and to provide insights on the strategic direction, an **International Advisory Panel (IAP)** comprising industry leaders and experts from the global community is also being established.

Conducive environment for business

In continuously creating an enabling environment for the efficient functioning of the MIFC, the Government has identified several key strategic objectives. The Government has also granted an attractive tax package to promote Malaysia as a competitive international Islamic financial centre. The objective is to **build the base** - that is, to create the necessary critical mass of participating financial players and to increase the scale of activity. Malaysia aims to attract global players as well as to enhance the capacity and capabilities of the existing financial institutions. Among the measures that have been introduced are:

- first, liberalising the Islamic banking, and takaful and retakaful markets with the issuance of new licences to allow for increased foreign participation;

- second, allowing foreign equity of up to 49 percent in existing Islamic banks and takaful companies;

- third, issuance of International Islamic Bank and International Takaful Operator licences under the Islamic Banking Act and the Takaful Act respectively to qualified foreign and Malaysian financial institutions to conduct the full range of Islamic banking business or takaful and retakaful business in international currencies and enjoy tax holiday for 10 years under the Income Tax Act starting from the year of assessment 2007;

- fourth, granting approval to Malaysian Islamic banks and takaful operators to set up International Currency Business Unit (ICBU) to offer Islamic financial services in international currencies and enjoy similar tax holiday; and

- fifth, provide greater flexibility to the Labuan offshore entities offering Islamic financial services to open operation offices anywhere in Malaysia. The Labuan tax law will continue to be applied to these players.

Players, therefore have the option in participating in the MIFC either by being licensed under Bank Negara Malaysia to benefit from the tax holiday for 10 years under the Income Tax Act and fully benefit from the **Double Tax Agreement**, or alternatively to be licensed under LOFSA and be taxed accordingly under the Labuan Offshore Business Activity Tax Act.

The second strategic objective is **activities generation** - that is, to promote Malaysia as the preferred choice as the centre for the offering of Islamic financial services. Associated with this objective is building the pool of talent and expertise, and to ensure that the environment is cost competitive and conducive for product innovation and product offering. The measures to address this includes:

- first, setting up the International Centre for Education in Islamic Finance (INCEIF). This represents the Malaysia's investment in human capital to support the global development of the Islamic financial services industry;

- second, establishing a Shariah Endowment Fund for scholarships, research and international Shariah dialogues for the regional and international Shariah communities to enhance the harmonisation of Shariah interpretation and practices;

- third, an additional 20 percent exemption in stamp duty on Islamic financial instruments on top of the stamp duty exemption that is currently available to ensure tax neutrality;

- fourth, encouraging Malaysian-owned banks including Islamic financial institutions to expand their operations abroad by allowing the profits of the newly established branches overseas or remittances of new overseas subsidiaries to be given income tax exemption for 5 years. This is to enhance market access and business networking, and also to widen the customer base and to generate new sources of businesses in uncharted territories; and

- fifth, liberalising the foreign exchange administration rules to allow multilateral development banks and multinational corporations to issue ringgit denominated instruments in our domestic bond market.

In further liberalising the market, I am pleased to announce that resident and foreign issuers will now be **able to raise foreign currency-denominated bonds**, in particular, Islamic bonds, in the Malaysian capital market. The foreign issuers eligible to take this opportunity are the sovereigns, quasi-sovereigns, multilateral development banks, multilateral financial institutions and

multinational corporations, while resident issuers are the local MNCs. This represents part of Bank Negara Malaysia's continuous efforts to promote the development of the Malaysian bond market, and to enhance Malaysia as a centre of origination, distribution and trading of sukuks. The issuance of foreign currency denominated bonds will also provide additional flexibility for both residents and foreign investors to diversify their investments into non-ringgit investments in Malaysia .

In taking the MIFC initiative to the next phase of development, I am also pleased to share with you some of the current work-in-progress to this agenda further forward. The International Islamic Bank (IIB) and International Takaful Operator (ITO) will be allowed to be set up as a **branch** in addition to a subsidiary as currently stipulated under the domestic banking and takaful legislation. To create greater international awareness on these new initiatives, financial ambassadors are being appointed to meet with potential players and investors and road shows will be conducted as part of the promotional plan.

In addition, the MIFC Executive Committee is formulating the **supporting immigration policies** with the Immigration Department where long-term employment pass, multiple entry permits, dependent pass and professional visit pass would be offered to expatriates identified as professionals and experts in Islamic finance. To attract specialist and high level expertise, a Permanent Resident status may also be offered based on the recommendation of the relevant financial regulators. A mechanism is also being put in place to ensure the efficient processing of these measures. This is aimed at addressing the acute current shortage of such talent and expertise in the global financial system. While the education infrastructure has already been put in place to address this shortage, Malaysia also needs to be competitive in attracting and retaining the talent. The Executive Committee will therefore look into customised incentives to attract best talents to Malaysia in addition to the entry of international legal firms that are able to provide services for the international currency business in Islamic finance.

Role to be played by financial institutions

One of the key success factors for a vibrant financial hub is having the critical mass of reputable and diversified range of financial institutions. With extensive incentives and measures in place, it is a priority for those already based in Malaysia to be encouraged to be the players in the MIFC. In building the base, the financial institutions in Malaysia, onshore and offshore, are encouraged to develop a niche in the overall landscape for MIFC. Players with expertise in structuring Islamic instruments should capitalise on the tax incentives by having the syndication team to be based in Malaysia for the issuance of ringgit and non-ringgit sukuks out of Malaysia, while those with investment and private banking as well as fund management expertise should intensify their focus on efforts in this area and structure innovative Islamic investment instruments. Existing players are also urged to be MIFC players and develop Malaysia as their regional hub with the potential to have the international currency business operations either through the onshore regulatory framework or under the Labuan offshore structure.

The success of MIFC will depend on the collaborative efforts of the financial regulators, the delivery system, the industry players and the supporting professionals. In meeting the MIFC objectives, we encourage the exploitation of this new growth area. At the onset, it is also emphasized that an equally important part of this process is having the right people in place with the appropriate skills, having in place the appropriate systems and governance framework to ensure the viability and sustainability of this industry.

This dialogue provides the opportunity to deliberate the issues from the different perspectives and dimensions so that the full potential of the MIFC initiatives can be realized.

JP Morgan/Khazanah Nasional Gala Dinner to Commemorate the Sovereign Wealth Funds Roundtable
2 November, 2006, Kuala Lumpur

Keynote Speech by

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It is my great pleasure to be here this evening to participate in this JP Morgan Round Table event. My remarks this evening will touch on sovereign wealth funds from the perspective of Central Banks, in particular, in the context of emerging market economies.

Why would Sovereign Wealth Funds be of interest to Central Banks? For a number of reasons. Firstly, the source of funds for such investment corporations have important implications. An important potential source of funds for such investment corporations are generally from "windfall gains" from revenues earned from resource booms or from a resource discovery or from increases in world prices. Other sources include carving out funds from the international reserves or from raising the funds from the domestic or international capital markets.
In most emerging market economies the mandate of the Central Bank is much broader than our counterparts in the developed industrialised economies that extends beyond that of monetary and financial stability. In addition, to being financial advisors to the Government, the Central Bank also has a developmental role, in particular, with respect to the development of the financial system and more broadly in the development of the economy.

In emerging market economies such sovereign wealth funds have a role as an important vehicle for managing the national wealth that has been derived from windfall gains from natural resources and to ensure its long-term benefits and optimum usage. The global experience has in fact shown that there is a negative correlation of growth and countries with abundant natural resources. The statistics show that countries with scarce resources grew at two to three times faster than countries endowed with abundant resources. This has been referred to as 'the curse' of natural resources.

The revenues earned from a resource boom can through such a sovereign wealth fund vehicle, be reinvested in other sectors of the economy to promote growth. The stimulus can provide the 'big push' to bring the economy to a higher level of development. The global experience has shown that there are too many examples of cases where such windfall gains have been squandered. King Faisal of Saudi Arabia was quoted in the 1970s as having said that, "In one generation to the next, we went from riding camels to riding cadillacs. The way we are wasting money, I fear the next generation will be riding camels again."

There is therefore a strong case for establishing such sovereign investment corporations to grow the national wealth and spur development and to ensure that the benefits are preserved for the future generations. The Central Bank as financial advisor to the Government has a part in the process of ensuring that this takes place.

The second potential source of funds for such sovereign investment corporations are from what has been termed 'excess foreign reserves'. In the current environment of large accumulation of reserves, this issue has been much discussed. Whether this is a desirable option would depend on the circumstances of the individual economies.

Firstly, there is the issue of reserve adequacy. At the outset it is important to assess the optimal level of reserves that is desirable. This would depend on a number of factors, including the openness of the economy, the extent of capital account liberalization and the exchange rate regime in place. The comfort level of international reserves for an economy like Malaysia where the trade volume is two times the size of its economy would be much higher than a relatively closed economy. In addition, an assessment would need to be made on the extent to which the build up of reserves have been from more permanent sources or whether they are accounted for by short-term inflows.

This growing size of the reserves of several countries has also generated greater scrutiny on the way central banks manage their reserves. Central banks are cognizant of this fact and have moved with the times, adopting increased diversification strategies in terms of asset classes and investment management and placing greater emphasis on returns and upgrading of systems and capacity. This has led to a blurring of the distinction between the reserve management function of central banks and the wealth management function of sovereign wealth funds.

There is however, no single ideal model for managing a country's wealth arising from higher reserves, although Singapore and South Korea have often been cited as examples. In both cases, there is more than one entity managing foreign exchange reserve assets, with different approaches – reserve management and wealth management; the major distinction being that reserve management places greater emphasis on liquidity and short-term capital preservation. There is also the case where such a fund is managed within the central bank itself, as in the case of Norway.

Another important factor that needs to be taken into consideration is the debt status of the country, whether it is a net debtor or net creditor country. For net debtor countries, where the level of international reserves are not sufficient to meet the external obligations, such carve outs would be less desirable. In addition, it needs to be recognized that the use of reserves for public investment is equivalent to deficit financing by the Central Bank and this would contribute to increasing the inflationary risks to the economy. Finally, a strong reserve level would also act as a deterrent for speculative activity.

The third source of funds for such investment corporations is through raising the funds from both the international and domestic financial markets. Being a sovereign investment corporation, their cost of funding will usually be advantageous, perhaps, only marginally higher than the sovereign itself, while the investments undertaken can reap higher returns.

The choice of markets would to a large extent depend on the circumstances such as the investment destination or whether it is for the purpose of establishing a benchmark in the market or developing new instruments or tapping new markets and investors. Recently, Malaysia's sovereign investment corporation, Khazanah, our host tonight raised funds from the international financial markets to enhance its capacity via an Islamic exchangeable bond. Besides achieving their financing objectives, they also introduced a widely accepted Shariah compliant instrument that was well received by global investors. This has supported the efforts to promote Malaysia as an Islamic Financial Centre.

The second area of interest to Central Banks concerns the nature of the investments activities undertaken by such investment corporations. Domestic investments in strategic industries allow public sector investments to be better managed in a sovereign investment corporation compared to by the civil service within the Government. The investment role and function in today's complex and dynamic markets is a very specialized field, and significantly different from the business of the Government. The operating environment is also different requiring a different skills set and

experience. While this makes a case for such investment corporations the governance, risk management systems and required talent needs to be in place. In establishing sovereign investment corporations there has to be a high level of accountability from the outset. Transparency of the funds is also a strong safeguard against misuse and unacceptable risk taking in the activity of the corporation.

One specific concern from the perspective of the Central Bank is the investment by such sovereign investment corporations in the financial services sector. This trend has become increasingly significant in this recent decade. The concern is when governance and competitiveness is affected by the presence of cross shareholding in the financial services sector. Cross shareholding, arising from significant interest in more than one institution would give rise to such conflict of interest. Such a situation would affect the efforts of inculcating strong corporate governance in the financial sector. This development could also affect competitiveness as it could lead to a monopolistic condition. Such a situation can hinder in particular, the development of a healthy and competitive banking sector.

From a regulatory perspective, cross shareholding among banks and other financial institutions also give rise to systemic concerns particularly where the shareholding of banking institutions are concentrated in a few major shareholders. Under stressed conditions, shareholders with an extensive shareholding network may have limited ability to provide further financial support. In addition, cross shareholding also diminishes the influence of minority shareholders, dilutes market pressure and weakens internal discipline.

Finally, it needs to be recognized that in emerging market economies the talents for these such sovereign investment corporations are scarce. Increasing the number of institutions to manage sovereign wealth will increase the demands for the same talent. Competition for this talent is also from the private sector and from the international investment banks. The high degree of mobility of this class of talent increases the challenge of meeting this precondition.

Let me conclude with a few words on our own sovereign investment corporation in Malaysia. As a board member of Khazanah since 2000, I have had the privilege to witness firsthand the transformation of the entity from a passive investment holding company to become a more forward looking and strategic investment institution. The earlier version of Khazanah was essentially an investment holding company entrusted to hold equity on behalf of the government in major companies of what was considered as key industries. As the economic landscape changed with increased globalization and with new emerging growth areas, Khazanah needed to reinvent itself to meet these new challenges.

Implementing change in any organization is always a challenge. For Khazanah, the transformation was required as the changing environment has rendered the then existing model to be no longer relevant. Within this relatively short period of two years, Khazanah has not only refocused to a new strategic direction, but also undertaken organizational transformation and put in place the new systems and mechanisms that are in accordance to international best practices. It is only time that will tell the economic payoff of this transformation.

The World Islamic Economic Forum 2006
7 November 2006, Islamabad, Pakistan

Transcription of Governor's Commentary

Malaysia has been a recipient for more than 100 years for foreign direct investment and I would like to emphasize that the one main factor that prompts foreign direct investment or portfolio investment is the return that is to be gained from that investment.

Malaysia has been a profit centre for foreign direct investment and this has been a factor that has continued to attract such investment. The evidence is in the current account of the balance of payments, where a significant outflow of repatriation of profits and dividends can be seen. Even during the crisis, these investments, including from investments in our financial services sector, were generating positive returns and so this has been the factor.

Very often we talk about how important it is to have financial reform or domestic reform in order to attract investment, but even at our very early stage of economic development, and we were less liberalized in that period, we were already attracting such investment.

Right now, foreign direct investment in our country is important and accounts for one-third to one-quarter of our domestic investment, and it accounts for about 6% of our GDP. This is one of the highest in the world.

What are the benefits that we see from such investments, and are there any important considerations that we need to take into account in attracting such investments? Of course at the initial stage, for us, employment generation was very important. Then of course, there is the transfer of technology and also there are many spill-over effects to support many industries in the domestic economy; it supports the SME sector; it provides us access to markets; and access to research and development.

However there are also other factors that we need to be very complicit about. Such investment, for it to be sustainable over time, such partnerships with foreign entities, need to be mutually beneficial to the investor and to the country. In situations which it marginalizes domestic enterprise, this is a factor that we need to take into consideration, for example when we liberalize our financial services sector.

We need to take into account also the socioeconomic agenda of the nation. For example in Malaysia, where we are multi-racial and multi-religious, we want to have an economy that is inclusive; that everybody benefits from the economic progress that we have gained. We also want to, for example, have a financial system that is inclusive. All target groups, all sectors of economic activities, must participate in this process.

Sometimes when foreign investment comes into our economy, we see very differential development taking place and this is one of the concerns. We want to have balanced growth. With balanced growth comes with it socioeconomic stability.

Many points have been highlighted of what the ingredients, and what the three conditions are to invite foreign investment. I would like to highlight and sum it up into five categories.

Firstly, we must have economic stability. Secondly, monetary stability; and that is an environment of low inflation and where there is predictability of what the future environment would be. Thirdly, financial stability; soundness of the system; efficient functioning of the financial system that can intermediate investments into productive activity. Then, social stability, and finally, politically stability. These are all the stabilities that are important preconditions.

The final point that I would like to make is that our environment is not static; it is dynamic. The environment changes all the time, and therefore if you are to continually attract investment, you need to enhance the flexibility of your economy to adjust to the changing opportunities that exist in the global environment. If you look at Malaysia for example, previously, we were in commodities; then we shifted and transitioned into manufacturing; and now we are major a recipient of foreign direct investments into services sector.

A country therefore needs to know where its comparative advantage lies, and to develop and to carve out these niche areas; and finally for the OIC economies, we need to look at the areas of complimentarities, where we can participate for example, in the globalization of production, in the supply chain of production, so that we can develop new silk road between east Asia and the Middle East and West Asia, whereby we can benefit and strengthen the potential that our economies offer, so that the benefits to all of us will be mutually reinforcing.

Bank Indonesia Annual International Seminar 2006
16 November 2006, Bali

Session 1: "Global Imbalances and Macroeconomic Instability"

Keynote Speech by

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The global imbalances are a shared concern of the global community in view of the risks that they impose on the international financial system and the global economy. I would like to take this opportunity to discuss these issues from the perspective of Asia. Firstly, to discuss the underlying drivers of the imbalances in Asia and secondly, the potential role Asia might have in the orderly resolution of these imbalances. And finally, the possible strategies that might be adopted to avoid disorderly adjustments, particularly in the event of a crisis.

An understanding of the drivers of imbalances in Asia is important in any assessment of the role that Asia might have in the adjustment process. The global imbalances in Asia have been to a large extent a consequence of the globalization of production. Inflows of foreign direct investment and the relocation of multinational activities into the Asian region have played a major role in driving the pattern of the current account surpluses in Asia. These foreign multinationals produce not just for the Asian market but also for exports to the rest of the world. Their decision to locate their operations in the Asian region is because wages, prices and other costs, including tax structures, are significantly lower in Asia. Asia's aggregate current account surplus therefore, does not reflect the ultimate beneficiaries of this trend. While Asia receives the wage benefits of globalization, the profits from this globalization process accrue to the foreign multinationals. Asia represents a significant profit centre for these multinationals and their investments in Asia in turn have been important in sustaining the current account positions in the region.

Secondly, it is important to recognize the structural nature of the savings–investment gap and hence the current account surplus in Asia. While exchange rate adjustments have been proposed as necessary to the adjustment process, it can only be part of the solution. The structural nature of Asia's current account surpluses is more evident when we disaggregate the savings-investment trends underlying the surpluses into three distinct groups of countries in Asia. In China, while investment activity has been robust, it has however not kept pace with the rise in savings. Under these circumstances, the pattern of aggregate demand is not likely to respond to exchange rate changes.

This is also evident in the case of Japan where the current account surplus has prevailed for more than two decades despite the significant appreciation of its currency. And for the rest of Asia, outside of China and Japan, the rate of savings has not increased but the rate of investment has declined, particularly after the 1997/98 Asian Crisis. This is due to a number of reasons including the restructuring in the domestic corporate sector, the earlier over-investments in the 1990s and the rising overseas investment. In addition, in a number of Asian economies, there has been significant change in the economic structure, resulting in the changing pattern of the investment activity to less capital-intensive activities, including to the services sector. Notwithstanding these trends, the overall rate of investment in emerging Asia (excluding China) as a share of GDP is about 25%. This is still higher than in any other region in the global economy (US 20% of GDP, Euro area 19% and Middle East 22%).

The gap between savings and investment across Asia brings us to the fundamental relationship between global imbalances and the stage of development of the Asian financial system. Financial intermediation has an important role in the savings and investment that take place. The current account surpluses in Asia represent high savings that is not matched by a high rate of investment. Several reasons may explain this. Firstly, it relates to the access to financial services by the population. This includes broad-based access to credit, insurance and pension schemes, as well as availability of social safety nets. This may prompt the need for higher savings. Secondly, the banking system still dominates the financial system in most of the Asian economies. While bank-based systems provide short-term financing, there needs to be a greater role for capital markets to facilitate long-term financing for investment. There continues to be significant investment opportunities in Asia, with infrastructure spending alone being estimated to be about USD 1 trillion over the next five years.

Enhanced financial intermediation and facilitation in Asia will not only narrow the savings-investment gaps in the region, but also more broadly, contribute to the growth prospects of the region. The increase in productive investment within the region will be important in creating jobs and raising incomes, providing a base for more robust private consumption. This will also contribute to stronger domestic demand across Asia. The cumulative aggregate demand in Asia has emerged as an important market. This has accelerated intra-regional trade which now averages 50% of the total trade in the region. This increased economic integration has been mutually reinforcing for the region and this rebalancing of global growth will contribute towards reducing the global imbalances.

Given the significance of the intermediation process, considerable attention has been given to financial market development.

At the national level, these efforts have involved enhancing the domestic financial infrastructure and institutional capacity building. In addition, measures have been implemented to improve the investment climate. In the post the financial crisis period, a more diversified financial system has emerged where the significance of bond markets in a number of Asian economies has increased. This has facilitated the raising of funds for long-term financing. In Malaysia, the bond market currently accounts for almost 90% of GDP with the size of the corporate debt securities market currently exceeding the public debt securities market. This market has been liberalized where non-resident entities are permited to raise domestic and foreign currency bonds in the domestic market. This has led to an increase in the depth and breadth of the market, which in turn further increased the attractiveness of the market as a cost-effective source of funding for the private sector.

Initiatives to improve the quality of corporate governance and increase the level of transparency and information dissemination have also been undertaken. Institutional capacity building, as well as legal, regulatory and supervisory reforms have also gathered momentum. National authorities have also placed greater focus on improving the public delivery systems and removing impediments to private investment. These measures serve to improve the investment climate and promote confidence and commitments for investment. In Malaysia, measures have also been taken to develop new financing channels as well as the supporting infrastructure for small- and medium-sized enterprises (SMEs) and to promote micro-financing for micro-enterprises as part of the effort to promote greater financial inclusion.

At the regional level, initiatives have been undertaken towards enhancing regional financial integration and thus facilitate more efficient allocation of surplus funds in the region into productive investments not only in the region but also to other parts of the world. Greater financial integration would facilitate intra-regional trade and investment. The financial integration process will also contribute towards reducing financing

costs and increase the potential for greater diversification, thus minimising risks and promoting greater regional financial stability.

Various efforts of a regional basis have been taken while more are in the pipeline. These involve measures in four key areas.

Firstly, strengthening the financial infrastructure including developing the regional financial markets and the supporting legal, regulatory and institutional arrangements. Such infrastructure includes regional rating agencies, regional credit guarantee mechanisms, and a regional settlement framework to facilitate cross-border transactions. This has also been reinforced by tax reforms.

Secondly, the progressive removal of impediments to greater cross-border financial transactions**.** The ASEAN Roadmap on Capital Account Liberalisation aims to achieve this. Many of the regional countries, including Malaysia, already have highly liberalised capital account regimes, with all Asian countries now being committed to capital account liberalisation.

Thirdly, the harmonisation of rules and practices that are consistent with international standards and best practices.

Fourthly, the strengthening of cooperation among the regional authorities has been important in reinforcing the private sector's role in the financial integration process. In this regard, regional institutional arrangements are being developed towards increased surveillance and crisis prevention, management and containment.

While Asia is undertaking significant changes to improve financial intermediation in the region, there are still issues that needs to be addressed at the international level in the current global financial architecture. There remains a substantial role for the other major developed economies, particularly Japan and Europe, to facilitate the rebalancing not only of demand but also of global financial flows so as to mitigate the risks to the international financial system. Policies to ensure sustained economic recovery in these economies and maintaining openness to trade would broaden the base of global demand for an orderly adjustment.

The further development of non-dollar markets are also necessary to facilitate more balanced global investment activities and thus reduce the potential for concentrated buildups that would be prone to risks of instability should reversal of financial flows occur. In the current environment, US financial markets are the largest financial markets in the world. It allows for large transactions to occur with minimal impact on market stability. The numbers of players, turnover, and frequency of issues are unmatched in any market. It also has greater diversity of investment opportunities in the different asset classes. This is a major reason prompting investment in these markets. The other major economies can therefore contribute significantly in this area.

While the global community has discussed at length measures needed to promote a gradual and orderly adjustment of the global imbalances, there has been a lack of attention to strategies for ***crisis*** *management* in the event the adjustments become disorderly. Improved surveillance, increased awareness of the risks involved, and instituting pre-emptive strategies among regional authorities to increase the potential for concerted action are some of the initiatives that can be taken to contain the impact of any disorderly adjustments.

Conclusion

The solution to address the global imbalances involves addressing the issue on several fronts, promoting appropriate macroeconomic conditions, structural adjustments, financial reforms, development and stability. By the very nature of the challenge, it is the collective effort of the international community and the individual economies that will produce a long lasting, sustainable solution.