Speech Notes
"Malaysia's Experience in Financial and Economic Crisis Management"
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Introduction:

First of all, I would like to thank Jinan University for inviting me to speak at this conference which is both timely and appropriate in the context of the present global economic crisis.

It is a great pleasure for me to be here before such a distinguished gathering of speakers and participants. Given the presence of eminent scholars and financial experts, I am confident this conference will be able to provide an Islamic perspective as well as provide policy inputs for the resolution of the crisis in line with the Shariah.

My presentation will attempt to put into perspective the Malaysian economic development and national aspiration since independence in 1957. After which I will focus on the various measures undertaken by the Malaysian Government to overcome the financial crisis of 1997 with particular emphasis on the financial sector as well as fiscal policy. I will also touch on the Malaysia's recent economic situation following the announcement of measures to address and to reinvigorate the economy in the face of current global crisis.

Ladies and gentlemen

The complex world we live is being aggravated by incomplete information, contradictory knowledge and understanding, conflicts of interest, divergent views and preferences conditioned by experience and ideology.

It is important to make correct assessments of opportunities, risks and trends so as to enable us to focus on building on those elements that provide the foundations for sustainable performance. It should go beyond being concerned with issues of immediate term and immediate relevance. A longer-term perspective is required, looking beyond the immediate term and immediate interests.

In managing the situation, sustainability requires that we pay attention to the entire cycle and that takes into account context and perspective. While managing the environment has been seen to be the realm of the governments, the response by businesses, consumers and the market will determine the overall resilience and performance of a nation. Malaysia is not immune to external developments and it is the public and private sector combined actions that will help secure sustainability of its economic prosperity.

Malaysia's Development

Malaysia has indeed come a long way since its struggle for independence. This relatively young nation has, by the grace of Allah, made significant strides in economic development and nation-building over the last fifty years. The government and its relevant machinery have strived to maintain macro-economic stability, which is so crucial to the nation-building process.

Malaysia's financial sector has successfully evolved, which has led to an efficient intermediation process. Vigilant and effective regulation has also played a key role in ensuring a strong and resilient financial sector, which has enabled Malaysia to face current economic challenges on a stronger footing.

In particular, the mobilisation of savings to fund economic activities has been a major element in sustaining broad-based economic growth. The proper functioning of the financial system have provided the economy with a positive environment for sustaining trade and investment activities, resulting in higher living standards for all Malaysians.

Economic Development

The first fifty years of Malaysia's nationhood has been most challenging but rewarding with many fulfilling outcomes and there were also lessons learned. While the country has experienced great prosperity during most of the period, our economic and financial progress has also been interrupted by incidents that have tested our steadfastness. Our determination to confront these challenges contributed to the growth and economic transformations we have experienced thus far in an environment of macroeconomic and financial stability.

During the period, Malaysia has experienced an average annual growth that exceeded 6 per cent and annual inflation that has been less than 3 per cent. The continued increase in incomes and the low and stable inflation have not only promoted a high rate of savings that has exceeded 30 per cent of GDP but it has also resulted in the financialisation of savings. This has allowed Malaysia to rely on domestic sources of funding to finance our growth and development during this period, thereby minimising our levels of external indebtedness.

Malaysia has transformed from its agrarian roots into a more diversified economy with a broad-based manufacturing sector and a vibrant services industry. Recognizing the dynamics and very competitive global environment, Malaysia adopted a development strategy based on the need for continuous self-review and improvement. In the process Malaysia is able to make necessary adjustments and seek new areas of growth based on the following fundamentals:-

- The public and private sectors' role in economic development is vital while recognizing that the key driver of growth must come from the efforts of the private sector. A major proportion of Malaysia's growth has emanated from private investment, which was financed by high levels of domestic savings.
- The development of proper enabling infrastructure, which is critical to provide a conducive business environment. For example, transportation and logistics networks, as well as public utilities and telecommunication facilities have been extensively developed throughout the nation. This physical infrastructure is complemented by "soft" infrastructure, including a credible legal system, an efficient government bureaucracy, and a vibrant financial market system.

- Investment for human capital and education. Access to education is viewed as an important means in our efforts to improve the standard of living of the people. Hence, a full spectrum of learning opportunities was developed to ensure comprehensive development of human capital for the nation. The development expenditure, including that for physical infrastructure and education, always constitutes the bulk of our annual budget.
- The development of rural areas has always been an integral part of Malaysia's development strategies, as a large proportion of our population continues to reside in rural areas. The government rural development programmes includes the modernisation of the agricultural sector as well as the development of small and medium enterprises with the view to maximizing the economic potential that rural areas have to offer.

Development Agenda

Underlying the strategies is the conviction that the benefits of economic development must be extended to all segments of society. Malaysia believes that sustained progress of a nation can only be secured if there is shared prosperity. Therefore, the strategies adopted to create an environment for wealth creation and economic development have been based on the philosophy that emphasises economic progress whilst maintaining socio-economic balances at all times.

Thus, a crucial thrust of Malaysia's development strategy is to give equal emphasis to both growth and equity - by giving recognition to the importance of regional development, narrowing the development gap between rural and urban areas, and harnessing the strengths of a diverse population.

Malaysia is focusing on specific niches where we can specialise and have natural advantages. In the downstream industries linked to palm-oil, rubber, oil and gas, we have considerable comparative advantages. In collaborating with Japan, China and Korea in building consumer-electronic and computer hardware, with India in software, we must create niches of technological strength in telecommunications, biotechnology and agriculture.

In Islamic finance, we are already pioneers and must capitalise on Kuala Lumpur's role as the emerging centre of the world's Islamic banking industry. As a Muslim-majority, ethnically-plural nation, we in Malaysia can also play an important role in managing the broader interface between Islam and the west.

Economic transformation

The Malaysian economy will need to be transformed further – i.e. the shift of emphasis from an investment-related competitive advantage to one that is driven by technology and innovation based on the following core strategies:-

The first strategy - that a fundamental factor for any country to achieve significant economic progress lies in the quality and ability of its people; the availability of high quality human capital will ultimately define the performance of a nation. With this in mind, Malaysia launched - in 2006 and 2007, respectively - the national education blueprint and the national higher education strategic plan to transform the nation's education system at all levels. In addition, other initiatives have also been developed to create a highly-skilled and competitive workforce. These efforts include the enhancement of training and skills programs for the private sector, and instilling a culture of excellence and high performance at all levels of the workforce.

The second strategy is to leverage on Malaysia’s changing competitive advantage and develop new potential sources of growth. These emerging areas of growth are characterised by their dynamism and their reliance on human rather than physical capital for success. In these areas, knowledge is more valuable than physical inputs. High value added activities, downstream resource-based manufacturing activities, together with the services sector, will be key in further driving our quest for sustainable development. In addition to the rapid growth of the traditional services sub-sector, new service industries have also emerged and are growing rapidly, particularly in the areas of finance, I.C.T, logistics, health, higher education and tourism.

An important component of this strategy is to enhance the growth of the small and medium enterprises (SME) sector. Currently, SME's represent a major source of domestic employment and contribute 32 percent to GDP. For this purpose, the national SME development council was established to coordinate policies and strategies for SME development.

New areas of growth are also emerging, ranging from the shared services and outsourcing industry to agro-business, biotechnology and Islamic finance.

1997 Financial Crisis

Malaysia’s development efforts were interrupted when the economy was severely affected by the financial crisis in 1997 which razed through the Asian region. Our GDP contracted in 1998 by 7.5 percent, industrial production fell by double digit rates and almost 84,000 workers lost their jobs. The Malaysian currency (ringgit) came under heavy speculative attack and forced it to devalue from 2.5 ringgit to the US dollar to a high of 4.8 ringgit. Our stock market plunged, resulting in almost 200 billion US dollars lost in market capitalization.

Our response to the crisis was equally pragmatic and unorthodox. Unlike the other crisis economies, we took a different route in responding to the crisis. We did not seek IMF assistance and therefore, were not bound by IMF strictures. We found the IMF prescribed fiscal austerity inappropriate. Instead, we opted for fiscal priming to generate domestic economic activities. We were able to peg the ringgit and impose temporary selective capital controls. These helped to expedite the restructuring and the clean-up measures of the financial system, with Danaharta leading the work-out of banking system NPLs, and Danamodal, in injecting fresh capital.

These measures stand out as the most significant innovative financial instrument to ensure stability in the financial system so that we can concentrate our efforts on generating economic growth. Its implementation illustrated Malaysia's ability to think out of the box, to move away from standard solutions to resolve complicated problems. More importantly, these measures have enabled Malaysians to continue to enjoy social stability and cohesiveness throughout the crisis period.

It must be noted that the fundamentals of the Malaysian economy and its financial system prior to the Asian financial turmoil which began in mid-1997 were strong. The economy registered robust growth of more than 8% for a decade. The Government was enjoying a fiscal surplus for five years since 1993. The external debt was generally low, at about 40% of GNP. Inflation averaged 3.5%. On the financial front, the banking system was strong and sound as reflected in the strong capitalisation and the high asset quality.

During this period of strong fundamentals and rising potential for economic expansion, Malaysia has the flexibility to introduce measures not only to support growth but also to improve the quality of the growth and its long term sustainability. This includes significant investment in education and according priority towards achieving socio-economic stability. Overall, a balanced and holistic approach to economic management is aimed to ensure the foundation for a strong economy and its competitive position in the global economy.

Alhamdulillah, as a result of our efforts, the economic transformation has enhanced the standard of living of all Malaysians. Today, our per capita income, adjusted for purchasing power parity is about 14,000 U.S. dollars - which is a 30-fold increase from 50 years ago. Our international reserves, remains high at 110 billion dollars, sufficient to finance 9 months of retained imports.

The financial transformation has taken place in an environment of economic stability. Malaysia’s economic performance has been characterized by sustained high quality growth and stable fundamentals. The underlying growth in the Malaysian economy has been solid. Malaysia has benefited from both the favourable external environment and the strong domestic demand. Malaysia has also benefited from the globalization of production with the geographical relocation of the production chain by an increasing number of both multi-national and local corporations across the Asian region.

This trend has leveraged on the respective comparative advantages in countries of the region. Malaysia 's distinct capabilities in a wide number of areas has increased its participation in this process. In addition, increased economic integration following the rise of intra-regional trade and investment has brought mutually reinforcing benefits in terms of the expanding regional opportunities. The strengthened corporate sector has also led to increased direct investment abroad by Malaysian companies.

A major strength of the Malaysian economy has been its economic flexibility. Significant changes in the structure of the economy continues to take place. The manufacturing sector has continued to move up the value chain while the services sector has gained increasing prominence, with its share of GDP rising from 45% in 1995 to almost 60% today. The role of private consumption in the economy has also been enhanced, supported by steadily rising incomes, low unemployment, and access to the financial system. Of importance is the recovery of investment activity.

Financial Sector

Our financial services sector has also evolved from its role of providing intermediary services to become more expansionary and dynamic, able to contribute towards growth generation and enhancing competitiveness to serve regional and even global marketplace. One unique feature of Malaysia's financial system that I wish to highlight is that our Islamic banking, Takaful or Islamic insurance, as well as the Islamic capital market have strongly complemented and successfully been operating in parallel with conventional banking, insurance and capital market system.

We have achieved significant progress in the development of Islamic banking and finance since the first Islamic bank was established 20 years ago. Since then, our Islamic banking assets have increased significantly, constituting more than 11 percent of total assets in our domestic banking system. In the development of Islamic financial services, Malaysia continues to take a leading position in market development, product innovation and regulatory capacity.

Islamic Finance

With some three decades of experience in developing Islamic finance, Malaysia now has a comprehensive and well developed Islamic financial system. The Islamic financial system in Malaysia is operating in parallel with the conventional system, and has drawn wide participation from both Muslims and non-Muslims.

In a dual financial environment, Islamic finance has proven to be a viable channel of financial intermediation. It is also competitive in terms of product and services offerings. As it continues to develop, Islamic finance will present the international business community with an alternative means of raising funds while investors are presented with new asset classes.

It is clear that the Islamic financial system has remained unscathed by the severe difficulties currently affecting the conventional international financial system is testament to its integrity and validity. Islamic finance is becoming an increasingly important part of the international financial system, and Malaysia hopes to leverage its experience in the sector to strengthen trade and investment ties across the globe.

Malaysia has developed a comprehensive Islamic financial system that includes the banking and takaful industries, and the Islamic money and capital markets - a matrix which mutually reinforces the integrity and stability of the Islamic financial system.

Significant progress has in particular, been achieved, in the development of the Malaysian sukuk, or Islamic bond market. The Malaysian sukuk market has now evolved into the world's largest Islamic bond market. In 2007, Malaysia accounted for about two third of the global sukuk outstanding amounting to about USD47 billion. In 2002, the Government of Malaysia issued the first global sovereign sukuk. With this issuance, it became an international benchmark for the issuance of global sukuk. There have since been several further sovereign issues in the global capital market. The sukuk market has been an important source of financing for productive investment activities, while for investors, it provides greater potential for diversification into new asset classes.

The development of the Malaysian sukuk market has involved wide ranging initiatives to facilitate an efficient issuance process, the price discovery process, the broadening of the investor base, the establishment of a benchmark yield promoting the liquidity in the secondary market and strengthening of the regulatory framework. These initiatives have been reinforced by the legal and Shariah framework and the supporting financial infrastructure including the settlement system and the bond information system.

The international prudential standards for Islamic finance is set by the Islamic Financial Services Board (IFSB), is located in Malaysia . The IFSB thus formulates the international regulatory and supervisory standards for Islamic financial institutions aimed at achieving best practices in order to secure soundness and stability of the Islamic financial system. With the setting up of the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), appropriate accounting standards have also been put in place to reflect the true and fair value of banking operations to ensure greater accountability and responsibility of the financial institutions.

With the increased maturity of our domestic bond market, further steps have been taken by Malaysia to allow foreign corporation, multinational corporations and multilateral agencies to raise funds in the Malaysian bond market with no restrictions for the utilisation of these funds. These funds maybe used to finance foreign investment activities outside the country. Following this liberalisation, the inaugural ringgit denominated sukuk issue was in 2004 by the International Finance Corporation (the investment arm of the IBRD World Bank), followed by the issue by the IBRD World Bank in 2005.

In November of 2006, our market was further liberalised to allow for the raising of foreign currency sukuks from our domestic market. More recently, a landmark issuance the 750 million dollars exchangeable sukuk Musyarakah by Khazanah Nasional, the Government's investment arm, marked the world's first issue of its kind, incorporating full convertibility features common to conventional equity-linked transactions. These issues have attracted investors from outside of Malaysia , thereby strengthening our inter-linkages with other international financial markets.

Islamic financial services

In the development of Islamic financial services, Malaysia continues to take a leading position in market development, product innovation and regulatory capacity. Our financial system now offers investment opportunities not merely for conventional fund managers but also for those looking for investment which are in accordance with the principle of the Syariah. Supported by the necessary infrastructure, such as Islamic stockbroking companies, Islamic banking facilities and Islamic insurance, an investor can choose to invest in a holistic Islamic manner in Malaysia. With this, we are already positioning ourselves as a premier international Islamic financial center.

In the area of Islamic capital market, 85 per cent of all listed securities on Bursa Malaysia are Syariah-compliant, accounting for almost two third of market capitalisation of the Bursa. In addition, we have also developed the Kuala Lumpur Syariah Index (KLSI) which is a broad based price weighted average index constructed from the list of Syariah compliant securities approved. Currently this index has 509 stocks.

We also have Shariah compliant or Islamic unit trust funds, managed by professional portfolio managers in accordance with Shariah principles. There are currently 86 such unit trust funds with net asset value in excess of 8.7 billion ringgit. Islamic private debt securities or corporate bonds have also developed in parallel with the equities market. Outstanding Islamic-based papers currently total almost 99 billion ringgit, accounting for more than 45 percent of the total outstanding private debt securities issued in the domestic capital market. With this, Malaysia currently accounts for 70 percent of total global Islamic bonds and 40 percent of global Islamic unit trust.

Malaysia was the first to issue a rated Islamic Asset Backed Securitisation or ABS, while the first Islamic ringgit bonds by Multilateral financial institutions was issued by the International Finance Corporation in 2005. Recently, the first issuance of Islamic REITS under a structured guideline has also been approved.

The Government recently launched the Malaysia International Islamic Financial Centre (MIFC), whereby Islamic financial products and services that are transacted in international currencies may now be conducted from anywhere in Malaysia. Several measures and incentives are in place to promote the centre in the offering of Islamic financial products and services. These include:

i. issuance of new conditional licenses for the setting up of International Islamic Banks and International Takaful Operators to qualified foreign and Malaysian financial institutions to conduct business in international currencies;
ii. approval for the setting up of International Currency Business Units within the existing Islamic banks and Takaful organizations and they are allowed to conduct Islamic commercial banking, investment banking and other banking businesses;
iii. income tax exemption for ten years on management fees for fund managers managing funds of foreign investors based on Shariah principles; and
iv. flexibilities for Labuan offshore Islamic banks and the Islamic divisions of offshore banks, as well as offshore Takaful operators to open operation offices anywhere in Malaysia with minimal presence in Labuan.

These measures and attractive incentives are part of the Government's initiatives to promote and strengthen Malaysia's position as a centre of origination, distribution and trading of Islamic capital market and treasury instruments, Islamic fund and wealth management, international currency financial services, and Takaful and re-Takaful business. It is aimed at positioning Malaysia as the gateway for tapping investment opportunities in the region.

New Opportunities

This decade has also witnessed a rapid evolution and global expansion of the Islamic financial services industry. More recently, its international dimension has gained significance as Islamic finance is becoming an increasingly important part of the international financial system. In doing so it is contributing to strengthening international inter-linkages between financial markets and systems that is more widespread and inclusive.

There is now a growing strong demand for Islamic financial product in the global market, far exceeding the current availability of financial products and services being provided by the Islamic financial institutions. The global development of the Islamic financial system has become particularly important in this more challenging financial and economic environment.

As the international financial system becomes more diversified and as this new form of financial intermediation develops, it has presented businesses with alternative means of raising funds while investors are presented with new asset classes. It has contributed towards greater diversification of risks.

More importantly, the very fundamental requirement of Islamic finance is that it requires an underlying economic transaction thereby avoiding emphasis on speculative purposes. It also prohibits the commoditisation of risks, which leads to its proliferation through multiple layers of leveraging and disproportionate distribution. Islamic finance as a form of financial intermediation will also contribute towards enhancing the efficient mobilisation and allocation of funds across regions.

This will bring about strengthening of a more wide spread and inclusive global financial integration. The greater diversification of risks also contributes towards promoting international financial stability. The transparent nature of Islamic financial contracts and the need for underlying economic transaction reinforces the stability of the Islamic financial system.

Current Global Crisis

The current global slowdown, clearly underscores the need for concerted commitments, by both national and international authorities, to institute policies, as well as regulatory and governance mechanisms, to address challenges and sustain global growth.

Malaysia is monitoring very closely the events unfolding, and is very concerned about the possibility of subsequent effects on the real sector. If the current financial crisis is not addressed comprehensively, the global slowdown is bound to worsen, and further impact negatively on the low-income economies. Malaysia is already taking various measures to cope with the present crisis.

The government has slashed its forecast for the economy to grow 3.5 percent this year. It now expects the economy will shrink 1 percent in the worst case scenario and grow 1 percent in the best case scenario. Unemployment is forecast to rise to 4.5 percent from 3.7 percent last year. Since October 2008, about 25,000 workers have been retrenched and 30,900 temporarily laid-off.

Malaysia's heavily trade dependent economy (accounting for almost 200% of GNP) has been severely hit by the decline in global demand. In January, exports fell 27.8 per cent. Commodity prices have also declined sharply, especially in oil and gas and palm oil, which are Malaysia's main exports. Foreign direct investment was expected to decline by almost 50 percent to 26 billion ringgit (US$7 billion) in 2009 against 51 billion ringgit (US$13.7 billion) in 2008.

US$16.2 billion Stimulus Package

The Malaysian government RM60 billion (US$16.2 billion) second stimulus package is sufficiently chunky to have an immediate and significant impact. The package — equivalent to 9 percent of one year's gross domestic product — is in addition to 7 billion ringgit (US$1.9 billion) of stimulus spending announced in November 2008.

The 80:20 split between private sector/capacity building initiatives and social safety net measures is well balanced and well crafted. The stimulus package is expected to intensify and accelerate the implementation of investment plans in high economic multiplier, strategic, service-oriented sectors, including telecommunications, leisure and tourism, technology, life sciences, healthcare and agriculture.

These sectors, with its higher emphasis on services and intellectual property content, represent the new growth engines for the nation and will support the government's ongoing structural upgrade of the economy. The sectors and specific investments are by and large in new areas and hence are more catalytic in nature that will further spur additional private sector participation over time. The government however acknowledged that the export-dependent nation may not be able to avoid a recession and mounting job losses.

The money will be spent in five broad areas — fiscal injection, guaranteed funds, equity investments, infrastructure projects and tax incentives over 2009 and 2010. A fiscal injection of 10 billion ringgit (US$2.7 billion) in 2009 will raise the government budget deficit from 4.8 percent of GDP to 7.6 percent this year. There will be another 5 billion ringgit (US$1.35 billion) injection in 2010.

The stimulus package has set aside 2 billion ringgit (US$540 million) to create 163,000 training and job placement opportunities in the public and private sectors and to give a tax deduction to employers who hire retrenched workers.

Assistance to the private sector will account for 29 billion ringgit (US$7.8 billion), including a 5 billion ringgit (US$1.35 billion) working capital fund, guaranteed by the government, to help companies facing a cash crunch. It will also try to make it easier for companies to raise money from the capital markets and provide support for the automotive, aviation and tourism industries.

Some 19 billion ringgit (US$5.13 billion) will be spent on investments in industries and infrastructure. This includes 10 billion (US$2.7 billion) to be made available to Khazanah, the government's investment arm, for investing over two years in domestic industries.

Another 5 billion ringgit (US$1.35 billion) will be allocated for projects including a budget airline terminal, expansion of the airport at tourist gateway Penang, a high speed broadband network and a covered walkway in the famous Golden Triangle shopping district in the country's main city, Kuala Lumpur.

About 10 billion (US$2.7 billion) will be spent on easing the people's cost of living burden, including giving tax relief for interest paid on housing loans up to 10,000 ringgit (US$2,700) a year for three years, improving schools, giving micro credit to fishermen and farmers, and issuing Islamic bonds with guaranteed 5 percent returns.

A levy on foreign workers will be doubled for all sectors, except construction, plantation and domestic help in a bid to reduce dependence on foreign labor and utilize the domestic labor force.

Conclusion

Adversity tempers the human spirit. It makes us wiser. In our case, it makes us realise that we are not infallible. Our economics are subject to the same corrections that occasionally strike other performing economies. Adversity can also make us more resilient. With the proper lessons drawn and the appropriate remedial measures undertaken, Malaysia can eventually emerge from this crisis stronger than before.

While some measures will probably be similar across economies, each country must essentially devise its own recovery plan suited to its own unique circumstances. Malaysia has taken a series of bold actions to protect it from destabilising external influences. We need to maintain our monetary independence to keep the domestic economy afloat and the real sector functioning. More importantly, we need to protect the very foundations of Malaysian economy and maintain intact the social fabrics of its nation.

The strategy for Malaysia in moving forward is to place emphasise on economic recovery and the transformation of the economy to become more efficient and competitive. Importance is also given to restructuring and strengthening the banking system. As can be observed in most financial crisis, stability and recovery in financial markets generally followed the recovery of the real sector.

Therefore, while efforts are being directed to ensure a stable macroeconomic framework of low inflation and a positive external balance and a financial system that is resilient to external shocks, important consideration is also given to minimise the damage of the financial turmoil on the domestic economy, in particular, to the more vulnerable segments of society.

Malaysia's favourable initial macroeconomic conditions, relatively strong financial system and low external debt exposure has allowed for greater flexibility in its policy strategy. To further facilitate the continued restructuring and transformation exercise, the controls represent a means to an end. It represents a means of creating the stable environment that will allow Malaysia to prepare itself to be an integral part of the global financial system within the new international financial architecture from a position of strength and resilience.

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