



Speech by Tan Sri Dato' Sri Dr. Zeti Akhtar Aziz Governor, Bank Negara Malaysia

At the International symposium hosted by the Center for Monetary Cooperation in Asia (CeMCoA) of the Bank of Japan on January 22, 2007 in Tokyo

“Ten Years After the Asian Currency Crisis: Future Challenges for Asian Economies and Financial Markets”

Ten years after the crisis, ASEAN stands out as a dynamic region with diverse strengths. With a growing population of over 550 million, ASEAN remains one of the fastest growing regions in the world (2005: 5.6%; world: 4.9%). The combined GDP of the ASEAN economies is expected to exceed USD 1 trillion in 2007. This growth has been extensive and includes all the developing economies in the group.

The ASEAN economies have always been highly open economies, with total trade accounting for more than 130 percent of GDP and the value of trade flows now exceeding USD 1 trillion. In view of this high degree of openness, ASEAN has also always been vulnerable to external developments. The ASEAN economies have however demonstrated, time and again, their capacity to rebound from adverse shocks, and to do so within a short period of time. While the 1997 – 1998 crisis was devastating, most ASEAN economies were able to restore stability and resume growth just after a year. ASEAN has also continued to weather other both regional and international shocks that have since occurred.

While the current global and regional environment has since the last ten years changed dramatically, bringing with it new risks and challenges, the region has emerged strengthened with greater economic and financial resilience. Strong macroeconomic fundamentals have been sustained, and reinforced by enhanced economic flexibility. The financial and corporate sector restructuring and reform that were undertaken during the ten years have also supported these developments. Equally important is the aggressive development of the domestic financial infrastructure and financial markets. The ASEAN economies have also developed complementarities with the major regional economies in the Asian region including China, Japan, South Korea and India that has contributed to deepening of regional economic integration, reinforcing further the strong trade and investment linkages that was already present in the region.

The issue before us now, is whether the South East Asian nations can rise to the challenge of sustaining its dynamism and prospects in this more challenging global environment. Allow me to elaborate on the elements that have facilitated the ability of the ASEAN economies previously to successfully adjust to shocks and to take account of the recent developments that have further strengthened their capacity and capability to deal with future shocks and thus sustain their dynamism.

Improved macroeconomic fundamentals

While the macroeconomic fundamentals were favourable just before the crisis, in the current environment, the external position of the regional economies has strengthened further. The current account balances are in surplus, the foreign currency reserves are at record highs and the external debt levels are at significantly lower levels, with improved maturity profiles. Government budget positions are broadly stronger with ongoing measures towards consolidation. Inflation has generally been contained, despite the recent adjustments due to the high oil prices. More flexible



exchange rate regimes are also now in place allowing for the potential for smooth adjustments to external shocks.

In this environment, foreign direct investment (FDI) has also continued to increase reflecting confidence in the ASEAN economies. In 2005, foreign direct investment to the ASEAN economies reached USD 37 billion, exceeding the pre-crisis peak of USD 34 billion in 1997.

Economic flexibility in ASEAN has been enhanced

Economic flexibility has always been one of ASEAN's strengths. It has been a major element that has facilitated adjustment to the changing global environment and to external shocks. This economic flexibility of the ASEAN economies has ten years later been further augmented. This has been achieved by the increased labour and capital mobility, financial market development, a strengthened financial system, and the extensive institutional developments that have taken place.

Economic flexibility has been important in enabling the ASEAN economies to shift to new areas of comparative advantage. Significant changes in economic structures have taken place and shifts to new sectors have occurred in response to the changing global competitive dynamics. Diverse new sources of growth have now emerged across ASEAN, with the economies now moving beyond their traditional reliance on manufactured exports to expanding the production of resource-based products, and increasingly to the services sector and thus providing greater flexibility to respond to shifts in external demand.

There has also been a rebalancing of the sources of growth between domestic and external demand. The role of private consumption has strengthened in the ASEAN economies. ASEAN now possesses a burgeoning consumer market that is valued at more than USD 330 billion. With high savings rate continuing to prevail, there is potential for this trend to be sustained. Consumption demand has also been supported by rising incomes, with GDP per capita having increased to over USD 1,500 compared to USD 1,157 in 2000. In the long-term, these trends are expected to be reinforced by the positive demographic structure in the ASEAN region. ASEAN's population is not only large but also young with 55% at less than 30 years old and becoming increasingly urbanized.

There is also greater involvement of the private sector in the economy following the period of adjustment post-crisis. Private investment which was initially slow to adjust has now shown prospects for a stronger recovery. The potential for greater investment is driven by the rising infrastructure requirements throughout the region that is estimated at USD 160 billion for the period 2006-2010. There has also been growing interest in resource-based industries. The investment climate has also improved amidst the better economic conditions and more efficient functioning systems that have been put in place.

Financial and corporate reforms and restructuring have supported these developments

An area in which the payoff has been significant is the financial sector. The banking sectors in the ASEAN region as a whole have increased their resilience and ability to manage risks as reflected by their profitability, asset quality and capitalization, all which have generally strengthened since the Asian crisis. The renewed strength in the banking sectors have been underpinned by recapitalisation programmes, rationalization and consolidation and improvements in banking supervision and regulation. The implementation of financial reforms has not only increased the capacity but the resilience of the financial system.

Similarly, corporate balance sheets across the region have strengthened considerably with significantly improved standards of corporate governance. With the more positive investment



climate, it has resulted in a resumption of investment activities. A major development since the crisis has been the development of the capital markets, in particular, the bond market. This has led to greater diversification of sources of financing for the corporate sector. In Malaysia, the bond market now accounts for almost 90% of GDP with the size of the corporate debt securities market now exceeding the public debt securities market. There has also been increased attention to greater financial inclusion, to reduce income disparities and achieve more balance growth.

The stronger domestic financial sectors in the ASEAN economies have also allowed for greater liberalization and deregulation to occur. This has not only enhanced the range of business opportunities for the financial institutions but also their potential to expand beyond domestic borders and building further on regional linkages.

Increased Asian regional complementarities

Post-crisis, ASEAN has further increased intra-regional trade and investment linkages within ASEAN and with the other major economies in the region. Intra-Asian trade now accounts for more than half of the total trade of the region. The emergence of China and India has created new export markets for ASEAN, thus diversifying the ASEAN export market from over-concentration in the traditional markets. ASEAN is among the few regions to have a significant and growing trade surplus with China, reaching about USD 20 billion in 2005. Meanwhile, the total trade between the ASEAN-5 and India has expanded by more than tenfold from only USD 2 billion in 1990 to USD 21 billion in 2005.

In investment activities, Japanese investors have had an early presence in most of the ASEAN economies. This has generally reflected the diverse comparative advantage of ASEAN economies that range from labour cost advantages to natural resources and the increasingly more deregulated and liberalised regimes. Foreign investors have also leveraged their supply chain networks on the ASEAN platform to take advantage of this diverse comparative advantage. Even within ASEAN, there has been an increasing trend of outward direct investment especially by Malaysia and Singapore, being undertaken to leverage on regional growth opportunities.

Greater regional financial integration

While there has been a high level of economic integration, a more recent development has been the acceleration of regional financial integration. As high savings economies, this would facilitate a more efficient allocation of part of the surplus funds of the region into productive investments in the region. This would contribute towards lower financing costs in the region and reducing the risks while at the same time promoting the economic potential of the region.

To facilitate financial integration, the liberalization of foreign exchange rules, the harmonization of standards and the removal of impediments to cross-border investment have been undertaken. The ASEAN Roadmap on Capital Market Development has been formulated to foster alliances and linkages in the equity and bond markets among ASEAN exchanges, including the harmonisation of regulations. In the equity markets, multiple listings are being promoted as regional bourses attract domestic companies in the region to list on their exchanges. The FTSE/ASEAN Index and the FTSE/ASEAN – 40 Index, launched in 2005, also serves to increase the integration of the regional bourses and to promote ASEAN as an asset class. In the bond markets, the Asian Bond Funds (ABF 1 and ABF 2) initiated by the central banks aim to broaden and deepen the regional bond markets. Meanwhile, the Asian Bond Markets Initiatives (ABMI) aims to enhance the infrastructure, which includes plans to develop a regional credit guarantee mechanism, a regional credit rating agency and a regional settlement link to facilitate cross-border transactions. Specifically, the ASEAN Roadmap on Capital Account Liberalization, launched in 2003, aims to



gradually achieve a freer flow of capital over the medium-term. Malaysia has since progressively further liberalised its rules for foreign exchange transactions culminating in the removal of most of the rules in April 2005.

Strengthened regional financial cooperation

During the 1997/1998 crisis, Asia did not come together to collaboratively and cumulatively act to contain the crisis and subsequently to facilitate its resolution. Perhaps, it was due to the nature of the crisis, its severity on the financial markets and the economies. Domestic stability had to be first restored before time could be taken to formulate a holistic crisis management solution. The instability in the currency markets lasted for about one and a half years. There was also no entity in the region during that period that provided any authoritative assessment on whether the programmes that were subsequently being implemented would in fact produce the desired outcomes.

While efforts to strengthen the domestic economies and the financial systems will continue, this has now being reinforced by the improved regional surveillance including on cross border financial flows, and by institutional arrangements that would contribute towards crisis containment and management. The regional cooperative efforts going forward will continue to gain momentum. These efforts should not be seen as attempting to substitute but rather as efforts to complement the existing international arrangements. The objective to be achieved is the same, that is, to build the regional capacity to be better positioned to prevent, contain and resolve any potential crisis at minimum costs to our financial systems and to our economies.

In conclusion, the cumulative effect of the changes since the Asian crisis has transformed ASEAN – opening up new opportunities and making the region resilient and a dynamic centre of growth. The ASEAN “tigers” are back, and poised to leap on to the next wave of economic advancement and prosperity.