Adnan Zaylani Mohamad Zahid: Review and outlook of the Malaysian financial market

Speech by Mr Adnan Zaylani Mohamad Zahid, Deputy Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the Financial Market Association of Malaysia 2024 Annual Dinner, Kuala Lumpur, 29 November 2024.

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It is an honour and privilege for me to be here tonight. Let me first extend my heartfelt congratulations to PPKM and the organising committee for putting together this much anticipated annual event. I always look forward to this dinner. Besides being highly entertaining, it's a time to catch up with friends and colleagues in the market in a different setting, as well as allowing me to share some thoughts on our financial markets.

We are, after all stepping into the final month of the year, so this is a good time as any for us to reflect on the year and to prepare ourselves for the challenges and opportunities that lie ahead.

Financial Market Review – Resiliency of the Ringgit

I recall a year ago, at this dinner, expressing somewhat, a 'cautiously optimistic' view on the ringgit for 2024. This was on the back of an expected end and turnaround in the Fed hiking cycle. Well, the first half of the year saw ringgit come under pressure, trading at historical low levels, driven by global uncertainties surrounding US policy rates, China's growth trajectory and ongoing geopolitical risk in Europe and Middle East. These factors created a highly challenging environment. For us, this marked only the second time that Malaysia has faced negative interest rate differentials compared to the US.

The wide interest rate differentials had shaped the behaviour of investors, corporates, exporters, importers and the broader public. We saw increased interest among investors and the public to allocate funds to foreign currency assets. Exporters preferred to retain earnings in foreign currencies, while importers front-loaded their purchases taking advantage of the forward discounts on the exchange rate. Similarly, some corporates were observed expediting the repayment of foreign currency debt to reduce their debt servicing cost as well as their exposure to exchange rate risk. These conditions led to the ringgit trading under pressure in the first half of 2024.

Since then, we have turned the corner. Firstly, the coordinated actions by BNM and the Government in encouraging income repatriation and conversion among the GLICs and GLCs played a crucial role in helping us stabilise the market during the challenging period. Together with our intervention, these measures not only curbed excessive volatility but also restored investor and public confidence to the market. Secondly, following a clearer easing path from the US Federal Reserve in July, the ringgit rebounded strongly, appreciating by 14.4% in the third quarter, the highest in the region. And while there has been a correction of late, on year-to-date basis, the ringgit is still up by 3.3%, being the only currency in the region to strengthen against the dollar amid all the volatility we have witnessed. Thirdly, the economy has performed quite well this year, delivering a robust performance with inflation being under control. The government has also embarked on a number of reforms that not only set the stage for stronger and healthy growth in the future, but also an encouraging fiscal consolidation trajectory, which further strengthen our long-term fundamentals. The stellar performance of the ringgit affirmed that the earlier pressure was largely unwarranted, and it has now reinforced the market's confidence in the ringgit's resilience and long-term strength.

Overall, our domestic markets have also shown commendable resilience. Across foreign exchange, money, and bond markets, we witnessed healthy volume growth, reflecting effective intermediation and robust two-way flows. Key metrics that we monitor – daily FX trading volume, averaged USD17.6 billion, while the money market recorded RM10.4 billion in daily transactions – all higher compared to last year. Additionally, the outstanding size of our bond market, which surpassed RM2 trillion last year, continued to expand – reflecting our financial sector's ability to absorb and intermediate long-term financing. There is still more we can do to expand our bond and sukuk markets and widen our investor base.

Indeed, on this, I understand that some industry players have been actively advocating for the inclusion of the MGII in the FTSE World Government Bond Index, and I certainly commend these efforts. It is about time for us to gain this recognition for our MGII, which now comprises 47.5% of our government bond market. From our observations, daily trading volumes of MGII is often now comparable to MGS. Yields have narrowed against MGS while liquidity has certainly improved tremendously. With the current initiative to introduce an additional structure of wakalah bi al-khadamat to the issuances, we believe that this will further enhance the appeal of MGII to the international investment community. We are certainly looking forward to these developments and a favourable outcome for the inclusion of MGII into the FTSE World Government Bond Index.

As it stands, the non-resident holdings of our government bond now comprise around 21.5% of the market, a significant portion consisting of stable, long-term investors. Foreign investments into our equity market have also been encouraging. From our surveillance data, this year would mark the first year of inflows since 2018. All these stands as further proof of global confidence in our market.

Our ability to remain agile and proactive throughout the year has been crucial in strengthening our resilience. Going forward, BNM will continue to be in the market to ensure stability and prevent excessive fluctuations. We will also continue with our active encouragement for our investors and corporates to bring back their income and sustain, if necessary, inflows from this rich source. This includes our initiative extended to corporates and businesses to support their repatriation of foreign currency balances, the Qualified Resident Investors (QRI) pilot programme. Since its inception in April, this programme has onboarded large corporate groups, bringing in substantial inflows thus far. Participants have lauded the programme for its simplicity, efficiency and quick turnaround times, as well as the certainty it provides for reconverting ringgit funds for future direct investment abroad.

Many of these measures and initiatives help us in achieving a better balance of flows and a more stable foreign exchange market. These measures and other initiatives to enhance domestic FX market liquidity will continue into 2025. In addition, next year's outlook for the Malaysia economy remains favourable. The economy is expected to grow by 4.5% - 5.5%, as outlined in Belanjawan 2025 with continued robust domestic demand and investment activity, supported by higher tourism and exports. All these are expected to lend enduring support to the ringgit.

Challenges Ahead and Call to Action

Having said that, it is never a done deal when it comes to the evolving market outlook. As we look ahead to 2025, new factors are emerging, potentially disrupting and presenting fresh challenges. One key area to monitor is the evolving international trade landscape following President Trump's re-election, which could impact both global growth and inflation trends. We can see that the dollar has been taking its cue on any developments surrounding how high tariffs will be. This is not an unfamiliar situation to us as we saw something similar when President Trump was elected in 2016. How did things fare for us back then? Looking back at his previous presidency, Malaysia's GDP grew by 10% between 2017 and 2019, and our exports increased by approximately 8%. The ringgit also appreciated by around 8% during the period.[1]

So, it may not be all that bad as what is being implied by market talk now. But there are of course other issues that demand our attention, such as uncertainty surrounding China's growth and ongoing geopolitical instability. Overall, the situation remains fluid, and we will live with volatility for a while.

How do we prepare ourselves then ahead of this?

One of our greatest strengths we have is the solid foundation of our economy and the positive prospects going forward. However, we also need to actively communicate with the global investment community. Strengthening our outreach efforts is critical to sustaining and attracting international inflows. By highlighting the positive developments, we can showcase Malaysia as an attractive and resilient investment destination. Indeed, this was the genesis of the Investment Relations Office and the InvestMalaysia Portal launched recently by the 2nd Finance Minister. This is a one-stop centre for all investors, not just portfolio, to obtain information on Malaysia and further improving access to the Malaysian market.

Complementing such outreach efforts, we must ensure that the increasing demand from global investors is met with availability of instruments into these attractive investment opportunities. For this, our financial markets need to step up their efforts in enabling investable assets creation and strengthening their market-making capabilities. On this, I would like to acknowledge the efforts and initiatives of the Islamic Financial Market Committee in working with IsDB and other stakeholders, to convene and connect issuers, investors and market players with a view to open up the avenues and marketplace for these investment opportunities.

The recent liberalization of the Foreign Exchange Policy (FEP) is one step in bringing in new and more investors. By allowing Multilateral Development Banks (MDBs) and non-resident Development Financial Institutions (DFIs) to issue ringgit-denominated debt securities, we open the doors to greater and more diverse participation in our bond and sukuk markets. This move not only broadens our investor base but also enhances market depth, enhancing Malaysia's financial markets appeal to international investors. A deeper and more liquid market supports the broader economy by facilitating efficient capital allocation. Such progress strengthens Malaysia's position as a hub for sustainable finance and a premier global investment destination.

Finally, a strong and well-functioning interbank market is also crucial. It plays a critical role in ensuring the smooth flow of both ringgit and foreign currency liquidity, which directly supports intermediation. The foreign exchange market, in particular, is often the first to feel the impact during periods of market stress. In such situations, market participants must step up as the first line of defence to maintain stability. This requires focusing on economic fundamentals rather than reacting to market sentiment alone, avoiding excessive bid-ask spreads during high uncertainty, and continuing to fulfil the role of market makers by proving consistent quotes, even in challenging conditions. Let me assure you that Bank Negara Malaysia will be very vigilant in this and will be there to maintain an orderly market and a stable currency.

As for the money market, challenges like market fragmentation and what ends up looking like liquidity hoarding can further disrupt the interbank market's role as an effective intermediary. When liquidity is unevenly distributed, it can lead to volatility in rates and undermine the market's ability to function effectively. To address this, we need to focus on creating a more efficient interbank market. One area where we will be pushing for is in the market infrastructure by expanding the network of interbank lines among players so we can achieve better price discovery and ensure smoother liquidity distribution. Other areas to further improve on liquidity intermediation includes our introduction of the 7-day reverse repo which has received good response from the market. As we approach the year end, we thus wouldn't expect similar situations of past years where rates spike, as interbank players compete for deposits. We also expect that with the recent Liquidity Risk Policy Document issued last month, which puts out requirements for LCR disclosure on an average basis, this pressure will be much less.

Initiatives for Further Resilience

The measures and initiatives introduced over the years have significantly contributed to the stability, growth and resilience of Malaysia's financial markets. However, there is always room to build upon these. I would like to outline three key initiatives for the coming year that we are looking to do.

First, we are enhancing our tools to strengthen market intermediation and integrity. Among others, the usage of Islamic FX swap as an additional liquidity management tool, which will help us to manage interbank liquidity more effectively. Also, operating frameworks are already undergoing studies to address market fragmentation in the interbank market. Similarly, efforts are underway to align our markets with global standards. The transition from KLIBOR to MYOR is a notable example. A discussion paper published last quarter outlines the roadmap for this transition, with enhancements to MYOR expected in 2025 and the cessation of KLIBOR by 2028. These changes will undoubtedly improve the integrity of our markets, while aligning them with international best practices.

Second, next year is a significant year for Malaysia as we assume the ASEAN chairmanship. This is a unique opportunity to advance regional collaboration, including for the financial sector and position Malaysia accordingly. For example, Malaysia currently accounts for 25% of the total issuance of ASEAN Green, Social and Sustainability debt securities. As we pursue catalytic projects under the National Energy Transition Roadmap, green sukuk will play a crucial role in meeting funding requirements with estimated RM1.85 trillion by 2050. Leveraging our global leadership position in Islamic Finance, with the presence of the MIFC Leadership Council (MLC) and Islamic Financial Market Committee (IFMC), we aim to scale up green sukuk adoption, grow Islamic assets and position Malaysia as the gateway to ASEAN.

Finally, I might add, this also provides Malaysia with a unique opportunity to offer ourselves as a centre for regional currency trading and liquidity management. For example, one key area where we have made considerable progress is in promoting the settlement of cross-border transactions in local currencies. Settling transactions in local currencies reduces the additional costs of dual-leg currency conversions and lowers reliance on the US dollar. Our local currency Settlement Frameworks with countries like Thailand and Indonesia provide harmonised rules that make bilateral transactions in local currencies more accessible. Local currency settlements also figure significantly in our trade and investment with China and Singapore, where accessibility to RMB and SGD has long been facilitated. This allows businesses to better manage their foreign exchange risk while promoting the resilience of regional currencies and trade against external shocks. Building on this foundation, Malaysia has the potential to further expand its role by leveraging the extensive presence of its banking network which is present across all ASEAN countries. In addition, our network of Appointed Overseas Office (AOO), spanning ASEAN and key global markets, further enhance our ability to support cross-border transactions and promote regional integration of local currency settlements.

All of this bodes well for the economy and our prospects. To realise this potential, I must highlight the significant need for collaboration and coordination between BNM and the industry. We have already witnessed meaningful collaboration, particularly through the Financial Market Committee (FMC) and MIFC Leadership Council, and I look forward to build and expand on this foundation and enhancing our joint efforts as we head into the coming year.

Conclusion

In closing, I want to emphasise that while we face challenges, the resilience of Malaysia's economy and financial markets gives us reason to be optimistic. The strategies we have in place, supported by sound fundamentals and innovative initiatives, position us well to navigate future uncertainties.

Izinkan saya akhiri ucapan ini dengan serangkap pantun.

Dari dollar Malaya ke ringgit Malaysia,
Legasi menuju negara yang kukuh,
Bekerja erat, maju bersama,
Sistem kewangan terbina utuh.

Thank you for your time, and I wish you all an enjoyable evening.

[1] Source: Governor' media statement during 3^{rd} quarter GDP release