

'We Are About in the Middle'

Malaysian central-bank **governor** Zeti Akhtar Aziz *explains why she prefers a cautious and measured approach* to bank consolidation and financial-sector reform

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ZETI AKHTAR AZIZ SIGNED OFF on Malaysia's exchange controls after her two bosses in the central bank resigned in protest. That was more than three years ago and world opinion has since shifted to a grudging, even admiring, respect for Prime Minister Mahathir Mohamad's controversial economic policies.

Zeti, 54, an economist by training, became central bank governor in 2000. Few economists would fault her leadership: The banking system is cleaned up, monetary policy has been accommodative and Malaysia's reserves are close to \$33 billion. Engaging and articulate, Malaysia's central bank governor sits down for a rare interview with REVIEW Editor Michael Vatikiotis and correspondent S. Jayasankaran. Excerpts:

HOW DO YOU SEE THE FUTURE OF MALAYSIA'S FINANCIAL SYSTEM?

We are different from Singapore or Hong Kong. We don't aspire to be an international financial centre where it would be important to liberalize and deregulate at a much faster pace. We would want a system where at least 50% of market share is held by domestic institutions. Having said that, we are increasingly more flexible. For example, we have allowed banks greater freedom to mobilize talent. Basically, we're not swinging from one end of the pendulum to another. We adopt a balanced approach. We are about in the middle.

HOW HEALTHY IS THE LOCAL BANKING SYSTEM?

Nonperforming loans have now stabilized. On a net six-month recognition basis, it is at 8.1% [of total loans by the banking sector]. On a three-month basis, it's 11.5%. This is a positive trend and we've addressed the situation satisfactorily. Danaharta, the asset-management agency, has successfully managed problem loans it acquired from the banks in 1998. In fact, the cash payout back to the banks is between 7 billion and 8 billion ringgit (\$1.8 billion-2.1 billion).

We set up Danaharta early because we knew the problem had to be addressed. In May 1998 we proposed to set up Danaharta, at a time when NPLs were only about 7%. We knew it would rise and become a problem. Danaharta has done what it was supposed to do-by neither warehousing assets nor by fire sales. And ultimately, we expect a recovery rate of about 60%.

WHAT LESSONS HAVE YOU LEARNED FROM THE ASIAN CRISIS?

To institute better risk-management practices and, as supervisors, we have become more forward-looking. We look at how institutions would be in three, six or nine month's time. We use stress tests and early-warning systems. We have a high degree of confidence that we will spot emerging problems early and take the necessary remedial action.

WHAT IS DRIVING BANK CONSOLIDATION?

It will be driven by the more competitive market conditions.

IS THE RINGGIT PEG SUSTAINABLE?

It's not an end in itself, it's just a mechanism. Right now, it's the best mechanism to facilitate international trade and investment in Malaysia.

WHY IS FOREIGN DIRECT INVESTMENT DECLINING?

Well, foreign inflows have been steady although they are not at pre-crisis levels. But there has been a shift in the type of investment coming in. It's becoming more diversified. Now it's mostly in the IT and services sectors, which are higher value added to the country. Last year, these investments were higher than manufacturing FDI. Traditionally, data for FDI only includes manufacturing applications and investments but data released by the central bank include investment across all sectors.

WHAT IS THE FUTURE OF ISLAMIC BANKING IN THE REGION?

We have had 20 years of experience in Islamic banking and we have developed a comprehensive system-a money market, Islamic insurance and various banking instruments. It has developed in parallel with the conventional banking system and is now growing rapidly. In 2000, it comprised 6% of the financial system; now it's 8%. Now, together with other Islamic countries and three multilateral agencies including the International Monetary Fund, an Islamic Financial Services Board will be set up here in Kuala Lumpur. It will set out prudential standards for international Islamic banking and finance. ■

Zaini Abdullah/Reuters