Keeping pace with dramatic changes

"THESE are some of the best years that we have seen at the central bank," a senior officer recently remarked. Governor Tan Sri Dr Zeti Akhtar Aziz is no stranger to the senior management team at Bank Negara.

With her at the helm, they are working together to further seal the ingredients for success.

Among other things, these include continuity, consistency and rapport in drawing up policies and strategies, and seeing to their implementation.

In the second part of her interview with senior editor (finance and banking) YAP LENG KUEN, Zeti speaks about her plans and the achievements of the central bank.

Star: It has been some time now since the 1997 financial crisis. Can you highlight some of the changes at the central bank since then?

Zeti: The environment in which central banks are operating has changed dramatically. To stay at the forefront in dealing with the new challenges that we are faced with, we have reviewed our strategic orientation and our key priorities.

In doing so, we have made many changes. The changes have been in our organisational structure, in the technology used in various functions and in the management of our human capital. Our organisation has also been transformed into a knowledge-based organisation (KBO).

In addition, the approach adopted in most of our work has changed towards being more project-based that relies on expertise across departments rather in any specific department. It has taken almost three years to bring about these changes to result in the transformation of the bank.

In terms of the structure of the bank, new departments were created and existing departments refocused on new priorities. In the recent three years, we have established five new departments. They are the International, Islamic Banking and Finance, Corporate Communications, Development Financial Institutions, and Financial Intelligence Departments.

We have also looked at how technology can be applied to all areas of our operations, not just to enhance efficiency but to enhance effectiveness of our functions as well.

In the current environment, we are also faced with an overload of information and knowledge required to make correct assessments and diagnosis and to formulate the appropriate policies. The information and knowledge required for this, therefore, needed to be managed. To do this, we have put in place the infrastructure, the technology and the systems bankwide. We also have corporate yellow pages to indicate where the information and expertise resides so that instant access can be made, given that time is of the essence.

Another area that we have given priority is the management of our staff – the human capital of the bank. In the mid-1990s, the bank did a re-engineering exercise and downsized from a staff of 2,700 to 1,600, reducing the number of non-executive staff. It was very drastic. Over the recent three years, however, we have recruited again but at the executive level and now have a staff strength of 2,300.

We are now a performance-based organisation in which staff set goals at the beginning of the year and they are evaluated against these goals.

The remuneration and reward system has also been modernised. We also have an exit mechanism for non-performers.

Other systems introduced include mentoring and succession planning as part of evolving the central banking corporate culture and to prepare the next generation of leadership. Investment in our intellectual capital has now more than doubled and training is designed for every stage of the career development of the staff.

Our approach to work now is increasingly more by projects. We have more than 160 projects ongoing. These projects comprise cross-departmental teams and are highly effective in producing high-quality work. Our work is also forward looking given that the very nature of our work is to recognise problems before they happen and to be in a state of readiness at all times.

These changes have taken a lot of time and effort and perseverance by the staff involved. It has also drawn interest from other central banks in our experience in these strategic changes made in our organisation.

It is hoped that with this, the bank will produce results that are of the highest standard of excellence in meeting our responsibilities and will position us to respond to the environment to ensure confidence and support the economy.

Star: The central bank has emerged from the crisis in quite a good shape. Can you recap some of its achievements following the crisis?

Zeti: The crisis started with highly unstable foreign exchange markets in May 1997 when our currency was subjected to bouts of speculative attacks. The waves of these currency adjustments, as we know, had damaging implications on the financial systems and economies of our region. Central banks in the region were in the frontline in dealing with this situation.

Our task at the time was to stabilise the currency and, at the same time, preserve our reserves. We knew that the resources of the market far exceeded ours and, therefore, the strategy was to intervene only selectively at strategic points rather than defend any particular level. While our currency depreciated, the slide was contained and there was no capital flight. Our reserves were also preserved; they never went below US$20bil.

The successful implementation of the currency controls during the most unstable market conditions allowed Malaysia to implement pro-growth policies and the stabilised market conditions allowed us to restructure our banking sector. The central bank put in place the machinery and infrastructure for the effective implementation of the controls minimising the potential disruptions to our systems.

The international market had turned its back on us at the time. To tell the story to the world, in May 1999, after an absence from the market for almost 10 years, the government decided to issue global bonds. Bank Negara, as the financial adviser to the government, assisted in the issue.

Just as we were about to launch the issue, the situation in Argentina and the US announcement of a bias towards tightening destabilised the market and caused the spreads to widen. Despite the situation in the market, we decided to proceed and were able to complete a successful issue, which was more than three times oversubscribed. It became a benchmark for other Malaysian corporates that wanted to access the international markets.

At the height of the crisis in early 1998, the central bank proposed the establishment of institutional arrangements to deal with banking sector problems. As a result, Danaharta, Danamodal and the Corporate Debt Restructuring Committee (CDRC) were set up. This has now facilitated the successful restructuring of our banking sector. The cost of this financial restructuring to our country amounted to 5% of gross national product (GNP), one of the lowest that has been experienced.

The early action, the very focused mandates, the right people appointed to manage the restructuring agencies and the strong commitment and support from the government were factors that contributed to the success that has been achieved. A further significant change has been the consolidation of the banking system from a fragmented industry comprising 71 domestic institutions to now 30 institutions in 10 banking groups. The insurance industry has also seen significant progress in terms of growth, capitalisation and consolidation.

This has allowed the central bank to shift the focus of its attention to the medium-term agenda – the development of our financial sector. The blueprint for this is in our *Financial Sector Masterplan*, which was released in early 2001.

Several new legislation were also enacted, the main ones include the Development Financial Institutions Act and the Money Laundering Act,

Star: Foreign reserves of central banks are on the rise. Would rising reserves be a temporary phenomenon and does it influence competitiveness?

Ours is an open economy, and under a fixed exchange rate regime, our reserves' level can be expected to fluctuate from time to time.

Since the middle of 2001, our reserves have been on an uptrend, increasing by US$8.2bil. This is a significant increase, despite the fact that our services account has a significant deficit and the transfers are also large.

In the capital account, we have also seen outflows as a result of repayment of debts as well as investments in strategic sectors abroad.

Despite this, our reserves have recorded increases and are now at about US$34bil, which is equivalent to 5.4 months of retained imports.

Going forward, the factors that have encouraged the inflows remain. We project a current account surplus of more than 6% of GNP next year. The interest rate differential is also expected to remain in Malaysia's favour.

In addition, following the increase in the applications for FDI, inflows can be expected to materialise from these next year.

External Reserves

1997	US$21.7bil
1998	US$26.1bil
1999	US$30.8bil
2000	US$29.9bil
2001	US$30.8bil
2002	US$34.2bil (as at Dec 13)

Source: BNM

While there will be some outflows in terms of repayments of debts and increases in imports, we can expect the reserves to continue to increase.

This is a comfortable level of reserves for our pegged currency regime. This is also reinforced by the fact that inflation is stable, the external balance is in surplus, and we have a low level of foreign indebtedness. These conditions will contribute towards a steady build-up of our reserves. Such a build-up is commensurate with the growth in the volume of trade and the size of the economy and is unlikely to impose pressures to strengthen the currency.

Malaysia has never tried to compete by exchange rate adjustments. Competitiveness is more from reduction in costs of production, increase in productivity, innovation and high quality of products and services.

We view these to be more permanent means to achieve competitiveness.

to contribute to the development of our financial infrastructure and ensure its continued stability.

More recently, we have also seen the significant growth and development of Islamic banking. The central bank has also participated in the global development of Islamic banking.

While we can feel good about the progress, there is so much more that needs to be done. We want to see our financial system become more efficient, competitive and resilient.

In addition, we want to see our banking system participate more aggressively in responding to the new requirements of our economy.

We see the insurance industry also responding to the new changing requirements of our population and the financial and social requirements of this population. That's where a lot more needs to be done.

Star: What about your personal achievements?

Zeti: My personal achievements are for other people to judge. I have been entrusted to lead the bank during the most challenging of times. An area that is important to me is the modernisation of the central bank in terms of its strategic orientation and its capacity to perform in this very different and challenging environment.

Star: Will you be around to see the *Financial Sector Masterplan* to its end?

Zeti: I was given the task to lead the team to draw up the *Financial Sector Masterplan* when I was deputy governor. From a personal point of view, it is one of the fulfilling experiences for me.

It took us about one-and-a-half years to draw up the *Financial Sector Masterplan*. Internally, it was a bank-wide effort. We also adopted a consultative process with input from the private sector and international agencies.

The masterplan is for a 10-year period. We will now be entering our third year.

It has been rewarding to be here during the first phase of the plan, which builds the very important foundations on which future developments will occur.

Star: Would the financial system be able to cope if you achieve the completion of the *Financial Sector Masterplan* ahead of target?

Zeti: We have a special tracking system to monitor the progress. Some areas will progress faster than others. The sequence of implementation is important so that implementation takes place in an orderly manner.

Several things have to be in place before the next stage can be implemented. Foundations have to be built before other building blocks can be put in place. For example, we need to have a financially savvy community as the financial system becomes more sophisticated and complex. In this regard, we will launch a major consumer awareness programme next year in January.

The progress of implementation will be reviewed by the benchmarks and milestones achieved. If progress is faster than planned, it will mean the system can absorb it.

Given that the financial system has an important role in supporting and facilitating economic growth, progress in its development is not an end in itself but the contribution it will make to enhance our growth and development prospects.

Star: Your staff observe that you have tremendous energy and seldom get tired. How do manage your time?

Zeti: Energy is derived from the interest in the job. You have to like what you do. You have to like it tremendously. The passion and drive will generate the energy. I also have been fortunate that this is reinforced by the commitment and dedication of the people who work with me. And of course it would not be possible without a supportive family.

I put in long hours. Time management becomes important and priorities need to be determined. While the schedules are usually demanding and hectic, it is important for me to spend some quality time with my family, especially with my two boys.

Star: Do you feel that after dealing with crisis, one after another especially over the last few years, you have changed in some way or other?

(*Zeti* is amused; she laughs). Looking ahead, there's probably going to be more of these problems. I have probably become more acutely aware of all the forces at work and the need to manage them. Certainly, to live through any crisis you need to be tough and you need to have nerves of steel.

Star: In view of the timeframe for completion of the Financial Sector Masterplan, do you find that you have to get quite tough with the bankers?

Zeti: In this new environment, banks cannot be just focused on producing immediate results, be they the quarter, half-year or full year. Sometimes banks tend to be myopic and do not see the broader picture. Sometimes they need to see beyond their own immediate interests.

While we have regular discussions with the industry and we also have a consultative process to allow for their inputs for new fundamental changes we plan to introduce, there is no question about being firm and tough with respect to enforcement of policies.

In this new environment, changes also have to be made by the industry and, hence, the importance of applying pressure to achieve them. Banks also have to recognise their roles in the changing economy and participate in the growth process and at the same time be soundly managed. Yes, the pressure is on, as the environment will get more challenging and more competitive.

Star: What have been your most memorable moments at the central bank?

Zeti: While there are many memorable moments in the more than 20 years I have been with the bank, the most memorable are probably the days in the run-up to the implementation of the controls and the week following its announcement.

This was a turning point for Malaysia. It was a moment in history. I remember the period well. It was on the Aug 27, 1998 – the day the GDP numbers for the second quarter of 1998 had to be announced. It was the worst ever number in our history – a contraction of 6.8%. I was given the task of announcing the numbers.

Later that night, I received a call informing me that the governor and deputy governor had resigned and that I was to be appointed acting governor.

In the days that followed, our work on the implementation of the controls intensified almost round the clock – on the documentation, infrastructure and systems that needed to be put in place.

I practically lived in the bank. Our efforts were focused on leaving no stone left unturned. We were navigating into uncharted territory.

On Sept 1, at eight in the morning, the bankers were called to the bank. I informed them of the exchange control measures that would be effective that morning.

This was followed by a press conference. While there were harsh negative reactions from the international community and markets, Malaysians for the most part were calm.

We set up 30 hotlines that operated 24 hours to respond to the questions from the public. More than 1,000 calls were received a day. We also had a team to deal with the problems as and when they emerged.

We had daily meetings with all the target groups such as exporters, multinationals, businesses, the diplomatic community and so on, to inform them that they were not the target of the controls and therefore would not be affected.

It was those that were involved in speculative activity that did not have any underlying transactions that were the target of the controls. It took about a week to see the successful implementation of the controls.

> An area that is important to me is the modernisation of the central bank in terms of its strategic orientation and its capacity to perform in this very different and challenging environment.
>
> — Tan Sri Dr Zeti Akhtar Aziz

Star: With the appointment of the new second Finance Minister Datuk Jamaludin Jarjis, would there be any changes in priorities or policies at the central bank?

Zeti: The Prime Minister is also the Minister of Finance and chairman of the National Economic Action Council (NEAC).

The Exco meets every two weeks and wide ranging issues relating to the management of the economy are discussed.

This institutional arrangement has been very effective and prompt in responding to developments and in the coordination of such policies. This has also allowed for the continuity of policies.

The new second Finance Minister is also a member of the Exco bringing an additional perspective to the deliberations.

Star: Safe havens in other parts of the world may become unattractive in view of the new regulatory requirement regarding access to information. How do you see Labuan in this context?

Zeti: Within a decade, Labuan has progressed tremendously to be recognised as one of the premier offshore centres in the Asia-Pacific region. The success of Labuan in attracting the critical mass of top players has been the result of the effective blend of a sound legal and regulatory framework as well as a conducive business environment.

The key to long-term survival and growth of offshore centres such as Labuan will be its ability to promote innovation, efficiency and dynamism among its players.

Labuan has certainly not been regarded as a safe haven where players and investors can leverage on legal and regulatory loopholes. On the contrary, the commitment and drive is to progress as a world-renowned offshore centre. Therefore, efforts have been directed to put in place world-class infrastructure and to adopt international best practices and regulatory requirements.

The strategic positioning has been to leverage on its market niche to ensure its attractiveness and competitiveness. The development of Labuan as an offshore Islamic financial centre and the establishment of the electronic Labuan International Financial Exchange (LFX) have been some of the important initiatives taken in recent years.

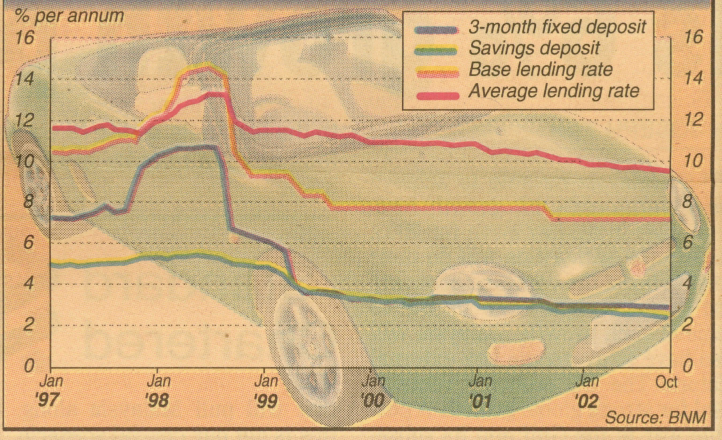
Star: How will Labuan compete with Dubai, which is described as another fast-growing financial centre?

Zeti: There are currently 50 offshore financial centres operating across the globe and Dubai is one of the newly established financial centres. One of the areas that Dubai will also focus on is Islamic banking and finance. This development is very welcomed. There are vast opportunities in Islamic banking and finance as its potential remains significantly untapped.

A critical mass needs to be built up in terms of number of players. As Dubai operates in a different time zone from Labuan, its participation together with Labuan would contribute towards achieving greater synergy and would be a catalyst for the global development of Islamic banking and finance.

The emergence of Dubai as a financial centre, therefore, complements our efforts both onshore and offshore in the development of Islamic banking and finance on the global front. Labuan has always adopted a smart partnership approach in the area of Islamic banking and finance as demonstrated by our participation in the establishment of the International Islamic Financial Market.

Interest Rates: Finance Companies



Source: BNM

Star: The SMIs are said to be cautious in their investment plans. What are some of the latest initiatives towards this sector?

Zeti: Bank Negara has proposed a comprehensive framework for the development of SMIs, which we feel are very important to the economy. We would like to see indigenous companies develop and grow and be listed. As part of this project a high level inter-Ministry Steering Committee has been established to initiate a more coordinated effort to develop SMIs in Malaysia.

SMIs are now operating in a period of uncertainty prevailing in the economy and the financial markets. Being small, they are more affected by the environment. Perhaps, this has contributed to the cautiousness. SMIs, therefore, need to be given more support in terms of supporting infrastructure, technology, information, skills, and access to financing and to markets.

Bank Negara has conducted a survey through the banking system and tabulated the 8,000 responses received which highlights the problems faced by the SMIs and the important requirements needed.

The SMIs in Malaysia are now relatively small in size and, therefore, not able to realise their true potential.

The survey showed that the SMIs are diversified across a wide range of economic activities; for example, only one third are in the manufacturing sector.

Right now, SMIs receive assistance from the different ministries depending on the sector they are in. Given that our economy is now becoming more diversified, the support provided to specific sectors need to be extended to all sectors across the board.

The comprehensive set of recommendations are directed towards strengthening the infrastructure for SMI development, building the capacity of the SMIs and enhancing access to financing and to advisory services for the SMIs. The objective is essentially to enhance the contribution of the SMIs to the economy.

In addition, banking institutions could be more supportive by assessing credit solely on project viability rather than institutions' past experience, by providing advisory services as well as enhancing their relationship with SMIs.

Star: Car sales have been on a slight decline recently. Will there be any impact on retail loans?

Zeti: Car sales have been high even though they have moderated recently. In an expanding economy, in which cars are considered an important item of demand, sales can be expected to be on an uptrend.

In addition, given that Malaysia has a young population, this demographic structure is likely to reinforce this demand pattern. The prevailing low interest rates will also support this trend.